REVENUE ACT OF 1941

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-SEVENTH CONGRESS

FIRST SESSION

ON

H. R. 5417

AN ACT TO PROVIDE REVENUE, AND FOR OTHER PURPOSES

REVISED

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REVENUE ACT OF 1941

FRIDAY, AUGUST 8, 1941

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

The committee met at 10 a. m., pursuant to call, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. Mr. Secretary, you may proceed as you will.

STATEMENT OF HON. HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY

The CHAIRMAN. You would not like to have interruptions until you have finished your formal statement?

Secretary MORGENTHAU. That is right.

The CHAIRMAN. The committee will be glad to observe that request. Questions will not be propounded if there are any questions, until after you have finished your formal statement.

You may proceed when you are ready.

Secretary MORGENTHAU. Mr. Chairman, and members of the committee: My purpose in being here today is to discuss taxation as an essential part of national defense. Our great problem in providing for the defense of the Nation is fundamentally the problem of production—of actually building planes and tanks, ships, and guns with labor, management, machinery, and raw materials. To solve that problem without impairing our economy or weakening the structure of democracy, our fiscal policy must be adapted to the needs of the times.

On April 24 I discussed with the Ways and Means Committee of the House the need of producing $3,500,000,000 annually in additional revenue. The Treasury Department presented a suggested program for raising that amount of money. As it passed the House, this bill will produce approximately $3,200,000,000 annually in additional revenue. In my opinion, it is very important that the revenue yield be raised to at least the original $3,500,000,000 level. It is also important that the bill be passed as promptly as possible. Income taxpayers and excess-profits taxpayers should know as quickly as possible what their taxes on 1941 income and profits are going to be, since more than 7 months of the year have already elapsed. The excise taxes and the estate tax cannot be imposed retroactively and every day's delay in the passage of this tax bill costs the Treasury several million dollars in revenue from those sources.

The rapid developments of the last few months have made this bill inadequate even before it is passed. Since my statement before the Ways and Means Committee, many things have happened. Two and one-half months ago the President proclaimed the existence of an unlimited national emergency. He called upon—

all loyal citizens to place the Nation's needs first in mind and in action to the end that we may mobilize and have ready for instant defensive use all of the physical power, all of the moral strength, and all of the natural resources of this Nation.

Since I appeared before the Ways and Means Committee, the amount of appropriations, authorizations, and recommendations over and above the Budget has increased by about $14,000,000,000, thus completely changing the fiscal picture and greatly increasing the need for revenue.

Since I appeared before the Ways and Means Committee, prices and the cost of living have increased at an accelerated rate, thereby accentuating the need for a strong fiscal program.

In the light of these and other developments resulting from all-out defense, I should like to point out what, in my opinion, will be necessary in all-out taxation to support such a program.

First of all, we shall need more revenue—much more revenue. The defense program is an absolute necessity. It must be paid for. Insofar as possible, it should be paid for now. Borrowing should be kept to a minimum to maintain our fiscal strength. The rise in the Federal debt means merely that the taxpayer's burden is being postponed—that both principal and interest must be paid later out of higher taxes collected at a time when they may be harder to pay and less willingly paid than now.

Along with increased taxation should go the maximum reduction in the ordinary nondefense expenditures of Government. The burden of paying for defense is so heavy that it should be relieved at every possible point.

Increased taxation is needed also to maintain economic stability. Rising purchasing power is exerting increasing pressure on the prices of many kinds of goods, while at the same time production of these goods is being increasingly curtailed by the necessity of diverting our resources to defense uses. This complication of increased demand and restricted output is causing inflationary price rises which threaten to increase the cost of the defense program, unbalance family budgets and seriously disturb our economic life.

This larger needed revenue should come from all sources where there is ability to pay—that's what an "all out" tax program means. The people of this country have never been more ready to make sacrifices for the common good. Our tax program has not kept pace with the defense program. We are still thinking too much of helping this group or that to escape its share of the burden. We have now come to the point where it is a matter not merely of fundamental equity, but of the utmost necessity that all exemptions from taxation be reduced to the absolute minimum.

An "all out" tax program for defense should reach ability to pay at several points not now fully tapped:

1. In my opinion such a tax program might well involve a substantial lowering of personal exemptions and a consequent broadening of the base of the income tax, if simultaneously we take immediate steps to remedy defects in the application of the principle of ability to pay in other parts of the tax structure. Under the bill before you, the base has been broadened to add about 2,500,000 new taxpayers, but even so there will remain a relatively large proportion of the population in the lower income groups which will not be directly affected by the income tax. A further lowering of the exemptions would produce some additional revenue and in addition it would give millions of Americans an opportunity—a welcome opportunity—to

make a direct contribution through taxes to the defense of their country. It would enable them to feel that they were participating personally and directly in the defense program. As the President wrote to Chairman Doughton on July 31:

> Most Americans who are in the lowest income brackets are willing and proud to chip in directly even if their individual contributions are very small in terms of dollars.

But I believe this committee will agree with me that we ought not to accept such sacrifices, even though willing sacrifices, from millions of people with low incomes on whom the burden of other types of taxes falls most heavily, unless we reach in other places ability to pay which is escaping its fair share of taxes. Among these are the following:

2. The excess-profits tax exempts profits of even the most prosperous corporation, except to the extent that such profits are in excess of its average profits for the years 1936–39. Surely Congress will not wish to impose additional taxes on millions more of our low-income group, unless it also imposes the excess profits tax on the exempt excess profits of such corporations.

3. Families pay lower Federal income taxes when both husband and wife receive incomes than when the same total amount of income is received by only one of them. This is a discrimination of which many wealthy people have taken advantage by large gifts of income-producing property between husband and wife.

Furthermore, in at least eight States of the Union, Federal income taxes are made substantially lower than in the remaining States because the local law permits the splitting of income between husbands and wives. Here are discriminations against the rest of the taxpayers which, I believe your committee will agree, must be eliminated if we are to extend the income tax downward to include millions of persons with low incomes. The discriminations can be eliminated by requiring husband and wife to file a single joint return with appropriate relief granted only where both husband and wife work outside the home.

Senator WALSH. Is that your own quotation or the quotation of the President?

Secretary MORGENTHAU. I am sorry, but I do not understand.

Senator WALSH. Up to where you read.

Secretary MORGENTHAU. I will go back to the President's quotation. It goes down to—

> Most Americans who are in the lowest income brackets are willing and proud to chip in directly, even if their individual contributions are very small in terms of dollars.

Senator WALSH. Excuse the interruption.

Secretary MORGENTHAU. I am glad you interrupted. The rest is mine.

4. For years, the concerns engaged in extracting certain of our natural resources, notably oil, have been granted far greater allowances for depletion than can be justified on any reasonable basis of tax equity. If the income tax is to be extended to lower incomes, this privilege of tax escape should simultaneously be removed.

5. A few months ago the Congress eliminated the tax-exemption privilege from new issues of Federal Securities. The purchasers of

new State and local securities still enjoy this exemption. The exemption was inequitable and expensive even in more normal times. It cannot be borne longer in a time like this, and especially if we are to increase the direct tax burdens of persons with small incomes.

6. In its suggestions to the Ways and Means Committee the Treasury recommended substantial increases in estate and gift taxes and lower exemptions. In part, this recommendation was followed but in my opinion, the estate and gift taxes should reach more estates and provide more revenue if we are going to tax smaller incomes.

Those are some of the things that I mean when I say that an "all-out" tax program for defense must go far beyond the present bill.

There is another condition which I would attach to lowering the personal exemptions. I think we ought not to take into the income tax system millions of new taxpayers with small incomes without simplifying the way in which their tax is computed.

Take, for example, a single person with a $900 salary. Under the present law, he first figures out what deductions he has—taxes paid, interest paid, contributions, and so on. Then he computes his earned income credit. Then he subtracts his personal exemptions from his income after deductions. On the balance, under rates of the bill before you, he computes a surtax of 5 percent. Then he goes back to the income and deducts his earned income credit. On the balance, he computes a normal tax at 4 percent. He then adds the normal tax and the surtax and takes 10 percent of the total for defense tax. He adds the defense tax to the normal tax and surtax and finally arrives at his income tax.

Senator BARKLEY. That is partly due to the fact that the experts have written most of these bills.

Secretary MORGENTHAU. That is right. If they left it to you and me, it would be different.

Senator LA FOLLETTE. I think it is hardly fair, if I may interject, to the experts. They did not invent this 10-percent defense tax.

Senator VANDENBERG. It is hardly fair to the Secretary, because he is supposed to be an expert, too.

Senator BARKLEY. No member of the committee will lay claim to such distinction.

Secretary MORGENTHAU. I am sure Senator Vandenberg will.

Senator VANDENBERG. I will not.

Secretary MORGENTHAU. When he started to fill out his return, he may have been full of patriotic enthusiasm to pay his share toward the defense program, but by the time he has finished his last computation his cheerfulness may well have collapsed under the strain. It is difficult enough for persons with substantial incomes who are used to dealing with financial papers and who can afford high-priced lawyers and accountants to make their computations for them. The person with a small income should not be put to this annoyance and possible expense.

Furthermore, the checking of these tax computations by the administrative authorities takes time. Frequent errors are found which must be rectified, requiring correspondence and further annoyance of the taxpayer as well as expense to the Government. We in the Treasury do not enjoy pestering the taxpayer any more than he enjoys being pestered by us.

For taxpayers with relatively large incomes, refinements in determining income and computing taxes are troublesome but are necessary in the interest of equity. For small taxpayers, however, especially

those now taxed for the first time, these refinements are cumbersome and confusing without serving any important purpose. The income taxes of millions of people can be determined with acceptable accuracy by less involved methods.

As the President suggested to Chairman Doughton, there should be a provision in the case of the small taxpayer—

for a straight, simple payment of some small contribution to the national tax income through a simple agency and on a simple form.

For such taxpayers a plain and easily understood table could be provided with the aid of which the small taxpayer could compute his tax bill in a very few moments. He would be spared time, trouble, and annoyance and the Government would be spared expense.

To indicate more clearly what I have in mind, I have had prepared a sample table showing how this might be worked out in practice for incomes up to $3,000. This is only a preliminary table and improvements and changes will no doubt be desirable, but it will illustrate how the proposal can be applied.

I have furnished each of you gentlemen with this table.

(The table referred to is as follows:)

KNOW YOUR TAXES

Illustrative schedule of Federal income taxes for individuals with total incomes of less than $3,000

SCHEDULE A

If your total income is—		Your tax is—		If your total income is—		Your tax is—		If your total income is—		Your tax is—	
From—	To—	Single person [1]	Married person [1]	From—	To—	Single person [1]	Married person [1]	From—	To—	Single person [1]	Married person [1]
$1	$750	.....	.....	$1,501	$1,525	$62	$1	$2,251	$2,275	$126	$59
751	775	$1	.....	1,526	1,550	64	2	2,276	2,300	128	61
776	800	2	.....	1,551	1,575	66	3	2,301	2,325	130	63
801	825	3	.....	1,576	1,600	68	4	2,326	2,350	132	65
826	850	5	.....	1,601	1,625	70	6	2,351	2,375	134	68
851	875	7	.....	1,626	1,650	73	7	2,376	2,400	136	70
876	900	9	.....	1,651	1,675	75	8	2,401	2,425	139	72
901	925	11	.....	1,676	1,700	77	10	2,426	2,450	141	74
926	950	13	.....	1,701	1,725	79	12	2,451	2,475	143	76
951	975	15	.....	1,726	1,750	81	14	2,476	2,500	145	78
976	1,000	17	.....	1,751	1,775	83	16	2,501	2,525	147	80
1,001	1,025	19	.....	1,776	1,800	85	19	2,526	2,550	149	82
1,026	1,050	22	.....	1,801	1,825	88	21	2,551	2,575	151	85
1,051	1,075	24	.....	1,826	1,850	90	23	2,576	2,600	153	87
1,076	1,100	26	.....	1,851	1,875	92	25	2,601	2,625	156	89
1,101	1,125	28	.....	1,876	1,900	94	27	2,626	2,650	158	91
1,126	1,150	30	.....	1,901	1,925	96	29	2,651	2,675	160	93
1,151	1,175	32	.....	1,926	1,950	98	31	2,676	2,700	162	95
1,176	1,200	34	.....	1,951	1,975	100	33	2,701	2,725	164	97
1,201	1,225	36	.....	1,976	2,000	102	36	2,726	2,750	166	99
1,226	1,250	39	.....	2,001	2,025	105	38	2,751	2,775	169	102
1,251	1,275	41	.....	2,026	2,050	107	40	2,776	2,800	172	104
1,276	1,300	43	.....	2,051	2,075	109	42	2,801	2,825	174	106
1,301	1,325	45	.....	2,076	2,100	111	44	2,826	2,850	177	108
1,326	1,350	47	.....	2,101	2,125	113	46	2,851	2,875	180	110
1,351	1,375	49	.....	2,126	2,150	115	48	2,876	2,900	183	112
1,376	1,400	51	.....	2,151	2,175	117	50	2,901	2,925	186	114
1,401	1,425	53	.....	2,176	2,200	119	53	2,926	2,950	189	116
1,426	1,450	56	.....	2,201	2,225	122	55	2,951	2,975	192	119
1,451	1,475	58	.....	2,226	2,250	124	57	2,976	3,000	195	121
1,476	1,500	60	.....								

[1] For each dependent, subtract $400 from your total income and use the balance to determine your tax.

NOTE.—The taxes in the above schedule, which is purely illustrative, were calculated on the following assumptions: Personal exemption for single person, $750 and for married persons, $1,500; rates the same as in H. R. 5417; tax for each income block is the average of the tax on the lower and upper limit of the block, reduced by 10 percent as a rough equivalent for deductions from income; and the tax is shown to the nearest dollar.

Secretary MORGENTHAU. The idea is this: This is put up in every post office and every public building. A man can just look down here and if his income is $1,001, he pays $19, and if it is $1,026, he pays $22; if you lower the exemptions and get an additional 5,000,000 return filers, we feel that some such plan as this will make it so that they can make their income-tax statements very readily.

Senator WALSH. This does away with all questions?

Secretary MORGENTHAU. Yes.

Senator WALSH. So he would just know from looking at this plan what he has to pay?

Secretary MORGENTHAU. Yes; just what he has to pay.

Senator BARKLEY. How can that be true, Mr. Secretary? Because each individual may have different amounts of deductions which are not figured in this tax.

Secretary MORGENTHAU. Well, we have the form which will go on the other side of this, which accompanies this specimen tax return.

Senator WALSH. Have you thought of the system of just asking the small taxpayers a series of questions and let the Treasury make out the computation?

Secretary MORGENTHAU. We can do that. We think with the help of you gentlemen, something like this can be proposed, with a very simple form that we have.

The CHAIRMAN. We will wait until you finish.

Secretary MORGENTHAU. Shall I wait until I finish?

The CHAIRMAN. I think, Mr. Secretary, it would be better if we wait until you finish your formal statement.

Secretary MORGENTHAU. We think it would be possible for a man to make out his income-tax statement in about 5 minutes without the help of anybody other than maybe the postmaster or some representative of the Treasury, without having to hire a lawyer and an accountant, and it would make the people a great deal happier about it, and it would take care of about 90 percent of the income-tax people that way.

The taxes imposed by the bill before you are very heavy; the taxes of an all-out program would be even heavier. I am convinced that the people are not opposed to heavy taxes, that in fact they favor heavy taxes because they know that the alternatives are much more onerous. At a time when expanding incomes are operating to force prices upward many kinds of measures must be employed if prices are to be kept under control. Without heavy taxation, the other measures have little chance to succeed.

Rising prices would take much more away from our people now and in the future than higher taxes now will take. Under the tax bill in its present form, a married couple with no dependents, having a net income of $5,000 a year, will have its Federal income tax increased by $198 or 4 percent of its income. Assuming that two-thirds of the family's income is spent on items affected by a changing cost of living, an increase in the cost of living of 6 percent would impose as great an additional burden on this family as would the proposed income tax. The cost of living index has increased 5½ percent since September 1940. It is clear from this simple illustration that rising prices tax the family income just as surely as do income taxes. Although, as prices rise, the income of some families will increase, many incomes will not increase and most incomes will not increase as fast or as much as prices.

If, in an attempt to protect the incomes of our people, we hold down taxes and as a result, the cost of living rises, we shall have taxed them just as surely as if we had levied on them directly—and we shall still have the inflated costs of defense to pay later from taxes.

An all-out tax program will build public morale in an all-out defense program. By reducing the necessity for borrowing, it will strengthen confidence in the impregnable fiscal position of the Government. By contributing to the control of prices, it will help prevent the demoralization which would result from inflation. By distributing the defense burden fairly, it will help unite the Nation. It will make all the people equal partners in sharing the cost of the defense of our country.

The CHAIRMAN. Senator Walsh, do you wish to ask the Secretary any questions?

Senator WALSH. Mr. Secretary, does the Treasury Department recommend the excess-profits-tax provisions of the House bill?

Secretary MORGENTHAU. Not as they passed the House.

Senator WALSH. Are you going to submit to the committee a substitute form of levying excess-profits taxes?

Secretary MORGENTHAU. We will be glad to if we are asked to.

Senator WALSH. You have such a plan?

Secretary MORGENTHAU. We have such a plan.

Senator WALSH. I do not care to ask any more questions now.

The CHAIRMAN. Senator La Follette?

Senator LA FOLLETTE. I think not.

The CHAIRMAN. Senator Barkley?

Senator BARKLEY. Mr. Secretary, you comment here on the joint return made by husband and wife and I gather from your statement that you still advocate the compulsory joint return by husband and wife as first carried in the House bill.

Secretary MORGENTHAU. With the one slight proviso that I added.

Senator BARKLEY. You take the position that the base is to be lowered among the lower-income taxpayers in the country and that this joint return ought to be included?

Secretary MORGENTHAU. That is right.

Senator BARKLEY. Are they necessarily connected?

Secretary MORGENTHAU. No.

Senator BARKLEY. In the letter of the President to Mr. Doughton, he urged the elimination of the joint return; did he not?

Secretary MORGENTHAU. No. Has somebody got his letter? I did not mean to be so contradictory.

The CHAIRMAN. He urged the liberalization of the joint return, by a liberal treatment of the earned income of the two.

Senator WALSH. The committee has the letter before them.

The CHAIRMAN. We have it here, Mr. Secretary. Would you like to have it?

Secretary MORGENTHAU. Thank you. I have a copy of it.

Senator BARKLEY. Of course, it is generally estimated that without the joint return it results in a loss of some $300,000,000.

Secretary MORGENTHAU. Would you mind, Senator, if I just read a paragraph from the President's letter?

Senator BARKLEY. No; go ahead.

Secretary MORGENTHAU. I am reading from the President's letter:

I am sure that I make it clear that the Treasury Department does not approve of mandatory joint tax returns except on the condition of granting substantial

relief to earned income of husband and wife. In this I heartily concur. But the committee draft leaves out the proviso altogether.

In other words, we were for the mandatory joint tax returns with the proviso and the President backed us up in that position.

Senator BARKLEY. Were the terms of the liberalization or the details of it set up by the Treasury?

Secretary MORGENTHAU. We presented them before the Ways and Means Committee.

Senator BARKLEY. Frankly, I have not been enthusiastic about the joint tax return, whether mandatory, or whether it carried a provision such as you susggest for this reason, and I would like to get your reaction to this; in nearly all the States over a period of years the legislatures have liberalized the laws with respect to separate ownership of property and rights of women in the control and ownership of property. In other words, all the States, through their laws, in the last generation, have constantly sought to free women from the domination of the husband in the control and ownership of her property. Now, I have felt and I feel yet that this provision, especially as it was carried in the House bill, before the House eliminated it, and I am not so sure that it would not, even under your suggestion, have a tendency to break down that independence and that liberalization of the State law with respect to the ownership of property by women and the control of property by women independent of their husbands, which has been the object of nearly all legislation in the past 35 or 40 years. What is your view about that?

Secretary MORGENTHAU. Unfortunately, a great many wealthy people have taken advantage of that, the men have transferred their property to the women in order to escape paying their fair share of the taxes, with the result, we estimate, that if that privilege were taken away, the Treasury would gain about $258,000,000. The privilege which has been extended to them over this time, as I say, has been abused.

Senator LA FOLLETTE. May I interrupt there, Senator?

Senator BARKLEY. Yes.

Senator LA FOLLETTE. Have you any estimate, Mr. Secretary, on what percentage of the present income taxpayers would be asked to pay the additional revenue? If you or Mr. Sullivan could answer that, I would appreciate it.

Secretary MORGENTHAU. I hear Mr. Sullivan saying he has got it, so let him answer that.

Mr. SULLIVAN (John L. Sullivan, Assistant Secretary of the Treasury). Exclusive of some 45,000 filing community property returns, the last available figures were about 153,000 men and 153,000 women filing separate tax returns on calendar year 1938 incomes.

Senator LA FOLLETTE. Out of a total of how many, approximately, for the record?

Mr. SULLIVAN. The husbands and wives filing joint returns, I believe, totaled 2,866,000 of which 1,038,000 were taxable returns.

The CHAIRMAN. Mr. Sullivan, could you compile any figures to indicate how much the estimated revenue would be reduced by an allowance of the earned income, or by an application of the earned income?

Mr. SULLIVAN. Yes, sir. We estimate that the mandatory joint return originally provided in H. R. 5417 would yield $287,200,000. The figure of $258,000,000 given by the Secretary is the additional yield

from mandatory joint tax returns at the rates of tax contained in H. R. 5417 if the earned-income credit he recommends is allowed.

The CHAIRMAN. $258,000,000?

Mr. SULLIVAN. That is correct, sir.

The CHAIRMAN. Now, may I ask you if you have any additional figures—I apprehend it would be rather difficult to be anything like accurate—if there were also exempted from the joint tax return property possessed by either the husband or wife at the time of marriage? Would it be possible to get a reasonable estimate?

Mr. SULLIVAN. We do not have that figure, sir. It will be pretty difficult to get a basis for that estimate.

Senator BARKLEY. May I ask this? The Secretary has referred to the fact that many wealthy people escape the payment of taxes by transfer of property to wives. Of course, that only involves the income of such property and in that case, the wife would make an independent return on the property that was owned by the husband.

Mr. SULLIVAN. That is correct, Senator Barkley. The return of income which each would make, would fall into lower brackets of surtax than if a joint return were filed and would therefore be subject to a much lower surtax.

Senator BARKLEY. How much in revenue has the Treasury lost by the transfer of property from wealthy husbands to their wives?

Mr. SULLIVAN. I think, from 1932 through 1939, there has been transferred by gifts reported for gift tax purposes $5,000,000,000, but we have no way of telling how much of that was from one spouse to another, or what additional gifts were made that were not subject to gift taxation.

Senator BARKLEY. Do you know what the income on that transferred property was?

Mr. SULLIVAN. We have no way of knowing that, sir.

Senator BARKLEY. The tax lost to the Treasury would depend on the income of this $5,000,000,000 worth of property?

Mr. SULLIVAN. That is right and the bracket in which the holders of the property were placed.

Senator BARKLEY. Would you estimate the difference between what the wife would pay on that transferred property and what the husband and wife would pay if they were compelled to make a joint return?

Mr. SULLIVAN. We have no way of estimating that, sir, but as I testified a few moments ago we estimate that the Treasury proposal for mandatory joint returns would yield $258,000,000 a year.

Senator CLARK. They would have to pay the gift tax at the time of the transfer.

Mr. SULLIVAN. That is right. The gift tax rates are three-fourths of the estate tax rates, Senator Clark.

Senator BARKLEY. Is it your contention that all of the 153,000 families would be affected by this change in the transfer of property back and forth between husband and wife?

Mr. SULLIVAN. No; that is not correct, sir.

Senator BARKLEY. How many of them would you say have escaped taxes by that method?

Mr. SULLIVAN. I cannot give you that offhand.

Senator BARKLEY. So, regardless of any transfers, regardless of whether they are wealthy or not, 153,000 is the number of those who would be affected by the provisions of the House bill if it was mandatory?

Mr. SULLIVAN. I think it would be a little bit more this year, Senator. Probably about 215,000 families would file separate and community property returns under existing law.

Senator BARKLEY. While I am asking questions—I do not want to take too much time—I wanted to ask the Secretary if he has any estimate on the total national income for 1941?

Secretary MORGENTHAU. Our men estimate somewhere between 88 and 90 billion dollars.

Senator BARKLEY. That is 10 or 12 billion dollars more than for 1940, isn't it? The 1940 income was some $76,000,000,000.

Secretary MORGENTHAU. Yes. That is correct, Senator Barkley. They say right now it is running at the rate of $88,000,000,000, but my men think that before the year is over, it will be over $90,000,000,000.

Senator BARKLEY. My recollection is that the total income for 1940 was about $76,000,000,000 and if it is estimated for 1941, it will be $90,000,000,000, that means an increase of $14,000,000,000.

Secretary MORGENTHAU. That is right.

Senator BARKLEY. In the total income.

Secretary MORGENAHAU. That is right.

Senator BARKLEY. Now the point in my mind is this, to try to reach the source of that $14,000,000,000 increase in income.

Secretary MORGENTHAU. Yes.

Senator BARKLEY. Now, to what extent has that $14,000,000,000 increase been distributed among the low-income taxpayers who would be affected by a lowering of the base?

Secretary MORGENTHAU. This is just my own opinion, without consulting anybody—I do not think it has had time to get down to most of the really low-income people yet.

Senator BARKLEY. So that any tax bill that increases the tax of the low income brackets, who have not participated as yet in this increase of $14,000,000,000 would be, of course, an additional burden upon them, who have not been compensated by the increase which we are talking about, is that true?

Secretary MORGENTHAU. As I say, I haven't got the exact figures. It takes quite a while for this increase of national income to reach the people at the bottom of the ladder.

Senator BARKLEY. The 3½ billion dollars that this bill is supposed to raise over and above present taxes then, is only about one-fourth of the total increase in the national income?

Secretary MORGENTHAU. Yes.

Senator BARKLEY. It seems to me that if there is any way to arrive at levying this tax where the increased income is going to benefit people, it ought to be done, instead of assuming that the $14,000,000,000 increase is being spread out over the whole population and therefore, we would be justified in taxing the small-salaried man who does not now pay an income tax or who does not pay as much as he would before any increased schedule.

Secretary MORGENTHAU. Eventually it will reach everybody in proportion to his earning power.

Senator BARKLEY. Well, it will not reach the salaried man unless his salary is increased by reason of increased income.

Secretary MORGENTHAU. Yes; it will hit him the hardest.

Senator BARKLEY. It will not reach him at all, if the price of his living expenses is to go up without any increase in his income.

Secretary MORGENTHAU. That is right.

Senator WALSH. Is there any better way of reaching a portion of that increased income than through the excess profits tax?

Secretary MORGENTHAU. I do not know any at the moment, I mean other than these six suggestions which I made here today.

Senator BARKLEY. Do not you think that people who are not engaged in defense work and whose profits are not to be increased, even indirectly, by the defense program, ought to bear their share of this burden, as well as everybody else? In other words, the tax ought not to be limited simply to those who are making direct profits out of defense activities? The general increase in income to some extent, benefits a lot of people who have no contract with the Government, who are not engaged in the manufacture of defense articles.

Secretary MORGENTHAU. That is right.

Senator BARKLEY. And any tax based simply upon an increase growing out of defense contracts might let a lot of people escape who will share in this increased income?

Secretary MORGENTHAU. That is perfectly right.

Senator CONNALLY. May I ask him some questions? Is it my turn now?

The CHAIRMAN. Yes. There is no particular order in which the committee members may ask questions.

Senator CONNALLY. Somebody suggested you were going down the line. I am willing to accept my humble place when it is reached.

Mr. Secretary, I am sorry I was not here when you started.

Secretary MORGENTHAU. I am sorry, too.

Senator CONNALLY. I hope to be here when you end.

Secretary MORGENTHAU. Are you participating in my end?

Senator CONNALLY. Well, if it is the right end, I will.

Secretary MORGENTHAU. Thank you.

Senator CONNALLY. I noticed you were on page 8 and then Mr. Sullivan was reaching his climax on it when I came in, about the joint-income return. He said something about billions of dollars of property had been transferred in recent years from husband to wife, ostensibly to evade the payment of a heavier tax. I suppose that was your implication, was it not, Mr. Sullivan?

Mr. SULLIVAN. The question was, How much property had been transferred?

Senator CONNALLY. I see here you say:

> Furthermore, in at least eight States of the Union, Federal income taxes are made substantially lower than in the remaining States because the local law permits the splitting of income between husbands and wives.

Have you any reason to believe that a State like mine, that adopted the community property as early as 1840, had in mind the avoidance of a tax in 1941 by the adoption of the community-property rule?

Secretary MORGENTHAU. I doubt whether they were that farsighted.

Senator CONNALLY. Well, if they had known who was running the Treasury in 1940, they might have been that farsighted.

What I am talking about is, you seek to pick out eight States here and make them more or less the goat and credit them with putting the idea in these rich States like your own of swapping back and forth to avoid taxes. As a matter of fact, the community-property rule was more or less an inheritance from the Roman law, the civil law,

and these eight States that have it were originally, most of them, parts of Mexico. My own State, when it was a free republic—it was not even part of the Union, and therefore was not looking forward, maybe at that time, to ever being a part of the Union; and while we are on that, we have had reason several times to doubt whether we ought to have joined or not—but still the point I am trying to make is this, that this was a domestic social policy that our people adopted in 1840 to give the wife half the income. It ought to be the law everywhere. If a man and wife get married the wife ought to be allowed something more than food, clothing, and a place to sleep. So there is no theory at all here that we adopted any policy such as this in the community property States to evade taxes, and the Federal Government has no right, through the pressure—the indirect pressure of a tax—to cause us to change or modify or alter our own laws that we have had from time immemorial. Now, if these parties are transferring their properties to evade taxes, as suggested by Mr. Sullivan, maybe we ought to raise the gift tax and provide that if a husband gives his wife part of his estate, he should pay a higher rate, or vice versa.

I hope it does not apply to the men giving the wives part of their property or the wives giving the husbands part of their property without any intention of evading the tax.

Secretary MORGENTHAU. May I interrupt you for one moment?

Senator CONNALLY. I want to add to that. I just resent the implication here that we people who adopted this rule 100 years ago are trying to evade some tax.

Secretary MORGENTHAU. May I interrupt?

Senator CONNALLY. Yes.

Secretary MORGENTHAU. On this page 8, in paragraph 3, you notice I say—

families pay lower Federal income taxes when both husband and wife receive income than when the same total amount of income is received by only one of them.

Senator CONNALLY. There is no tax on families. There is a general tax on individual incomes but you do not tax families.

Secretary MORGENTHAU. This reads:

This is a discrimination of which many wealthy people have taken advantage by large gifts of income-producing property between husband and wife.

We are not talking about the eight States. Then I go on:

Furthermore, in at least eight States of the Union—

and so forth.

Senator CONNALLY. Yes.

Secretary MORGENTHAU. So that the one thing is applicable to the present law, where you can file separately or jointly.

Then I go on talking about the eight States there. Furthermore, it breaks the thing into two thoughts.

Senator CONNALLY. I read the whole statement. That is all, Mr. Chairman.

The CHAIRMAN. Senator Capper, do you wish to ask any questions?

Senator CAPPER. No.

The CHAIRMAN. Senator Vandenberg?

Senator VANDENBERG. Mr. Secretary, I want to see if I can get at just one figure for comparative purposes. I think it might be instruc-

tive to the country. You put great emphasis on the necessity for an "all-out" tax program in connection with an "all-out" defense program.

Secretary MORGENTHAU. That is right.

Senator VANDENBERG. At that original meeting in your office in April, I think—which was a very historic one for me, because that is the only one I have ever been permitted to look in at—my recollection is you said the protection of public credit required inescapably that we should go on a one-third, two-thirds basis, in other words, that we should pay two-thirds of our operating governmental costs. My recollection is you said you would be a little doubtful about what would happen to the public credit if we did not go on a two-thirds pay-as-you-go basis. Is that correct?

Senator MORGENTHAU. Yes.

Senator VANDENBERG. Well, at that time, the Budget was $19,000,000,000 and the revenue was $9,000,000,000. You estimated the necessary new revenue at $4,000,000,000 in order to produce $13,000,000,000 and that should be on a two-thirds pay-as-you-go basis.

Secretary MORGENTHAU. Yes.

Senator VANDENBERG. What would this bill have to raise if we were to still maintain our belief in your proposition that the public-credit protection requires a two-thirds, pay-as-you-go basis?

Secretary MORGENTHAU. Can I ask Mr. Bell out loud, so you may participate in whatever wisdom he has?

Senator VANDENBERG. Yes.

Secretary MORGENTHAU. As I understand it, Mr. Bell, the last official figure we have from the Budget is that they are going to ask for this fiscal year's expenditures, $22,000,000,000?

Mr. BELL (D. W. Bell, Under Secretary of the Treasury). That is right.

Secretary MORGENTHAU. How much do they figure the revenue to be?

Mr. BELL. Nine and four-tenths billions.

Secretary MORGENTHAU. That would leave a deficit of how much?

Mr. BELL. Twelve and eight-tenths billions. In order to raise two-thirds of the expenditures by revenue you would have to have about $15,000,000,000, so that the increase of the taxes over the present tax structure would be about five and six-tenths billion.

Secretary MORGENTHAU. Including this bill?

Mr. BELL. Yes.

Secretary MORGENTHAU. You mean another five billion on top of the three and five-tenths billion?

Mr. BELL. No, sir; on top of the revenue we are now getting under the present tax law.

Secretary MORGENTHAU. How much on top of the three and five-tenths billion?

Mr. BELL. About two billion.

Secretary MORGENTHAU. Figuring three and five-tenths billion, how much more—one and five-tenths billion?

Mr. BELL. I figure two billion more.

Senator VANDENBERG. I did not mean to stall the machinery.

Secretary MORGENTHAU. The answer to your question is, if we had another meeting in our office and you would be gracious enough to

come, under present conditions, we would tell you we would need another $2,000,000,000 in taxes.

Senator VANDENBERG. Your statement on page 3 says that $14,000,000,000 has been added to the Budget since our original meeting, and if that is true, since you originally estimated it at $19,000,000,000, the total now would be $33,000,000,000.

Secretary MORGENTHAU. If you will just take a moment, it is appropriations, authorizations, and recommendations.

Mr. BELL. Not expense.

Senator VANDENBERG. Yes.

Secretary MORGENTHAU. We can only go by the Budget figure of what is going to be spent, and the most recent figure is $22,000,000,000.

Senator VANDENBERG. So the answer to my question is, if we were to cling to your two-thirds as-you-go formula, we would have to raise $2,000,000,000 more than this bill raises?

Secretary MORGENTHAU. $2,000,000,000 on top of the $3,500,000,000.

Senator VANDENBERG. That is what I mean.

Secretary MORGENTHAU. Yes.

Senator VANDENBERG. I want to ask about just one other thing in connection with your national income, which you say is now $88,000,000,000 and which your experts contemplate will rise to $90,000,000,000.

Secretary MORGENTHAU. Yes.

Senator VANDENBERG. To what extent does that take into account the decimation of little business, with the priorities handicap that little business is now suffering from?

Secretary MORGENTHAU. I could not answer that. Those figures on national income are computed by the Department of Commerce. We just take the figures from them; that is all. I do not know how to answer your question.

Senator VANDENBERG. Do not you feel that the operation of priorities is going to seriously upset all of your estimates?

Secretary MORGENTHAU. I would not know how to answer that question.

Senator VANDENBERG. That is all.

Senator LA FOLLETTE. I think the record ought to show it was stated here yesterday, insofar as the Treasury is capable of doing so, they have allowed for dissemination of priorities in their estimates of income. Of course, that is a very difficult task, since nobody knows exactly the extent of it, although I think everybody who knows anything about it recognizes it should be very great.

Mr. SULLIVAN. That is true, Senator La Follette, insofar as the estimate we have given on tax revenues as distinguished from national income.

Senator LA FOLLETTE. That is what I am talking about.

Mr. SULLIVAN. Yes.

Senator GERRY. How about the revenues from the increased national income?

Secretary MORGENTHAU. Mr. Sullivan, will you answer that?

Mr. SULLIVAN. I will ask Mr. O'Donnell to answer that.

Mr. O'DONNELL (Al F. O'Donnell, Assistant Director of Research and Statistics, Treasury Department). Of course, we do not estimate revenues from the national income, Senator Gerry. In each instance

where you pass a law, the Congress defines each specific base upon which a tax is levied. For instance, in the case of automobiles, we tax the value of automobiles sold by the manufacturers, and therefore it becomes our problem to estimate the value of the automobiles which will be produced. When we made our Budget estimates, for instance, last December, we were faced with production for the 1941 model automobile year of something like 5¼ million passenger cars and trucks, of which perhaps 4.2 million would be passenger cars.

Now, in making our estimates of revenues for fiscal year 1942 last December we saw ahead to this problem of priorities, that Senator Vandenberg has mentioned. We thought that the automobile industry was going to be one of those industries most seriously hurt, and in figuring our Budget estimate of revenue from the manufacturers' excise tax on passenger automobiles, we cut down the estimated value of production to something like the equivalent of 3,100,000 passenger automobiles on which taxes would be collected in fiscal year 1942. Now, even today, 8 months after it was made, this estimate is not materially out of line with the projected plans for the automobile industry.

Thus, Senator Gerry, even though we expected higher levels of national income in fiscal year 1942 than in the preceding fiscal year, the estimate of the anticipated revenues from this particular tax were lowered to take into account anticipated priorities.

Now, it is in that sense that I say we tried to anticipate what is going to happen.

Senator VANDENBERG. May I ask you, in connection with that particular exhibit——

Mr. O'DONNELL. Yes, sir.

Senator VANDENBERG. Do you carry your conception down into the dislocation throughout the country among all the dealers of automobiles?

Mr. O'DONNELL. We try to do that, sir, particularly when we estimate the yield of the income taxes. We take into consideration the fact that we will no longer get a normal relationship between the statistical indices which we look to to indicate corporate and individual incomes. The indexes will not indicate the relationships which prevailed in normal times, and we do try to make allowances for that fact.

Senator VANDENBERG. My observation, in my own State, at least, is that small business is going to the wall pretty rapidly under the pressure of priorities. In fact, I think the priority proposition is probably going to be more dangerous in the next 6 months than even Mr. Hitler is.

The CHAIRMAN. Senator Bailey, do you desire to ask any questions?

Senator BAILEY. I would like to have some suggestion by the Secretary on this point: You want 3.5 billion dollars of revenue in addition to the present revenue?

Secretary MORGENTHAU. Very much so.

Senator BAILEY. What would be the total revenue then?

Secretary MORGENTHAU. About 12.7 billion or 12.8 billion dollars.

Senator BAILEY. It would be from 12 to 12.5 billion general revenue to the Federal Treasury if this bill passes and we jack it up 3.5 billion. To what extent could you relieve the very bad situation which you portray here by reducing the nondefense expenditures, just assuming that the Congress would do so?

Secretary MORGENTHAU. Well, to whatever amount the Congress reduces it, it makes the gross expenditures of the Federal Government that much less and it makes the fiscal picture look that much better.

Senator BAILEY. Is not that really a logical way out of the situation?

Secretary MORGENTHAU. I think it is one of the ways. I still think we ought to have our 3.5 billion.

Senator BAILEY. The 3.5 billion is for defense purposes?

Secretary MORGENTHAU. Yes.

Senator BAILEY. Suppose we could reduce the nondefense expenditures by 2 billions, you would not need your 3.5 billions to any such degree as you now need it, at any rate?

Secretary MORGENTHAU. I am sorry, but I did not get the question.

Senator BAILEY. I say, if you should reduce the nondefense expenditures by 2 billion, you would not need the 3½ billion that you are now calling upon to nearly the extent that you now need it?

Secretary MORGENTHAU. That is correct, but we still ought to have it.

Senator BAILEY. I am not challenging that, but that situation would be relieved.

Secretary MORGENTHAU. Would be relieved to that extent.

Senator BAILEY. Is not that the sound and reasonable way out of this situation?

Secretary MORGENTHAU. I think that all of us—if I may include myself with you gentlemen as one, I mean in the terrific responsibility we are carrying—well, I will talk just for myself; I do not think that I would be fulfilling my duty if I did not keep repeating, which I do every time I get a chance to come before Congress, that every dollar for nondefense should be eliminated at this time which can be spared. Now, there are some things we have to have, but there are a great many things which I think we needed to get us out of the depression which we could very well do without at this time.

Senator BAILEY. Now, as the fiscal head of the Government, have you made any estimate as to what we might reasonably reduce the nondefense expenditures to?

Secretary MORGENTHAU. Senator Bailey, we have our own ideas, but it is really up to the Director of the Budget to furnish the committee with that information, because he has all of the facts, he has access to all of the departments. I am just one of many departments. He is the central agency who is charged with that duty.

Senator BAILEY. It is the function of the Secretary of the Treasury to call for reduced expenditures, as well as to demand increased revenues.

Secretary MORGENTHAU. I have done that in my statement here.

Senator BAILEY. To what extent do you suggest a reduction of nondefense expenditures?

Secretary MORGENTHAU. I do not name the figure. As I say, I feel under our set-up that is up to the Director of the Budget. He is available and he has access to all the departments which I do not.

Senator BAILEY. The figure was a billion dollars.

Secretary MORGENTHAU. That is right.

Senator VANDENBERG. Have you seen any recent evidence on the part of Congress of a willingness to save any money at all?

Secretary MORGENTHAU. No, sir.

Senator BAILEY. None in the world.

Secretary MORGENTHAU. No, sir.

Senator BAILEY. On the other hand, we have appropriated more and authorized more.

Senator BYRD. Is not this true, Mr. Secretary, that the only effective way to reduce the nondefense spending is to incorporate it in the Budget and submit it by the President to the Congress?

Secretary MORGENTHAU. That is one way, and the Congress could also take the initiative.

Senator BYRD. Do you think Congress should be expected to override the President and the Administration and the Budget to reduce nondefense spending?

Senator VANDENBERG. They did yesterday.

SENATOR BYRD. I mean, is that a practical matter to do? If the administration and the Director of the Budget do not think that the nondefense spending should be reduced, why should Congress think it?

Secretary MORGENTHAU. Well, Senator, you and I know the facts of life.

Senator BYRD. I am speaking about all this nondefense spending. As a matter of fact, it must come primarily in the Budget, and it is submitted by the President to the Congress.

Secretary MORGENTHAU. That is one way.

Senator BYRD. I mean, isn't that the practical way and the only way under the condition that confronts us here?

Secretary MORGENTHAU. No.

Senator BYRD. What other way should you suggest?

Secretary MORGENTHAU. Well, for me to give examples, I am afraid some of you gentlemen might resent it as being in the nature of criticism. I do not want to be placed in that position.

Senator BARKLEY. Of course, the Congress could do it if it would, but it will not.

Senator BAILEY. I differ with the Senator.

Secretary MORGENTHAU. You can say that, Senator Barkley. I cannot.

Senator BAILEY. The Secretary and the Congress will do it if some effort is made as to leadership and coordination. I think if the President, yourself, and the leaders on both sides in the House and Senate get together on a program of retrenchment, the Congress would sustain it.

Secretary MORGENTHAU. Senator Bailey, I have made the suggestion two or three times but nothing has come of it. I would be delighted, at least, to the extent of the opportunity you have given me to make it myself, but they tell me it is impractical and that is this, that the taxing committees in the Senate and House and Appropriations Committee sit down with the appropriate people in executive government and work out a program, but just as long as the appropriating committee is entirely independent of the taxing committee and we do not sit down with the Budget and with the Treasury, I do not think we will ever get anywhere.

Senator BAILEY. I think that is just the point. We have not undertaken to coordinate a program with the Treasury. We are left at loose ends, and here we go with only one outlet, that is only an

increase in the revenue. I notice the chairman of the Ways and Means Committee said this was not the last tax bill. This is the last one I am going to vote for of this character until we do reduce the nondefense expenditures.

Senator BYRD. Would you be willing, Mr. Secretary, to use your influence with the Director of the Budget to bring a Budget to the Congress that will reduce the nondefense spending in the next fiscal year?

Secretary MORGENTHAU. I am very glad to use whatever little influence I have. He is in no way responsible to me, though, so I do not have very much influence.

Senator BYRD. The President submits the Budget and he could very well submit a Budget with a reduction in nondefense spending.

Secretary MORGENTHAU. I am glad to use whatever influence goes with my position along these lines, because I feel it very deeply.

Senator BARKLEY. Would you consider that you had more influence with the President, or he had more influence with you?

Secretary MORGENTHAU. I would put my money on the President.

Senator VANDENBERG. Do you consider the continuing purchases of foreign gold and silver by the Treasury as a nondefense expenditure?

Secretary MORGENTHAU. As to the gold, if you do not mind, that is in a separate category. As to the silver, if you gentlemen want to strike all the silver legislation off the books, it is quite all right with me.

Senator VANDENBERG. Well that is a partial assistance.

Secretary MORGENTHAU. It is quite all right with me. The gold, however, is in a category by itself. If you want to strike the silver legislation off the books, it is all right with me.

Senator BARKLEY. If you strike off the silver legislation, you strike it off for the silver in the United States as well as outside of the United States?

Secretary MORGENTHAU. That is right.

The CHAIRMAN. Are there any additional questions? Senator Byrd, do you have any questions?

Senator BYRD. Mr. Secretary, I would like to ask this question: Is it not possible and probable that the $22,000,000,000 that you now estimate the total expenditures will be increased to, and inasmuch as you increased your estimates repeatedly, from month to month, is it not possible that the expenditures may reach $25,000,000,000 this fiscal year?

Secretary MORGENTHAU. Perfectly possible.

Senator BYRD. I am entirely in accord with your original plan to pay for the expenditures two-thirds pay-as-you-go and one-third by borrowing. Assuming that the $22,000,000,000 is the minimum, and in my judgment it will be $25,000,000,000 and I think you agree it could be $25,000,000,000——

Secretary MORGENTHAU. I agree with you that the defense program is going to work out to nearer $25,000,000,000 than $22,000,000,000.

Senator BYRD. Now, we will need $2,000,000,000 additional in order to make your plan applicable to the $22,000,000,000. How would you suggest raising $2,000,000,000 additional assuming the committee would want to consider that and go into it?

Secretary MORGENTHAU. In this statement which you gentlemen gave me an opportunity to read to you today, if all six of these suggestions were made into the law they would raise somewhere between

$800,000,000 to a billion dollars additional; between $800,000,000 to a billion dollars revenue in those six suggestions which I read.

Senator BYRD. In other words, it would raise a total of 4.5 billion if the present bill should be amended according to your suggestion?

Secretary MORGENTHAU. On top of 3.2 billion.

Senator BYRD. I say 4 billion.

Secretary MORGENTHAU. Yes.

Senator BYRD. How would you suggest getting the additional billion?

Secretary MORGENTHAU. I want to do a little thinking on that.

Senator BYRD. Would you favor a general sales tax, a manufacturers' sales tax?

Secretary MORGENTHAU. That would be the last thing I would recommend.

Senator BYRD. But you have no plans beyond that which you recommended which raises approximately $800,000,000 in addition to the bill as passed by the House?

Secretary MORGENTHAU. Well, coming before this committee, we take it very seriously. We take a great deal of pains and care to prepare a statement. Now to the best of my ability, I have thought out what the Treasury should say here today.

Senator BYRD. As a matter of fact your proposals today do not carry out your formula?

Secretary MORGENTHAU. No.

Senator BYRD. Even on the most limited expenditures?

Secretary MORGENTHAU. That is right.

Senator BYRD. The formula of two-thirds pay-as-you-go and one-third borrowing.

Secretary MORGENTHAU. That is right.

Senator BYRD. Does this $800,000,000 additional include the $300,000,000 that was lost by the House?

Secretary MORGENTHAU. It is in that.

Senator BYRD. In not agreeing to the tax on husband and wife?

Secretary MORGENTHAU. Yes.

Senator BYRD. That is $500,000,000 of additional new taxes that have not yet been suggested, that your suggestions would bring in?

Secretary MORGENTHAU. That is approximately correct.

Senator BYRD. Would you care to submit to the committee a proposal whereby your formula could be carried out in full?

Secretary MORGENTHAU. I would be very glad to.

Senator BYRD. I would be glad to see it.

Senator BARKLEY. Let me ask you right on that point: Outside of the possible imposition of this general sales tax, concerning which I agree with you, I would favor only as a last resort, what other new sources of income are there from which we could get $500,000,000 or $2,000,000,000 of income, or any substantial part of it?

Secretary MORGENTHAU. There are not any new sources, Senator Barkley; you would just have to increase the present sources.

Senator BARKLEY. That is it. It is a simple matter in one way, provided you do not go so far as to kill the goose that lays the golden egg, to increase the various rates that are now imposed in the bill to raise the required amount. Outside of the general sales tax which you mentioned, there is no substantial new source which you can tap?

Secretary MORGENTHAU. That is correct.

The CHAIRMAN. Any questions, Senator Gerry?

Senator GERRY. No.

Senator BAILEY. Do you know what we are spending on the silver program now?

Secretary MORGENTHAU. Yes. We bought something like 35,000,000 ounces. I will ask Mr. White to go into that subject.

Mr. WHITE (Harry D. White, Director of Monetary Research, Treasury Department). In the first 6 months of this year we bought approximately 35,000,000 ounces of domestic silver. In dollars it would be approximately $25,000,000.

Senator BAILEY. How about the foreign silver?

Mr. WHITE. The foreign silver has been very much less than that. I think something in the neighborhood of $2,000,000 or $3,000,000 a month.

Senator BAILEY. At the rate of $33,000,000 a year?

Mr. WHITE. The rate is not that high. The first 6 months of this year we purchased approximately $12,000,000 of foreign silver.

Senator WALSH. What would we save if we repeal the silver legislation?

Mr. WHITE. The Treasury would not save anything, because the Treasury issues currency equal to the cost value of the silver which it buys, and then there is the silver seigniorage which it could take advantage of if it wished to. As far as the budget is concerned, neither the purchases of silver nor the purchases of gold add to the expenses of the Government.

Senator BYRD. What have been the total purchases of gold?

Mr. WHITE. This year?

Senator BYRD. Since the plan was adopted.

Mr. WHITE. I cannot give you an exact figure. Approximately $15,500,000,000.

Senator BYRD None of that expenditure is affected in the Budget?

Mr. WHITE. No. Gold certificates or gold-certificate credits are issued against the gold which is purchased.

Senator VANDENBERG. If you repealed the legislation and let silver take its normal price instead of a pumped-up price, would not it make a difference in the Treasury's prospective situation?

Mr. WHITE. Indirectly, it may make some difference in the sense that the continued issue of silver certificates at this time by increasing the amount of money in circulation has a tendency to increase the prices slightly. With increasing prices it makes the financial picture so far as the Treasury is concerned, a little more difficult. However, when you talk about the effect of silver on the financial picture, we are dealing in the realm of small magnitudes.

Senator VANDENBERG. Is there an inflationary influence in the gold and silver purchases?

Mr. WHITE. There is in the silver but, as I say, only slightly. You are dealing in magnitudes of $35,000,000 of silver purchases in a 6-months' period as against 45 billions of currency and demand deposits. You can appreciate the fact that the consequences of such relatively small additions to the money supply on the price system would not be very significant.

Senator BARKLEY. As a matter of fact, the use of the phrase "purchase of silver" is a misnomer, is it not? The Treasury does not pay out any money for silver; it saves the silver and issues silver certifi-

cates which are taken back by the person who brings the silver to the mint and the Treasury and the silver certificates are issued and put in circulation?

Mr. WHITE. Yes.

Senator BARKLEY. You do not add to the taxes by the purchase of silver?

Mr. WHITE. No.

Senator BARKLEY. Or gold, either?

Mr. WHITE. No.

Senator BYRD. It is as good as any other money.

Senator BARKLEY. It is paid to the man who brings the silver in.

Senator BYRD. That man can take the money and spend it for anything he likes.

Senator BARKLEY. The Treasury did not pay for it.

Senator BYRD. Somebody paid for it. I have often wondered what would happen if gold, for example, went back to its price of $20 an ounce and the Government then had a loss of eight or nine billion dollars on the gold it paid $35 an ounce for. How would that be financed?

Mr. WHITE. Well, if you revalue the gold——

Senator BYRD (interposing). I do not mean if you revalue the gold. Suppose the artificial level of gold were stopped and gold went to the original level that it was when it started to go up, of $20 an ounce and thereby occasion a loss in the gold we now have by billions of dollars, how would that be financed in the Government operations?

Mr. WHITE. Senator, I do not understand what you mean when you speak of an artificial price for gold. The price of gold in any country is the rate which the particular government establishes as the mint price, provided of course, the government is ready to buy or sell gold at that mint price.

Now then, that is the price of gold in this country, it is $35 an ounce.

Senator BYRD. It was increased arbitrarily from $20 an ounce.

Mr. WHITE. It was increased by legislation to $35 an ounce.

Senator BYRD. I contend that that is an artificial price, and I am assuming that the price went down to the prior level.

Mr. WHITE. Assuming the Congress reduced the price from $35 an ounce to $20 an ounce, that constitutes a revaluation of the gold.

Senator BYRD. Is it your judgment that the gold would be $35 an ounce now in the event our Government did not pay $35 for it?

Mr. WHITE. The price of gold is whatever Congress states that it shall be, provided the Treasury buys and sells gold at the statutory price.

Senator BYRD. There is no question in your mind but that the value of gold was increased to $35 an ounce arbitrarily by the price fixed. Was that not in excess of the world price that existed at the time that price was fixed?

Mr. WHITE. I do not want to appear pedantic, but obviously the price of gold in the United States is what you gentlemen make it. If Congress states it is $35 an ounce, that is what it is. In each country the price of gold is in the terms of the currency of that country. In England it is in pounds, in France it is francs, in Argentina it is pesos. The answer to your question, I take it, is that the price of gold in the United States is what Congress fixes it at.

Now, let us proceed from there? What was the further question?

Senator CONNALLY. Let me ask a question. The gold is worth in any country whatever that country says it is worth in terms of the money of that country, is it not?

Mr. WHITE. That is not wholly true, Senator. It may fix a price for gold, and the price in that country, in the currency of that country, might be out of alinement with the market price because the government cannot or does not wish to buy and sell gold at the statutory price.

Senator CONNALLY. That would not be because it did not have a sound currency. In the United States, for instance, we called it worth $20 an ounce; it was worth $20 an ounce because we said 20 grains of gold was a dollar.

Mr. WHITE. Exactly.

Senator CONNALLY. And it is worth $35 an ounce now because we say that the same amount of gold is now worth $35, which was formerly worth $20.

Mr. WHITE. Exactly.

Senator BYRD. It is only worth $35 on the assumption that we buy all of the gold offered at $35.

Senator CONNALLY. No; it would be worth just the same regardless of that.

Senator BYRD. It would not be worth that over the world unless we were willing to pay $35 an ounce for all the gold that was offered us.

Mr. WHITE. When Congress says that the price of gold is $35 an ounce, and if we do not impose any restrictions on the amount of gold bought and sold, then whatever gold comes in we pay $35 an ounce for.

Senator BYRD. We have bought all the gold that has been offered to us, at $35 an ounce, have we not?

Mr. WHITE. We have.

Senator BYRD. Russia or any other country in the world?

Mr. WHITE. From countries all over the world.

Senator BYRD. What is the cost of production of gold?

Mr. WHITE. It varies very greatly, not only from country to country but from mine to mine. It not only varies from mine to mine but as you well know, it will vary from portions of the same mine.

Senator BYRD. There must be some average figure.

Mr. WHITE. The possibility or likelihood of getting an accurate average figure on the cost of production of gold the world over is extremely small, because gold mines do not issue their cost figures.

Senator BYRD. You are an expert and well-informated about it. What is your opinion about it?

Mr. WHITE. Let me put it this way, Senator, and see whether this answers your question. There are some very rich gold mines that can produce gold at a cost roughly equivalent to $12 an ounce. There are very few such gold mines, however. There are a large number of gold mines that produce gold at costs running from $20 to $30 an ounce. There are some gold mines that produce gold and make a very small profit.

Senator BYRD. What would be the average for these larger mines, 75 percent, say of the production?

Mr. WHITE. I should say somewhere between $20 and $30. It is just a guess and nothing more.

Senator BYRD. We are paying more, considerably more for gold than the cost of production?

Mr. WHITE. For gold from many mines that is true.

Senator BYRD. What percentage of the total gold in the world does this country now own?

Mr. WHITE. I should say roughly about 75 percent.

Senator BYRD. As long as we pay substantially more than the cost of production of gold, then we are paying an artificial price, are we not?

Mr. WHITE. No; I should not say that. Would you say, Senator, that the price of wheat on the market is artificial because there were different costs and some farmers get more than the cost of production?

Senator BYRD. That would be governed by how much the fluctuation would be. As I understand you, some large mines produced it at $12 an ounce.

Mr. WHITE. Yes.

Senator BYRD. If you pay $35 an ounce, that is considerably in excess of the cost of production at practically any mine?

Mr. WHITE. If you wish to say when Congress passes a law fixing the price of gold, that Congress is doing something artificial, that is all right.

Senator BARKLEY. What Congress does is not to fix the price of gold, except indirectly by saying how much gold is going into a dollar.

Mr. WHITE. That is correct.

Senator BYRD. I want to differ with you, Senator Barkley. We are buying all the gold that is offered to us from all over the world, and the Treasury will pay $35 an ounce for that gold.

Senator BARKLEY. How much of this 75 percent of the gold does the United States own?

Mr. WHITE. It owns all of it. It has title to all of it.

Senator BARKLEY. I am distinguishing between the Government of the United States and the Federal Reserve Bank. What is the proportion of that gold that is in the Treasury?

Mr. WHITE. The title to gold rests in the Government.

Senator CONNALLY. The Government issues gold certificates against the gold, it issues certificates to the Federal Reserve bank.

Mr. WHITE. That is right.

Senator BARKLEY. Not to the public. The average man does not get any gold certificates.

Senator BYRD. The gold certificates are passed between the Government and the banks.

Senator LA FOLLETTE. I would like to very respectfully suggest that the Banking and Currency Committee may feel we are impinging on their domain.

Senator DANAHER. We do not get any further there either.

The CHAIRMAN. Senator Gerry, any questions?

Senator GERRY. No.

The CHAIRMAN. Senator Guffey?

Senator GUFFEY. I have no questions.

The CHAIRMAN. Senator Danaher?

Senator DANAHER. Mr. Chairman, I would like to ask the Secretary if there is under consideration some new plan for the taxation of insurance companies?

Secretary MORGENTHAU. Not as far as I know. It has not been brought to my attention.

Senator DANAHER. I understood you in your statement, or at least in answer to some questions, you said the last thing you wished to impose would be a general manufacturers' sales tax, or words to that effect?

Secretary MORGENTHAU. That is right.

Senator DANAHER. Well, would not you consider the imposition of this manufacturers' sales tax, which we call an excise tax in the bill submitted, to be just that?

Secretary MORGENTHAU. To my mind, there is quite a difference.

Senator DANAHER. "There shall be imposed on the following articles sold by the manufacturers: Sporting goods, electrical appliances, office equipment, photographic apparatus, washing machines," those are not excise taxes, are they?

Secretary MORGENTHAU. That list has been very carefully selected from the point of view of articles which would compete with our national defense, or articles which are considered luxuries at this time.

Senator DANAHER. Do you consider typewriters to be luxuries?

Secretary MORGENTHAU. That depends upon who uses them.

Senator DANAHER. The Government uses over half of those produced. Are you going to drive those out of business on that principle?

Secretary MORGENTHAU. We may have to. [Laughter.]

The CHAIRMAN. Senator Radcliffe, have you any questions?

Senator RADCLIFFE. Mr. Secretary, do you believe that the mandatory joint return is essentially sound, or do you approve of it merely because of the fact that there have been certain transfers of the character which you referred to?

Secretary MORGENTHAU. I would say a combination of both.

Senator RADCLIFFE. Will you explain that?

Secretary MORGENTHAU. I just feel this way, that at this time, a husband and wife through being able to make separate returns, have a privilege that enables them to pay less than if they paid on one return by each one of them, and if we are going to go out and ask the man who earns $750 a year to pay a dollar or two of tax, I for one, cannot face that man unless I can say to him, "I have exhausted every other opportunity to make every other group pay their fair contribution."

Senator RADCLIFFE. That is, you think the method is sound even though there were not these transfers to which you referred. Do you think that is a sound way of doing it, even though they were not transferred from husband to wife and therefore, the taxes not reduced?

Secretary MORGENTHAU. I believe, under the present abnormal conditions, it is sound.

The CHAIRMAN. Senator Brown, do you wish to ask the Secretary any questions?

Senator BROWN. Mr. Secretary, this bill is divided into main parts, income taxes producing 2½ billion and miscellaneous income-revenue taxes producing the balance of about a little over a billion. How much are we losing every day or every month by not having the excise taxes in effect now?

Secretary MORGENTHAU. May Mr. Sullivan answer that?

Senator BROWN. Yes.

Mr. SULLIVAN. A little over $2,400,000.

Senator BROWN. Per day?

Mr. SULLIVAN. Per day, sir.

Senator BROWN. It took the Ways and Means Committee roughly 3 months to perfect this bill and present if for passage in the House. I made a suggestion some time ago that I thought it would be wise to attempt to divide the tax bill and give consideration as rapidly and as early as possible to the excise taxes. While there would be considerable discussion, I do not think there will be as much discussion as there will be over the income taxes, with the joint return fight, lowering the base fight, so on and so forth. Would it, from your standpoint, be possible and desirable to attempt to divide this bill into two parts and pass the excise tax section and leave out the income tax for further consideration, having in mind that the income taxes do not and cannot be effective until January 1, while the excise taxes, as I recall it, under this bill would go into effect 10 days after passage?

Mr. SULLIVAN. Our experience, Senator Brown, has been that the members of the committees feel that there is an interrelation between the different parts of the taxes; that is, what they are willing to do in personal income taxes depends in some measure upon what they do in excise taxes. Now we share with you the view that it is important and profitable to have the excise portions of this bill go into effect as soon as possible.

We also feel that it is important to the taxpayer, as Secretary Morgenthau said in his statement, that the individual and the corporate income taxpayer shall have a fair idea of what his taxes are to be as soon as possible.

Senator BROWN. My view is, we are losing pretty close to $90,000,000 a month by not having these excise taxes in effect. We have been in difficulties over the income-tax side of this bill. If we take as long a time as the Ways and Means Committee did—which I hope we will not—if it takes 3 months—we might get these excise-tax difficulties out of the way in a month and we would save $180,000,000; that is, we would gain $180,000,000 if we could do that.

Mr. SULLIVAN. That would be about $2,500,000 a day.

Senator BARKLEY. Inasmuch as the House has sent this bill over as a whole, if we simply struck out all of it except the excise taxes and passed it, the whole bill would have to go to conference between the House and Senate.

Senator CLARK. That would mean striking out all except the excise taxes and then going over it again?

Senator BARKLEY. We could not initiate the excise taxes and raise the income we are talking about.

Senator JOHNSON. I wanted to ask, Mr. Secretary, if the Treasury is entirely satisfied with title V and title VI that have to do with the levying of excise taxes, or will there be additional recommendations from the Treasury with respect to these two titles?

Secretary MORGENTHAU. Senator, I would be glad to answer, but I believe Mr. Sullivan is going to follow me. Will it be agreeable to you to wait?

Senator JOHNSON. Perfectly agreeable.

Secretary MORGENTHAU. I think that is right.

Does not he follow me, Mr. Chairman?

The CHAIRMAN. Yes; if you wish him to.

Secretary MORGENTHAU. That is agreeable.

The CHAIRMAN. That is entirely up to the Treasury.

Secretary MORGENTHAU. Could he take care of that?

The CHAIRMAN. Yes.

Secretary MORGENTHAU. Is that agreeable?

Senator JOHNSON. Perfectly agreeable.

Senator WALSH. Mr. Secretary, I was impressed with your suggestion about simplifying the form on which tax returns can be made by people with incomes under $3,000. Has the Treasury thought of a system to simply ask the taxpayer questions in writing and having him file it and the Treasury compute a tax and send him his tax bill, which is done by local communities very often?

Secretary MORGENTHAU. We have not thought of that, but Mr. Sullivan has the simplest blank I have ever seen.

Senator WALSH. It requires a taxpayer, however, to do the compilation?

Secretary MORGENTHAU. This would not.

Senator WALSH. He would not have to figure what his tax was finally?

Mr. SULLIVAN. No, sir.

Senator WALSH. Very good. That is along the line on which I have been speaking.

Secretary MORGENTHAU. Yes.

Senator WALSH. There is one other thing I would like to ask about. Will you or somebody from the Treasury submit the proposed increases of the estate and gift taxes?

Secretary MORGENTHAU. We will be glad to.

Senator WALSH. And the Treasury's plan for excess-profits taxes?

Secretary MORGENTHAU. Yes, sir; we will be glad to.

Senator GUFFEY. Mr. Secretary, is it your intention, or the intention of your Department, to offer a modified joint tax return on the lines you suggested to the present form?

Secretary MORGENTHAU. This blank which I was talking about is in connection with income of people under $3,000.

Senator GUFFEY. I mean a modified joint tax return for husband and wife.

Secretary MORGENTHAU. We can.

Senator GUFFEY. Are you going to submit one on that?

Secretary MORGENTHAU. We will, at your request, be glad to.

Senator CONNALLY. It will not include the Senator from Pennsylvania, of course.

The CHAIRMAN. Senator Clark, did you have anything?

Senator CLARK. No.

The CHAIRMAN. Are there any other questions for the Secretary to answer? If there are no other questions, we will proceed with Mr. Sullivan.

Senator CONNALLY. I want to ask some questions of somebody.

The CHAIRMAN. Do you wish to ask him some additional questions?

Senator CONNALLY. Yes, Mr. Chairman. Is there a tax on yachts now?

Mr. SULLIVAN. Under this bill there is a tax.

Senator CONNALLY. Has there not been all the time?

Mr. SULLIVAN. No, sir.

Senator CONNALLY. You do tax yachts. How about sporting goods?

Mr. SULLIVAN. Sporting goods are included.

Senator CONNALLY. Shotguns and rifles for sporting purposes?

Mr. SULLIVAN. They are already taxed under the present law.

Senator CONNALLY. We haven't any increase on those?

Mr. SULLIVAN. No, sir.

The CHAIRMAN. Mr. Secretary and Mr. Sullivan, will you please supply the committee, if you are not presently prepared to do so, with the estimated yield from the excise taxes for 1942?

Mr. SULLIVAN. Yes, sir.

The CHAIRMAN. Under existing law?

Mr. SULLIVAN. Yes, sir.

The CHAIRMAN. We will be glad to have that. And you will also, of course, have the estimated yield under this bill.

Mr. SULLIVAN. Yes.

The CHAIRMAN. I was particularly interested in getting the 1942 fiscal estimate under existing law and the yield from the excise taxes.

Mr. SULLIVAN. I think it might be helpful to the committee, Mr. Chairman, if we prepared that chart in a form showing the anticipated yield under the present law, the additional yield under the proposed bill, and then the total in the third column.

Mr. CHAIRMAN. Exactly.

Mr. SULLIVAN. Provided this bill is enacted into the law. We will have that for you as soon as possible, sir.

The CHAIRMAN. Would it be possible to have also a statement from the Treasury of the total number of corporations that would pay excess-profits taxes under the present law and indicating the percentage of the taxpaying corporations paying excess-profits taxes between the two classes, that is, those who take the earned income credit and those who take the invested capital credit?

Mr. SULLIVAN. I can give that to you now if you like it, sir.

The CHAIRMAN. When you come on the witness stand.

Mr. SULLIVAN. I have that; yes, sir.

The CHAIRMAN. You have that already?

Mr. SULLIVAN. Yes.

The CHAIRMAN. Now, Mr. Secretary, I believe there are no other questions.

Senator CONNALLY. I want to ask him a little short question.

The CHAIRMAN. All right.

Senator CONNALLY. Mr. Secretary, what is the present limit on the amount of earned income that you can deduct?

Secretary MORGENTHAU. $14,000.

Senator BARKLEY. May I ask, Mr. Sullivan, if he has prepared or can furnish the committee with a table or a list of a numerical estimate of the couples, husbands and wives, who would be included in the modification of the joint return suggestion that has been made by the Secretary? You said awhile ago that your revised figures would estimate about 170,000 families.

Mr. SULLIVAN. About 215,000 families would file separate and community property returns under existing law.

Senator BARKLEY. How many of them would be included in your earned income brackets as applying to both husband and wife?

Mr. SULLIVAN. I will try and give you our best guess on that as soon as possible, Senator Barkley.

Senator VANDENBERG. May I ask if there is any estimate available as to what this would produce if we were to follow this?

Mr. SULLIVAN. We will have that for you; yes, sir.

Senator BAILEY. Have you a table as to the consolidated return or the prohibition of the separate return of husband and wife, by States, as to how many people would be affected in each State?

Mr. SULLIVAN. Yes.

Senator BAILEY. That is in the House report?

Mr. SULLIVAN. Yes, sir. That is already in.

(See H. Rept. 1040, 77th Cong., 1st sess., p. 16.)

The CHAIRMAN. Mr. Secretary, we thank you for your appearance before the committee. You desire Mr. Sullivan to come on next?

Secretary MORGENTHAU. Thank you, Mr. Chairman, for the courtesy. I am available at any time.

The CHAIRMAN. All right, Mr. Sullivan, you may proceed when you are ready.

STATEMENT OF HON. JOHN L. SULLIVAN, ASSISTANT SECRETARY OF THE TREASURY

The CHAIRMAN. Mr. Sullivan, you have a prepared statement?

Mr. SULLIVAN. I have, sir.

The CHAIRMAN. Do you wish to proceed with that until you finish before questions are asked?

Mr. SULLIVAN. Whichever way is preferable to the committee. I think we might perhaps save a little time if I did finish, because in the statement I might eventually answer questions which might otherwise be asked.

The CHAIRMAN. It probably would be more orderly if you finish your prepared statement first. As you say, it might answer some questions that would arise in the mind of someone.

Mr. SULLIVAN. Mr. Chairman, and members of the committee: In his discussion of taxation as an essential part of national defense, Secretary Morgenthau emphasized the need for paying a large proportion of the defense costs from present taxes and the need for making full use of the potentialities of the tax system in resisting price inflation. In the final analysis, the job of defense is largely a production job. The tax system therefore, must be designed to enhance and not burden defense output. The job of defense is also one of national unity. This makes it imperative that as far as possible the huge tax burden necessitated by the emergency be apportioned among the various groups of our population equitably and without discrimination.

The Secretary has laid before you the broad outlines of our tax problem. My statement will deal more directly with the provisions of the pending bill.

In the Secretary's statement before the Ways and Means Committee he indicated a need for legislation to produce annually $3,500,000,000 additional revenue. This recommendation was based on the conclusion that current taxes should provide approximately two-thirds of the Federal expenditures during the emergency period. In terms of the fiscal year 1942 revenues and expenditures indicated last April, $3,500,000,000 additional revenue would have met the two-thirds–one-third ratio of taxes to borrowing.

In the past 3 months the fiscal situation has undergone further change. Expenditures for the fiscal year 1942 are now estimated at $22,169,000,000 rather than the $19,000,000,000 as of April 24. Receipts from the existing revenue system, without the pending bill, are

estimated at $9,402,000,000. Thus, even with $3,500,000,000 additional revenue, the revenue system would still be $1,900,000,000 short of the two-thirds-one-third goal.

This bill, H. R. 5417, is estimated to produce in a year of full operation $3,216,400,000 or $283,600,000 less than the amount recommended by the Secretary. Of this total, $864,800,000 or 26.9 percent of the additional revenues will be derived from increases in individual income taxes, $1,345,200,000 or 41.8 percent from increases in corporation taxes, $151,900,000 or 4.7 percent from increases in estate and gift taxes and $854,500,000 or 26.6 percent from new excise and increases in existing excises.

With respect to the individual income tax, the provisions of the bill are confined principally to increases in the tax rates. The present rate of the normal individual income tax is unchanged, but the surtax rates are increased substantially. Moreover, the surtax under the revised schedule applies to the first dollar of surtax net income, whereas, under existing law the first $4,000 of surtax net income is free from surtax. The bill provides for increases in the surtax rather than in the normal tax, in order to place most of the additional tax burden on the recipients of interest from partially tax-exempt securities.

The rate schedule under the bill differs in certain respects from that proposed to the Ways and Means Committee by the Treasury. The bill imposes a tax of 5 percent upon the first $2,000 of surtax net income and increases existing rates up to those applicable to $750,000. The Treasury recommended that the surtax start at 11 percent on the first $2,000 of surtax net income. Because of the importance of curbing the present inflationary tendency and because of the revenue it would produce, the Treasury repeats its recommendation.

Senator BYRD. Could you give me the estimate of revenue that would be derived from that as compared to the 5 percent?

Mr. SULLIVAN. Yes; under the original Treasury proposal for an individual income tax surtax schedule without mandatory joint returns, it yielded a little bit in excess of 1.5 billion dollars gross yield and 1.3 billions net after allowing for the increased corporation taxes. The surtax schedule that was enacted by the House, including the mandatory joint returns which accounted for about $300,000,000, I think totaled a net increase of about 1.2 billion dollars. Is that correct, Mr. O'Donnell?

Mr. O'DONNELL. The additional net yield after allowing for the effect of increases in corporation taxes, of the individual income taxes at calendar year 1941 estimated levels of business is now estimated at $864,800,000 after the exclusion of the mandatory joint return provision which was contained in the original House bill. That provision was estimated to yield $287,200,000 net as compared with the $258,000,000 net which we estimate will be raised by the present Treasury proposal for a mandatory joint return provision.

Mr. SULLIVAN. $864,800,000 without the mandatory joint return.

Senator BYRD. If that was increased to 11 percent, as you recommended, how much additional would be raised as compared to the 5 percent?

Mr. SULLIVAN. About $450,000,000.

Senator CONNALLY. That is $436,000,000 is it not?

Mr. SULLIVAN. Yes.

Senator WALSH. That leaves out the joint returns?

Mr. SULLIVAN. Yes, sir.

Senator WALSH. $450,000,000?

Mr. SULLIVAN. Yes. The pending bill leaves the amount of the personal exemptions and the credit for dependents unchanged. The Revenue Act of 1940 decreased the exemptions from $1,000 to $800 for a single person and from $2,500 to $2,000 for a married couple. Approximately 8,200,000 new returns are expected to be filed in 1941, and it is estimated that there were approximately 4,000,000 new taxpayers.

Although it leaves the personal exemptions unchanged, this bill will actually broaden the base. It makes the surtax applicable to the first dollar of income after the personal exemption and credit for dependents and since the earned income credit is allowed for normal tax but not for surtax purposes, some income not now subject to tax will be subject to the surtax. Under existing law the earned income credit permits a single person to be free of income tax unless his income is in excess of $888 while a married couple with no dependents is free of income tax unless it receives more than $2,222, although the personal exemptions in these instances are only $800 and $2,000 respectively. The result of the application of the surtax to the first dollar of surtax net income, as provided in the bill, is to make taxable approximately 2,470,000 people who otherwise would be free of tax with the same income. These, together with the persons who will become taxable as a result of increases in their income are expected to raise the number of 1942 income taxpayers 3,405,000 over the 1941 number.

Senator VANDENBERG. And what does that make the total number of taxpayers?

Mr. SULLIVAN. It is estimated, Senator Vandenburg, that if the pending bill is enacted, 17,107,000 individual income-tax returns will be filed during the calendar year 1942, and of this number 10,025,000 will be taxable. To complete the picture at this point, if you care to write these figures down, if the recommendations subsequently to be made in this statement are adopted, that will add to the 17,107,000 people filing income tax returns, another 4,900,000, so that there will be a grand total of 22,000,000 individual income-tax returns filed in 1942.

Senator CONNALLY. Mr. Sullivan, let me ask you, the figures 10,000,000 who file returns and do not pay any tax——

Mr. SULLIVAN (interposing). The 10,000,000 are the ones who are taxable.

Senator CONNALLY. 7,000,000 who will file returns will not pay any tax. Whom do you require to file a return now under this bill?

Mr. SULLIVAN. The requirements are on gross income, rather than net income, you see. A person could have a gross income and the deductions may be such as not to require him to pay any tax.

Senator CONNALLY. You mean, if he has a gross income of over $800 he has got to file a return whether he pays any tax or not?

Mr. SULLIVAN. That is correct.

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

Mr. SULLIVAN. Even though there is a cost in our handling of the nontaxable returns, Senator Connally, it is not very great. It only averages about 50 cents per nontaxable return. We think it is well worth while to maintain a continuity of tax record on the individual,

because if the next year he goes over and he has not filed, we look him up and we would get more than the 50 cents.

Senator Connally. You would get more taxes from people who are now not filing any return at all, thinking they are not taxable?

Mr. Sullivan. That is correct, sir. That is our anticipation.

Senator Vandenberg. Will you add one more figure at that point? You are going to have 22,000,000 returns under your proposal?

Mr. Sullivan. Yes.

Senator Vandenberg. How many will be taxable?

Mr. Sullivan. Well, under the pending bill, of the 17,107,000 we would anticipate that 10,925,000 would file taxable returns. Now, I estimate that if exemptions are lowered to $750 and $1,500 an additional 4,900,000 returns would be filed, of which 2,275,000 would be taxable.

Senator Vandenberg. In round numbers, you would have 13,000,000 returns?

Mr. Sullivan. Just about.

Senator La Follette. While you are getting more money from the people in the upper brackets when you reduce the exemption?

Mr. Sullivan. That is quite true.

Senator La Follette. That is where the real revenue actually comes from.

Mr. Sullivan. Of the $303,000,000 we anticipate we will gain as the result of lowering the exemptions, the overwhelming portion comes from the people who today, last year, over the last few years have already been on the tax roll. When you lower the personal exemption for married people $500 as you did last year, one of the results of that is that the married person who is already paying a tax has $500 removed from his exemption and put on his income at the very top bracket.

Senator Vandenberg. There is not any doubt about that. I was just trying to find out how much you were broadening the base in terms of people.

Mr. Sullivan. Yes.

Senator Connally. What would you say about reducing the married exemption to $1,500 but not taxing them as high as you would, say from $2,000 up, say 4 percent, 3 percent, do not you think we would get a good deal of money there?

Mr. Sullivan. I think when we come to the tables you will see that the schedules that are now in the law are not at all too harsh on those people in the lowest brackets.

Senator Connally. I am talking about reducing the exemption from $2,000.

Mr. Sullivan. I am going to recommend that they be reduced to $1,500 for married people and $750 for single people, and that the surtax rates apply on that basis, and we have the tables here to show just what they will have to pay in taxes.

Senator Vandenberg. The total bill passes far beyond the figures you and I have been talking about. For instance, the automobile use tax will reach around 32,000,000 people.

Mr. Sullivan. It will if it is enacted.

Senator Vandenberg. That is what I mean. Certainly it will not, if it is not.

Mr. Sullivan. I beg pardon?

Senator Vandenberg. Certainly it will not if it is not enacted.

Mr. SULLIVAN. That is right. I will reserve my comment on that for a moment.

Senator VANDENBERG. All right.

Mr. SULLIVAN. In the early stages of this bill the Treasury Department took the position that, in view of this substantial broadening of the base, personal exemptions should not be lowered further. However, the threat of rising prices alters the situation. If the cost of living rises substantially, the effect will be to tax small incomes much more than an income tax would at the rates provided in this bill. The reduction of personal exemptions will make it possible for a large number of persons in the country to feel that they are making direct contributions to the defense program. During the course of this tax bill we have had evidence that many people want to make such a direct contribution.

As the Secretary pointed out, persons with small incomes should have an opportunity for filing a short, simple return and finding the amount of the tax on a table instead of being obliged to file the regular return and to make the regular tax computation. The secretary has placed in your hands an illustrative schedule and discussed briefly its application.

I would like to indicate in somewhat more detail how the proposal would operate.

(At this point the following return form was distributed to members of the committee:)

[Front]

Form 1040A 1941

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

UNITED STATES
OPTIONAL INDIVIDUAL INCOME AND DEFENSE TAX RETURN

(Auditor's Stamp)

Applicable to salaries, wages, and other incidental income not in excess of $3,000.

(NOTE.—If you are engaged in a profession or business (including farming), or are a member of a partnership, or had income or losses from the sale of property, use Form 1040)

To be filed with the Collector of Internal Revenue for your district on or before March 15, 1941

PRINT NAME AND HOME OR RESIDENTIAL ADDRESS PLAINLY BELOW

(Name) (Use given names of both husband and wife, if this is a joint return)

(Street and number, or rural route)

(Post office) (County) (State)

Do not write in these spaces

Serial No.

Amount Paid, $

(Cashier's Stamp)

Cash—Check—M. O.

QUESTIONS

1. What is your occupation? .....
2. Check whether you are a citizen ☐ or a resident alien ☐
3. Did you file a return for any prior year? ..... If so, what was the latest year? ..... To which Collector's office was it sent? .....
4. Are items of income or deductions of both husband and wife included in this return? .....
5. State name of husband or wife if a separate return was made, personal exemption, if any, claimed thereon, and the Collector's office to which it was sent: .....

Item No.		
1.	Salaries and other compensation for personal services	$
2.	All other income	
3.	Total income	$
4.	Tax to be paid (from Schedule A on reverse side)	$

Explanation of status with respect to personal exemption and credit for dependents

(1) Personal Exemption		(2) Credit for Dependents			
Status	Credit Claimed	Name of Dependent and Relationship	Under 18 years old	Over 18 years old	Credit Claimed
Single, or married and not living with husband or wife	$				$
Married and living with husband or wife					
Head of family (explain below)					
		Reason for support if over 18 years old			

AFFIDAVIT

I/we swear (or affirm) that this return has been examined by me/us, and, to the best of my/our knowledge and belief, is a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and regulations issued under authority thereof; and that I /we had no income from sources other than stated hereon.

Subscribed and sworn to by ....
(Signature)

before me this ... ... day of ....., 1942. .....
(Signature)

.....
(Signature and title of officer administering oath)

(If this is a joint return (not made by agent), it must be signed by both husband and wife. It must be sworn to before a proper officer by the spouse preparing the return. If neither or both prepare the return, it must be sworn to by both spouses.)

[Back]

Schedule A

If your total income is—		Your tax is—		If your total income is—		Your tax is—		If your total income is—		Your tax is—	
From—	To—	Single person [1]	Married person [1]	From—	To—	Single person [1]	Married person [1]	From—	To—	Single person [1]	Married person [1]
$1	$750	.....	.....	$1,501	$1,525	$62	$1	$2,251	$2,275	$126	$59
751	775	$1	.....	1,526	1,550	64	2	2,276	2,300	128	61
776	800	2	.....	1,551	1,575	66	3	2,301	2,325	130	63
801	825	3	.....	1,576	1,600	68	4	2,326	2,350	132	65
826	850	5	.....	1,601	1,625	70	6	2,351	2,375	134	68
851	875	7	.....	1,626	1,650	73	7	2,376	2,400	136	70
876	900	9	.....	1,651	1,675	75	8	2,401	2,425	139	72
901	925	11	.....	1,676	1,700	77	10	2,426	2,450	141	74
926	950	13	.....	1,701	1,725	79	12	2,451	2,475	143	76
951	975	15	.....	1,726	1,750	81	14	2,476	2,500	145	78
976	1,000	17	.....	1,751	1,775	83	16	2,501	2,525	147	80
1,001	1,025	19	.....	1,776	1,800	85	19	2,526	2,550	149	82
1,026	1,050	22	.....	1,801	1,825	88	21	2,551	2,575	151	85
1,051	1,075	24	.....	1,826	1,850	90	23	2,576	2,600	153	87
1,076	1,100	26	.....	1,851	1,875	92	25	2,601	2,625	156	89
1,101	1,125	28	.....	1,876	1,900	94	27	2,626	2,650	158	91
1,126	1,150	30	.....	1,901	1,925	96	29	2,651	2,675	160	93
1,151	1,175	32	.....	1,926	1,950	98	31	2,676	2,700	162	95
1,176	1,200	34	.....	1,951	1,975	100	33	2,701	2,725	164	97
1,201	1,225	36	.....	1,976	2,000	102	36	2,726	2,750	166	99
1,226	1,250	39	.....	2,001	2,025	105	38	2,751	2,775	169	102
1,251	1,275	41	.....	2,026	2,050	107	40	2,776	2,800	172	104
1,276	1,300	43	.....	2,051	2,075	109	42	2,801	2,825	174	106
1,301	1,325	45	.....	2,076	2,100	111	44	2,826	2,850	177	108
1,326	1,350	47	.....	2,101	2,125	113	46	2,851	2,875	180	110
1,351	1,375	49	.....	2,126	2,150	115	48	2,876	2,900	183	112
1,376	1,400	51	.....	2,151	2,175	117	50	2,901	2,925	186	114
1,401	1,425	53	.....	2,176	2,200	119	53	2,926	2,950	189	116
1,426	1,450	56	.....	2,201	2,225	122	55	2,951	2,975	192	119
1,451	1,475	58	.....	2,226	2,250	124	57	2,976	3,000	195	121
1,476	1,500	60	.....								

[1] For each dependent, subtract $400 from your total income and use the balance to determine your tax.

The proposal is intended to apply primarily to persons with incomes from wages, salaries, and interest. A great majority of small incomes is of these types. The incomes of small businessmen, however, are more complicated, involving, as they do, costs of materials, inventories, depreciation, and other expense items.

The simple return form would not be of value to them since computations of these items would be necessary before income could be determined. For other taxpayers with incomes of not more than $3,000, however, the short form would be provided.

Since the short form would be made optional rather than compulsory, the taxpayer would not lose any rights he has under existing law to benefit if he desires from specific deductions such as losses not covered by insurance or capital losses.

In order that the typical taxpayer using the simple table might derive substantially the same tax benefit from deductions that he now derives, the tax appearing on the table should take into account the average amount now deducted by persons with small incomes. Finally, in order to simplify the income-tax table, incomes would be grouped in blocks of $25 with the same tax payable for all incomes within that particular block.

For example, take the case of a single man with a salary of $1,880. If we assume that the personal exemptions recommended by the President of $750 for single persons and $1,500 for married persons and heads of families were adopted, this taxpayer would compute his tax in the following manner:

Now, before I go further with my statement, I would like particularly to call to your attention that this is merely an illustrative schedule and an illustrative form. [Referring to the schedule introduced by Secretary Morgenthau.] It has been drawn up on certain assumptions and it is being presented to you here today, not for recommendation in the form in which you now find it, but to demonstrate the general idea that is involved in this recommendation.

Senator WALSH. It does not need any action by us. The Treasury itself, can adopt this form; can it not?

Mr. SULLIVAN. No. I think we will have to have some provision in the statute, Senator Walsh, to do it.

Here is a man who has an income of $1,880; on the face of the short income-tax form, he would write down his salary of $1,880 on line 1; he would then look at the back of the return and see that his income fell in the block from $1,876 to $1,900, and being single, he would find that his tax would be $94 and this he would enter on the front of the return at line 4. That would comprise all of the computation that man would have to make.

Now, let us assume that it is a married couple with two children and they have a salary income of $2,700 and an interest of $54; they enter the $2,700 on line 1 and the $54 interest on line 2 under the heading "all other income"; they add them together and get $2,754; they turn the form over, they follow it down and they find out where $2,754 is. From this $2,754 of course they have to deduct $800 for the credit for their two dependents. That leaves them $1,954. They look down the table for the $1,954 and they find that they owe a tax of $33 which they write in on the fourth line, and that is the end of their computation.

We believe that this is an extremely simple method which will be very helpful to these people, many of whom have had no financial experience and many of whom have never even seen an income-tax return.

Senator RADCLIFFE. Mr. Sullivan, do you think it is advisable to make a reference, to include husband and wife? As you say, many of the people do not know anything about the returns. The word "dependents" might not be clear to them.

Mr. SULLIVAN. There are some complications in this thing that can easily be ironed out; that I was saving for our discussions when we go into executive session. As a matter of fact, to use just one table, we will have to provide that married spouses, where they both work, will have to report jointly, or if, they choose to report individually they will have to report as single persons, since under these recommendations the personal exemption for a married couple will be exactly twice that of a single person. That works out mathematically correct. We will also have to provide that they cannot pro rate their personal exemption to their credit for dependents. One or the other will have to take that.

Senator BARKLEY. In your illustration here, if a man has got interest in addition to salary, you add $54 interest.

Mr. SULLIVAN. That is right.

Senator BARKLEY. Suppose, instead of receiving interest, he is paying interest; where would he put that?

Mr. SULLIVAN. That is just one of these cases, Senator Barkley, where that man might choose to use the other form. That is one of

the reasons why this form has to be optional. In other words, you note that this relates to the person or the couple who earn no more than $3,000. Now, I doubt very much if the court would sustain legislation forcing people to use this form up to $3,000 which would make a single man pay $195 or a married person $121 and leave in the law the fact that a person who made $3,050 and had to suffer a capital loss, whose house burned down and he suffered a loss of $2,000, he would be paying a lesser tax than the man who only earned $3,000 and for that reason, where there are unusual deductions, we allow them to use the regular 1040 form. They use this at their own election for the purpose of saving the annoyance of computation; and this is drawn up on this basis, that we have tried to allow them, in the computation of this tax, the average amount of deductions which in the past years have been taken by people in those particular brackets. I think it is a good average, but it is not going to answer every case.

Senator BARKLEY. This is commendable in its simplicity, but it seems to me it could be used almost alone by nonproperty owners who draw a salary, because anybody who owns property would be entitled to a deduction for his taxes. There is no place in here for him to deduct his property taxes.

Mr. SULLIVAN. That is right, sir. In computing this we have used as deductions a rough reduction in the tax of about 10 percent, which is about what the average deductions of people in those brackets come to. People who have deductions that are out of line with that, who have capital losses, and other unusual types of deductions, would still use the present form. We think that this would be extremely helpful to the people who do not own property and whose financial and business experience is limited.

The CHAIRMAN. Would it be possible to let me throw this out? I see Mr. Helvering is here. Would not it be feasible and practicable to provide for the repayment of any overpayment of taxes by the low bracket taxpayer without application for refund? Immediate repayment in other words? For instance, would it not be possible to say that any taxpayer whose total ultimate liability did not exceed, X dollars would be reimbursed for any actual overpayment he made without application for refund, or without filing any application, simply paid by the Treasury under its own computation?

Mr. SULLIVAN. I think that happens under the law today.

The CHAIRMAN. Does it happen today?

Mr. SULLIVAN. Yes. Any error that appears on the face of the return is immediately corrected by the receiving office. I have known instances of people coming into the office and saying, "A miracle has happened here. I just got a notice that I overpaid my tax. Is this really true?"

Senator CONNALLY. I got a check back a year or two ago for $4 and something that I overpaid.

Mr. SULLIVAN. I once proposed that there be a tax on refunds.

Senator CONNALLY. What?

Mr. SULLIVAN. I once proposed that there be a tax on refunds on the theory that the recipient would gladly pay.

The CHAIRMAN. But the lower income taxpayer would not have to protect himself against the statute of limitations unless there was an immediate reimbursement?

Mr. SULLIVAN. If we did not find it before the statute of limitations expired I doubt it would be likely that we would ever find it.

The CHAIRMAN. You would never find it?

Mr. SULLIVAN. No.

The CHAIRMAN. The income-tax law is not quite as bad as I thought it was.

Mr. SULLIVAN. Thank you, sir. The estate tax changes in the bill are likewise limited to rate increases. The Treasury's recommendations that the $40,000 insurance exclusion under the estate tax and the $40,000 specific exemption under the estate and gift taxes be reduced to $25,000 each, were not incorporated in this bill. The increases in the estate-tax rates in the bill extend throughout the rate schedule but are substantially lower than those proposed by the Treasury. The present 2 percent rate on the first bracket of the net estate has been increased to 3 percent. The maximum rate of 70 percent effective on the bracket in excess of $50,000,000 has been shifted to become effective on that portion of the net estate exceeding $10,000,000. The gift-tax rates have also been increased so that they continue to be three-fourths of the estate-tax rates. The anticipated revenue increase from these changes amounts to $151,900,000. It has been estimated that if the higher rates and lower exemptions proposed by the Treasury were adopted, the increased yield would be $347,200,000 over present law yields.

The pending bill makes several changes in the corporation taxes. It gives expression to the principle that corporations generally, even those without excessive profits, should bear part of the heavy burden imposed by the defense program. To that end, it provides for an increase in the corporation income tax of 5 percent on the first $25,000 of surtax net income and 6 percent on the balance. This increase—as that of the personal income tax—is imposed in the form of a surtax, in order to reach a substantial part of the interest from more than $20,000,000,000 of partially tax-exempt securities which are held by corporations, principally banks and insurance companies. Corporations having incomes over $25,000 will thus be taxed at an effective rate of almost 30 percent.

When these partially tax-exempt securities were issued it was impossible to foresee the extraordinary demands which would be made upon the American people. Neither the Government nor the corporate purchasers anticipated that the tax benefit from these partially tax-exempt securities would be as great as it is. Each increase in the normal tax rate has increased the tax savings which accrue to the corporate holders of these bonds. To avoid granting a further unexpected bonus, it is necessary that the increase in rates be in the form of a surtax.

Senator BROWN. You are satisfied, Mr. Sullivan, that there are no legal difficulties there?

Mr. SULLIVAN. We are. It has been pointed out, however, that the combined effect of this surtax, together with the postponement of deductions attributable to bonds purchased at a premium until the bonds mature or are sold, may adversely affect the market for many outstanding Treasury securities. We therefore suggest that consideration be given, in the case of public and private bonds purchased at a premium, to requiring the holder to amortize the pre-

mium over the life of the bond in place of the present system of allowing a capital loss at the time of maturity measured by the difference between purchase price and redemption price. Such a proposal would, in effect, treat the interest on such bonds at the effective rate rather than at the coupon rate for tax purposes and would thus be both more realistic and in accordance with commercial practice.

The bill makes permanent the defense taxes which were imposed for a 5-year period by the Revenue Act of 1940. These defense taxes amount, in general, to 10 percent of the taxes to which they are added. In view of their now permanent nature, I suggest that these defense tax rates be integrated with the basic rates, so that the amount of the various taxes can be computed on the basis of a single-rate structure. This will simplify both the text of the revenue laws and the computations to be made by taxpayers thereunder. In the case of the capital stock tax, the House bill increases the tax rate from $1.10 to $1.25 upon each $1,000 of the declared value of capital stock. The anticipated gross increase in revenue from this change is $22,300,000.

The proposed changes in the excess-profits tax are estimated to increase the revenue from this tax by 1,198.3 million dollars. This increase in revenue is accomplished without change in the optional methods of computing the excess-profits credit provided by the Second Revenue Act of 1940. The Secretary has already called to your attention the fact that the Department does not favor a continuation of a method which leaves free of excess-profits tax those corporations with consistently high earnings which represent the greatest ability to pay.

The bill increases the rates of tax, modifies the excess-profits tax base, and imposes a special tax on corporations using the invested capital credit.

The tax brackets of the existing law, graduated according to the amount of the adjusted excess profits net income, are retained. The increase in the tax rate amounts to 10 percentage points in each bracket The proposed rates range from 35 percent on adjusted excess profits net income of not more than $20,000 to 60 percent on amounts over $500,000. The corresponding rates in the existing law are 25 percent and 50 percent.

The most important structural change provided by the bill is the disallowance of the income tax as a deduction in computing the excess-profits tax. This change will increase the amount of income subject to the excess-profits tax and hence the revenue from the excess-profits tax. However, the increase will be partly offset by a decrease in the income subject to the corporation income tax because the excess-profits tax is allowed as a deduction for the purpose of computing the income tax, both normal and surtax.

The excessiveness of profits should be measured by the whole of corporate profits as proposed in the bill and not by the part remaining after income tax as in the present law. Under graduated rates the present procedure results in dropping the taxable excess profits into the lower-bracket rates, thus diminishing the revenue. Further, because the base period income tax is lower than the current income tax—16½ percent as against 24 percent for 1940 and 30 percent for 1941—corporations using the average earnings method are allowed a

greater deduction from profits of the current year than from the profits of the base period average. Such reduction in the excess-profits tax of corporations using the average earnings method seems entirely unwarranted in view of the already liberal excess-profits credits.

In the existing law the invested capital credit is a flat 8 percent on the entire amount of the invested capital. The bill provides that the credit be reduced to 7 percent on invested capital exceeding $5,000,000.

In order not to discourage new equity financing——

Senator CONNALLY (interposing). What would you say about reducing the rate from 8 to 6?

Mr. SULLIVAN. With the reversal of the precedence of deductions in the bill what you are virtually doing is reducing that to 4.9 percent, sir. That is the result of reversing the precedence of the deductions.

In order not to discourage new equity financing, it is desirable to allow a larger tax-free return on new capital than would be obtained under the reversal in method of computing the tax. A special allowance on new capital investment when the excess-profits credit is computed under the invested capital method is made by including new capital at 125 percent of its value. This is the equivalent of allowing an invested capital credit with respect to new capital of 10 percent where the total invested capital is less than $5,000,000 and 8¾ percent where the invested capital is more than $5,000,000.

Senator BYRD. Will you explain that? The allowance does not apply to borrowed money.

Mr. SULLIVAN. That is right.

Senator BYRD. Only to the extent of 50 percent.

Mr. SULLIVAN. That is right.

Senator BYRD. Still I do not think that is right. There is too much difference.

Mr. SULLIVAN. That is even a greater allowance than has ever been allowed under the law before, Senator Byrd.

The allowance is applicable only on new capital which consists of money or property paid in for stock. It does not extend to new capital raised by borrowing nor to earnings and profits retained in the business. Safeguards are provided against the use of the new capital allowance for tax-avoidance purposes.

The excess-profits tax in the present law fails to reach a very large part of defense profits, despite the clear expression of congressional intent that profits growing out of the defense effort should be subject to excess-profits tax. Our examination of the available data shows that many corporations that are the principal beneficiaries of the defense effort and whose profits in 1940 were many times larger than in 1939 and in any of the preceding base period years will pay little or no excess-profits tax. This situation cannot be justified in the light of the growing revenue requirements. In order to reach these profits which are attributable solely to the defense program, the Treasury recommended, and the bill provides, that a flat rate of 10 percent should be applied in such cases to that part of the current profits that exceeds the base period earnings but does not exceed the invested capital credit.

Senator VANDENBERG. Do you consider that an adequate and satisfactory answer to the situation you described?

Mr. SULLIVAN. No, sir; we consider that an improvement to the present bill.

Senator CLARK. What would be the Treasury's recommendation?

Mr. SULLIVAN. The Treasury recommendation was that all companies be obliged to report on an invested-capital basis. Last year you recall we recommended that these companies get a credit of not less than 4 percent of their invested capital but not more than 10 percent of their invested capital. That figure in general would be determined by the average earnings during the base-period years. In view of the reversal of the precedence of the deductions, we want to raise those brackets, because the 4 percent under the reversal of deductions would be very much less and altogether too small. I think we would recommend the same proposal with those brackets changed to 6 or 12 or 15.

The excise portions of the pending bill are estimated to yield $854,500,000. Forty-seven percent of this total derives from raising the rates or broadening the bases of 14 existing excises. Twenty-two new excises are expected to yield 53 percent of the total.

The Treasury recommended but the bill does not contain increases in the existing rates of tax on gasoline, tobacco products, and beer. The Treasury also recommended that the present tax on passenger automobiles be increased to 15 percent; the bill provides for an increase to only 7 percent. At the same time, the Treasury does not approve all the excises incorporated in the present bill. Particularly, it disapproves the proposed $5 use tax on every motor vehicle.

Senator CONNALLY. You mean it is a flat tax? They charge a fellow just as much for riding around in a Ford as a Cadillac?

Mr. SULLIVAN. Yes; and if he uses it only 1 day in the week we charge him just as much as the taxicab that runs 24 hours a day except when it is laid up for repairs.

This tax will conflict directly with one of the most important State and local sources of revenue. In some States the proposed tax will in effect increase the average cost of automobile registration by more than 100 percent.

The proposed tax has no relationship to the extent of use or the value of the object taxed and, therefore, is unusually inequitable. It taxes a $5,000 town car exactly the same $5 as the fifth-hand car worth only $20. This proposed use tax must be collected from 32,000,000 taxpayers located throughout every State and county in the country. This would require an additional personnel in the Bureau of Internal Revenue of at least 3,800 new employees. The administrative cost is estimated to be $9,600,000 or approximately $6 per $100 of tax collected, which is more than five times the average cost of collecting other excise taxes. This automobile use tax is estimated to yield about $160,000,000. Contrast these figures with those pertaining, for example, to the gasoline tax. That tax, yielding $343,000,000 a year, is collected by 15 internal-revenue employees. In this regard it should be noted that to the average motorist who travels 10,000 miles annually the use tax is equivalent in burden to a one-half cent gasoline tax. Or, contrast the proposed automobile use tax with the tobacco taxes. Their annual yield is $698,000,000, which is collected by 88 internal-revenue employees. An increase in either the gasoline tax or the tobacco tax, moreover, would not require any additional personnel.

The measure before you will constitute the largest tax act in history. The Committee on Ways and Means has labored on it assidu-

ously and conscientiously for the past 3½ months. Some have criticized this bill as severe, but our present national peril requires many sacrifices. The severity of this bill is minor when compared to the severity of other sacrifices which are cheerfully made by our citizens. At a time when many men are being called upon to forego gainful occupations to enter our armed forces for a remuneration of $21 per month and at a time when it has become necessary to extend their period of service, those citizens in civilian life will, I am sure, cheerfully make the contributions called for under this bill and will be ready to make ever greater contributions if it becomes necessary.

The CHAIRMAN. Mr. Sullivan, I asked while the Secretary was in the witness chair what the estimated yield for fiscal 1942 of the present excise taxes is.

Mr. SULLIVAN. Mr. O'Donnell will answer that.

The CHAIRMAN. You have here the estimated yield of excise taxes under the pending bill.

Mr. O'DONNELL. Yes, sir.

I will offer for the record at this point a table showing the estimated increased yield over present law of the provisions of H. R. 5417 as it passed the House.

Estimated increase or decrease (—) in revenue yield due to revenue bill of 1941 (H. R. 5417)[1]

Tax	Proposed change	Estimated increase or decrease (—) over present law[2]
Income taxes:		
Corporation:		
Normal tax	Allow excess-profits tax as a deduction in computing normal tax net income; increase withholding rate and increase income-tax rate on nonresident alien individuals and corporations.	—$520,100,000
Surtax	5 percent on surtax net income not in excess of $25,000; 6 percent on surtax net income in excess of $25,000.	644,700,000
Excess-profits tax	Revise basis; increase rates 10 percentage points in each bracket.	1,198,300,000
Total		1,322,900,000
Individual	Increase surtax rates	864,800,000
Total income taxes		2,187,700,000
Miscellaneous internal revenue:		
Capital-stock tax	Increase rate from $1.10 to $1.25	22,300,000
Estate tax	Increase rates	135,900,000
Gift tax	do	16,000,000
Total		174,200,000
Manufacturers' and retailers' excise taxes:		
Distilled spirits	Increase rates $1 per gallon	[3] 122,300,000
Wines	Increase rates	[3] 5,000,000
Passenger automobiles, parts, and accessories	Double rates; revise base	72,200,000
Automobile trucks, busses, and trailers	do	16,100,000
Tires and tubes	Double rates	[3] 44,600,000
Refrigerators, refrigerating apparatus, and air-conditioners	Increase rates from 5½ percent to 10 percent; revise base.	16,600,000
Matches	2 cents per 1,000 except fancy wooden or colored wooden (unchanged).	[3] 8,200,000

[1] As passed by House, Aug. 4, 1941.

[2] Full-year effect. Estimates for corporation and individual income taxes and the gift tax are based on income levels estimated for calendar year 1941; all other estimates are based on income levels estimated for fiscal year 1942.

[3] Excluding nonrecurring floor-stocks taxes collectible only in fiscal year 1942—distilled spirits $38,000,000 wines $1,000,000; tires and tubes, $6,700,000; matches $700,000.

Estimated increase or decrease (—) in revenue yield due to revenue bill of 1941 (H. R. 6417)—Continued

Tax	Proposed change	Estimated increase or decrease (—) over present law
Miscellaneous internal revenue—Continued.		
Manufacturers' and retailers' excise taxes—Continued.		
Playing cards	Increase rate from 11 cents to 13 cents	$1,000,000
Radio receiving sets and parts.	Increase rate from 5½ percent to 10 percent; revise base.	9,400,000
Phonographs and phonograph records.	10 percent of manufacturers' sales price	4,500,000
Musical instruments	do	3,600,000
Sporting goods	do	8,500,000
Luggage	do	4,500,000
Electrical appliances	do	12,600,000
Photographic apparatus	do	10,000,000
Electric signs	do	2,700,000
Business and store machines.	do	13,000,000
Rubber articles	do	21,300,000
Washing machines (commercial).	do	400,000
Optical equipment	do	300,000
Soft drinks	Various rates on bottled soft drinks, finished or fountain sirups and carbonic acid gas.	22,600,000
Jewelry, etc	10 percent of retailers' sales price	56,200,000
Furs	do	20,700,000
Toilet preparations	do	19,700,000
Total manufacturers' and retailers' excise taxes.		496,000,000
Miscellaneous taxes:		
Admissions	Reduce exemption to 9 cents and eliminate certain present law exemptions. Exempt service men in uniform when admitted free, or at reduced rates on reduced admission charge.	60,000,000
Cabarets, roof gardens, etc	5 percent of total bill	2,000,000
Club dues	Reduce exemption to $10 and tax certain privilege fees	2,800,000
Safe-deposit boxes	Increase rate from 11 percent to 20 percent	1,700,000
Telephone, telegraph, radio, and cable facilities, leased wires, etc.	On dispatches, messages, or conversations for which the charge is more than 24 cents, 5 cents for each 50 cents or fraction thereof; revise definition of leased wires.	26,600,000
Telephone bill	5 percent of total bill excluding messages subject to tax above.	43,600,000
Transportation of persons	5 percent of amount paid; 35-cent exemption	36,500,000
Use of motor vehicles and boats.	$5 per motor vehicle; boats at graduated rates determined by size.	160,200,000
Bowling alleys, and billiard and pool tables.	$15 per alley, billiard or pool table per year	2,000,000
Coin-operated amusement and gaming devices.	$25 per device per year	8,900,000
Radio broadcasting	Various rates based on amount of net time sales; stations with net time sales of $100,000 or less per year exempt.	12,600,000
Outdoor advertising	Various rates determined by size of sign	1,700,000
Total miscellaneous taxes		358,500,000
Total excise and miscellaneous taxes.		854,500,000
Total miscellaneous internal revenue.		1,028,700,000
Total		3,216,400,000

Treasury Department, Division of Research and Statistics. Aug. 8, 1941.

Mr. O'DONNELL. With reference to the yield of the present law excise taxes, I will give you those by broad categories, and I will exclude from my oral discussion what are technically called excise taxes, namely, capital stock, estate, and gift taxes, but will include those estimates in the table which I will insert in the record at the conclusion of my remarks.

The CHAIRMAN. Yes.

Mr. O'DONNELL. The liquor taxes are estimated to produce $839,500,000.

The CHAIRMAN. That is the existing tax now?

Mr. O'DONNELL. That is correct, sir. This is not encompassing any changes in the bill.

The CHAIRMAN. Will you give me that again?

Mr. O'DONNELL. $839,500,000.

Tobacco taxes, $723,530,000.

Stamp taxes, including the taxes on issues of securities, bond transfers, and deeds of conveyance, stock transfers, silver bullion sales transfers, and playing card stamp taxes are estimated to yield $44,180,000. The manufacturers' excise taxes—and the table which we will insert in the record will give you the detail of what taxes are included—are estimated to yield $676,000,000.

Miscellaneous taxes, which comprises the taxes on telephone, telegraph, radio and cable facilities, transportation of oil by pipe line, leases of safe deposit boxes, admissions to theaters, concerts, cabarets, club dues, initiation fees, oleomargarine and those special taxes on adulterated butter, coconut and vegetable oils, bituminous coal tax, sugar taxes, and other miscellaneous taxes are expected to yield $208,320,000.

Senator CONNALLY. Those vegetable oils are excise taxes?

Mr. O'DONNELL. Yes, sir.

Senator CONNALLY. On foreign oils or domestic?

Mr. O'DONNELL. I would rather yield to Mr. Tarleau to answer that question.

Senator CONNALLY. You do not have excise taxes on oils?

Mr. TARLEAU. (Thomas Tarleau, Legislative Counsel, Treasury Department). Import excise taxes.

The CHAIRMAN. These are the existing taxes?

Mr. O'DONNELL. Yes, sir; and the estimated total yield of the miscellaneous internal revenue taxes now in the law for fiscal year 1942 is $3,135,630,000 as shown in the table which will be inserted in the record at this point. The fiscal year 1942 collections of the excise taxes will not reflect a full year's operations of the increased excise taxes collected under this bill. For the information of the committee, however, there has been included a second column in the table which shows the amount of a full year's collections of these excises at levels of business estimated for fiscal year 1942. This presentation is therefore hypothetical but it enables us to present in the third column, the total amount of miscellaneous internal revenue which would be collected in a full year of collections with business levels comparable to those estimated to prevail in fiscal year 1942.

Miscellaneous internal revenue—Estimated fiscal year 1942 receipts under present law [1] and estimated full year effect of the revenue bill of 1941 (H. R. 5417) [2] at levels of income estimated for fiscal year 1942

[Thousands of dollars]

	Estimated receipts under present law	Estimated increase or decrease (−) due to revenue bill of 1941 [2]	Estimated total receipts under revenue bill of 1941 [2]
		Hypothetical full year effect [3]	Hypothetical fiscal year [3]
Capital stock tax	193,400	22,300	215,700
Estate tax	350,700	135,900	486,600
Gift tax	100,000	16,000	116,000
Liquor taxes:			
Distilled spirits (excise tax)	458,800	122,300	581,100
Fermented malt liquors	330,800	.....	330,800
Wines (domestic and imported) (excise tax)	15,200	5,000	20,200
Rectification tax	12,800	.....	12,800
Container stamps	10,400	.....	10,400
Special taxes in connection with liquor occupations	10,200	.....	10,200
All other	1,300	.....	1,300
Total liquor taxes	839,500	127,300	966,800
Tobacco taxes:			
Cigars (large)	13,900	.....	13,900
Cigarettes (small)	645,100	.....	645,100
Snuff	6,800	.....	6,800
Tobacco (chewing and smoking)	56,100	.....	56,100
Cigarette paper and tubes	1,500	.....	1,500
All other	130	.....	130
Total tobacco taxes	723,530	.....	723,530
Stamp taxes:			
Issues of securities, bond transfers, and deeds of conveyance	25,300	.....	25,300
Stock transfers	14,000	.....	14,000
Silver bullion sales or transfers	80	.....	80
Playing cards	4,800	1,000	5,800
Total stamp taxes	44,180	1,000	45,180
Manufacturers' excise taxes:			
Lubricating oils	37,100	.....	37,100
Gasoline	399,800	.....	399,800
Electrical energy	51,400	.....	51,400
Tires and inner tubes	54,200	44,600	98,800
Automobile trucks	12,400	16,100	28,500
Passenger automobiles and motorcycles	73,400	72,200	158,900
Parts and accessories for automobiles	13,300		
Radio sets, etc	7,900	9,400	17,300
Mechanical refrigerators	12,300	16,600	28,900
Firearms, shells, pistols, and revolvers	5,400	.....	5,400
Matches	.....	8,200	8,200
Electrical appliances	.....	12,600	12,600
Phonographs and phonograph records	.....	4,500	4,500
Musical instruments	.....	3,600	3,600
Sporting goods	.....	8,500	8,500
Luggage	.....	4,500	4,500
Photographic apparatus	.....	10,000	10,000
Electric signs	.....	2,700	2,700
Business and store machines	.....	13,000	13,000
Washing machines (commercial)	.....	400	400
Rubber articles	.....	21,300	21,300
Optical equipment	.....	300	300
Soft drinks	.....	22,600	22,600
Toilet preparations	8,800	−8,800	.....
Total manufacturers' excise taxes	676,000	262,300	938,300

[1] Detail of estimates released in summary form by the Bureau of the Budget, June 1, 1941.
[2] As passed by House of Representatives, Aug. 4, 1941.
[3] Assuming that all provisions of the law were fully reflected in receipts for an entire year.

Miscellaneous internal revenue—Estimated fiscal year 1942 receipts under present law [1] and estimated full year effect of the revenue bill of 1941 (H. R. 5417) [2] at levels of income estimated for fiscal year 1942—Continued

[Thousands of dollars]

	Estimated receipts under present law	Estimated increase or decrease (−) due to revenue bill of 1941 [2]	Estimated total receipts under revenue bill of 1941 [2]
		Hypothetical full year effect [3]	Hypothetical fiscal year [3]
Retailers' excise taxes:			
Jewelry, etc		56,200	56,200
Furs		20,700	20,700
Toilet preparations		28,500	28,500
Total retailers' excise taxes		105,400	105,400
Miscellaneous taxes:			
Transportation of persons		36,500	36,500
Use of motor vehicles and boats		160,200	160,200
Bowling alleys, billiard and pool tables		2,000	2,000
Coin-operated amusement and gaming devices		8,900	8,900
Radio broadcasting		12,500	12,500
Outdoor advertising		1,700	1,700
Telephone bill		43,600	43,600
Telephone, telegraph, radio, and cable facilities, leased wires, etc	28,000	26,600	54,600
Transportation of oil by pipe line	13,300		13,300
Leases of safe deposit boxes	2,200	1,700	3,900
Admissions to theaters, concerts, cabarets, etc	83,100	62,000	145,100
Club dues and initiation fees	7,000	2,800	9,800
Oleomargarine, etc., including special taxes, and adulterated butter	2,300		2,300
Coconut and other vegetable oils processed	4,500		4,500
Bituminous-coal tax	4,900		4,900
Sugar tax	62,400		62,400
All other, including repealed taxes	620		620
Total miscellaneous taxes	208,320	358,500	566,820
Total (other than capital stock, estate and gift taxes)	2,491,530	854,500	3,346,030
Total miscellaneous internal revenue	3,135,630	1,028,700	4,164,330

[1] Detail of estimates released in summary form by the Bureau of the Budget, June 1, 1941.
[2] As passed by House of Representatives, Aug. 4, 1941.
[3] Assuming that all provisions of the law were fully reflected in receipts for an entire year.

Treasury Department, Division of Research and Statistics. Aug. 8, 1941.

Mr. O'DONNELL. Another table has been prepared at the request of the committee and is offered for the record at this point. This table shows the estimated calendar-year liabilities under present law and estimated increased income-tax liabilities under a full-year effect at levels of income estimated for calendar year 1941 of the income-tax provisions of the revenue bill of 1941 as it passed the House of Representatives.

Income taxes—estimated calendar year 1941 liabilities under present law and estimated increased income-tax liabilities under a full-year effect of the income-tax provisions of the revenue bill of 1941 (H. R. 5417)[1] *at levels of income estimated for calendar year 1941*

[In thousands of dollars]

	Estimated liabilities under present law	Estimated increase (+) or decrease (−) due to revenue bill of 1941	Estimated total income tax liabilities under revenue bill of 1941
Income taxes:			
Corporation normal tax	2,939,200	−520,100	2,419,100
Corporation surtax		+644,700	644,700
Individual	2,223,300	+864,800	3,088,100
Back taxes	260,000		260,000
Excess-profits tax	1,026,400	+1,198,300	2,224,700
Declared value excess-profits tax	37,000		37,000
Unjust-enrichment tax	4,000		4,000
Total income taxes	6,489,900	+2,187,700	8,677,600

[1] As passed by the House of Representatives, Aug. 4, 1941.

Source: Treasury Department, Division of Research and Statistics. Aug. 8, 1941.

Senator BARKLEY. Mr. Sullivan in his statement a moment ago as to the amount of tobacco taxes put the figure at $698,000,000. What was the figure of $723,000,000 that was read just a moment ago?

Mr. SULLIVAN. The figure I gave you, sir, was what was actually collected in fiscal 1941 just closed. The $723,530,000 figure is the estimate for fiscal year 1942.

The CHAIRMAN. This is the estimate for the existing excise taxes.

Senator CONNALLY. This motor-vehicle tax, that includes motorcycles, I suppose, does it not?

Mr. SULLIVAN. Yes; and buses.

Senator CONNALLY. Could you tax them at a higher rate than you do an automobile?

Mr. SULLIVAN. I could not, but you could.

Senator CONNALLY. I think they ought to be.

Senator WALSH. Mr. Sullivan.

Mr. SULLIVAN. Yes; Senator Walsh.

Senator WALSH. As I understand your presentation, there are two sharp differences between the House bill and the committee's recommendations, one relating to the form of levying excess-profits taxes and the other relating to the estate tax, estate and gift taxes. Will you state, if you can, how much increased revenue would come to the Government by adopting the Treasury's excess-profits tax plan which is going to be submitted later, and how much more would come by adopting the Treasury's plan for the estate and gift taxes?

Mr. SULLIVAN. If the Treasury plan on the estate and gift taxes were adopted, it would yield $195,300,000 in excess of the present provisions of the bill. If the Treasury's proposal under excess profits were to be adopted with the same reversal in the precedence of deductions as in H. R. 5417, you would get, depending on how much money you wished to get, the same amount of money that can be raised under the present proposals, with this difference, that the average effective tax rate on corporations would be about 6.3 percent less than it is under the present bill.

You see, the effect of adopting the Treasury proposal on excess profits would be to widen the base and whatever particular burden this committee determined should be levied on corporations in the

form of excess profits taxes would be spread over a wider base, and the rate to raise the same amount of money would be about 6.3 percentage points lower than the rates that have to be used to raise that same amount of money under the proposal in the bill as it comes to you.

Senator WALSH. The Treasury is of the opinion that their proposal would reach a larger percentage and more of the manufacturers or producers of defense materials than the House provisions?

Mr. SULLIVAN. Yes; and beyond that and perhaps of more importance, Senator Walsh, is the fact that it would reach a greater amount of the profits of those concerns who are now being lightly tapped by the present excess-profits tax bill.

The CHAIRMAN. You would not actually reach any more of the direct defense profits, because for the most part your defense work is done by highly capitalized corporations which are on the invested capital basis now.

Mr. SULLIVAN. That is true, although there are outstanding examples the other way around. In the main, that is true.

The CHAIRMAN. Yes.

Mr. SULLIVAN. I think you asked me for some figures.

The CHAIRMAN. Yes.

Mr. SULLIVAN. Would you like those now, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. SULLIVAN. On the returns that were received?

The CHAIRMAN. Yes.

Mr. SULLIVAN. I think I should preface this statement by reminding you that the amendments to the excess-profits tax passed very shortly before March 15.

The CHAIRMAN. Yes; and you gave them an additional time.

Mr. SULLIVAN. And because of that the Commissioner felt obliged to give very liberal extensions in the filing date to corporations, and for that reason the picture is not clearly set forth, is not nearly as complete at this time as last year we hoped it would be. The report I now give you deals with the excess-profits tax returns received in the Internal Revenue Bureau through July 17, 1941. There were a total of taxable returns of 10,468. Of this number, 3,583 used the invested-capital method and 6,885 used the average-earnings method. Roughly speaking, those who used the average-earnings method outnumbered those who used the invested-capital method about 2 to 1.

Senator CONNALLY. Were those mostly small corporations that used the invested-capital method?

Mr. SULLIVAN. We can give you the break-down by size, too, Senator Connally. Now those 6,800 who used the average-earnings method reported excess-profits taxes of $135,000,000, whereas the 3,500 using the invested-capital method reported excess-profits taxes of $35,000,000. In other words, that ratio is almost 4 to 1.

Senator CLARK. Mr. Sullivan, what would be the result in the way of additional revenue if you retained the rates of the pending bill and then went to the Treasury's method of invested capital?

Mr. SULLIVAN. I think you might want to lower the rates, Senator.

Senator CLARK. I say, what would be the effect in the revenue if you did retain the rates of the pending bill and then went to the Treasury's method of invested capital?

Mr. SULLIVAN. The increase in revenue would be substantial.

Senator CONNALLY. You would lose a lot of money?

Mr. SULLIVAN. No; we would make a lot of money.
Senator CLARK. It would be a tremendous increase?
Mr. SULLIVAN. That is correct, sir.
Senator CLARK. Will you make an estimate of that?
Mr. SULLIVAN. We can and will insert it in the record.
(The figures referred to are as follows:)

Estimated increase over yield of the present law of the Treasury excess-profits plan using H. R. 5417 tax brackets and rates compared with estimated increase due to H. R. 5417, at levels of income estimated for calendar year 1941

[In millions of dollars]

Tax	Increase (+), decrease (−) over yield of present law		Increase (+), decrease (−) Treasury plan yield over yield of H. R. 5417
	Treasury plan	H. R. 5417	
Corporation:			
Income	−684.1	−520.1	−164.0
Surtax	+603.8	+644.7	−40.9
Excess profits	+1,880.7	+1,198.3	+682.4
Total	+1,800.4	+1,322.9	+477.5
Individual, net increase	+784.9	+864.8	−79.9
Total increase, income taxes	+2,585.3	+2,187.7	+397.6

Treasury Department, Aug. 9, 1941, Division of Research and Statistics.

Senator CONNALLY. You would make a lot even on the reduction of the 8-percent rate?
Mr. SULLIVAN. Yes.
Senator CONNALLY. I thought you wanted to reduce that.
Mr. SULLIVAN. We do, but you see under the present law some companies that are making 30, 40, and 50 percent are not subject to tax if they made that amount during the base period. I have a further résumé of these returns if you would like to have them, Mr. Chairman.
The CHAIRMAN. Yes; I would be very glad to get them.
Mr. SULLIVAN. This through June 30. The total number filed and that were taxable, 11,845; nontaxable, 79,000. The estimated totals that we will expect when the year is over to have received, 88,000 nontaxable excess-profits-tax returns and 13,400 taxable returns.
The CHAIRMAN. What do you estimate it will yield? The total yield of excess-profits taxes?
Mr. SULLIVAN. I am afraid that no figure I could give you, Senator, would be helpful, because there are now outstanding, or there were as of today, August 8, 4,200 extensions. Now many of those are very large concerns.
The CHAIRMAN. You haven't any way of estimating that?
Mr. SULLIVAN. We can. I mean we can go to the financial journals and get financial evidence of their invested capital and their earnings, but it is not going to be at all an accurate picture, and I am afraid it would not be helpful to you.
The CHAIRMAN. Under the House bill, of course, you would increase the total number of excess-profits-tax returns?
Mr. SULLIVAN. Very appreciably.
The CHAIRMAN. You estimate the House bill will now produce from excess profits in fiscal 1942 how much?

Mr. SULLIVAN. $1,198,000,000 increase over existing law. That is on calendar year 1942 liability.

The CHAIRMAN. You mean calendar 1941?

Mr. SULLIVAN. On the liability at calendar year 1941 estimated levels of income; that is correct.

The CHAIRMAN. Yes.

Mr. SULLIVAN. Only about 45 percent of which we will probably collect in fiscal 1942.

Senator BYRD. You said you had some figures about the smaller corporations, as to whether they used the invested capital or average earnings methods.

Mr. SULLIVAN. Yes.

The CHAIRMAN. If the estimated yield on the calendar year 1941 under existing rates holds good, how much would it be?

Mr. SULLIVAN. $1,026,000,000, sir.

The CHAIRMAN. That would make a total from excess profits then of how much?

Mr. SULLIVAN. $2,224,000,000.

The CHAIRMAN. From excess profits?

Mr. SULLIVAN. That is correct, coming from the provisions of the present law and the proposed changes in the pending bill.

The CHAIRMAN. And assuming the estimate under the present rates holds good for the whole year?

Mr. SULLIVAN. We always assume that, sir.

Senator CONNALLY. Are you finished, Senator George?

The CHAIRMAN. No; I want to ask him another question. I notice your particular criticism, Mr. Sullivan, is on the $5 use tax on automobiles.

Mr. SULLIVAN. Yes, sir.

The CHAIRMAN. You very well stated objections, which of course are obvious. I suppose the House had in view this thought, had it not, that this tax would be paid only by those people who were able to own or possess an automobile and that it would carry a certain tax consciousness all the way down as far as those users went?

Mr. SULLIVAN. Oh, yes, sir; and I think that their thinking on that, so far as that objective was concerned, was correct, but now if we are to reduce the personal exemptions to $1,500 for married couples and $750 for single persons——

The CHAIRMAN (interposing). We would get into that same class of owners.

Mr. SULLIVAN. That means, Senator, that a single individual who earns $14.43 a week will pay an income tax.

The CHAIRMAN. He will pay an income tax if the base is decreased.

Mr. SULLIVAN. Yes.

Senator WALSH. If he has an automobile he would pay $5 more.

Senator BYRD. He would pay about $1.

Mr. SULLIVAN. $1, that is right, but we are reaching down far enough to get hold of almost anybody who has an automobile, I think.

Senator BYRD. May I ask Mr. Sullivan some questions? What percentage of the smaller corporations use the average-earnings method for computing the excess-profits tax and what percentage use the invested-capital method?

Mr. SULLIVAN. I do not know how helpful these figures are. You remember I said there were 3,500 corporations that used the invested-capital method. Of that 3,500, 2,800 were under $20,000 of excess-profits income. Of the 6,800 reporting by the average-earnings method, 4,800 were under $20,000 excess profits net income.

Senator BYRD. You did not get my question. What I want to know is what percentage of the smaller corporations use the average-earnings method for computing the excess profits and what percentage use the invested-capital method.

Mr. SULLIVAN. I will figure the percentage for you.

Senator CONNALLY. Are you through, Senator?

Mr. SULLIVAN. Just a minute. There is a misunderstanding as to the Senator's question. When you say the smaller corporations, you mean the corporations with small assets? The figures I gave you were on the basis of small excess profits net incomes. Now, do you want that on small corporate assets?

Senator BYRD. Yes.

Mr. SULLIVAN. Small companies?

Senator BYRD. Reasonably small companies.

Mr. SULLIVAN. Would it be satisfactory if we gave that to you later?

Senator BYRD. Yes.

Mr. SULLIVAN. Have we got it, Mr. Blough?

Mr. BLOUGH (Roy Blough, Director of Tax Research, Treasury Department). These figures are for concerns classified by income after normal taxes?

Senator BYRD. What I want to know is whether the small corporations are using the invested capital method or average-earnings method.

Mr. BLOUGH. I think these figures will show that.

Senator BYRD. I want to ascertain the facts about it.

Mr. SULLIVAN. We will be very happy to give you the facts about it, Senator Byrd, they are as follows:

Of corporations with total assets of under $250,000, filing taxable excess-profits tax returns and received in the Bureau through July 17, 1941, 34 percent used the invested-capital method and 66 percent the income (average earnings) method. Of those using the income method, 54 percent used the general-average method and 46 percent the increased-earnings method.

Senator CONNALLY. Mr. Sullivan, may I ask you a question, not on this point? Is there a clause in this bill exempting from tariff duties all articles imported for national-defense purposes?

Mr. SULLIVAN. No, sir.

Senator CONNALLY. Not any?

Mr. SULLIVAN. No, sir.

Senator CONNALLY. There is somewhere a bill that does.

Mr. SULLIVAN. I am sorry, but I was not aware of it.

Senator BARKLEY. Let me ask you this, Mr. Sullivan. It has no relationship to any particular rate or schedule. Let us suppose that instead of trying to raise $3,200,000,000, that we try to raise $4,000,000,000, would you be prepared, would the Treasury be prepared to make suggestions as to where the other $800,000,000 could be raised over and above the $3,200,000,000, both with the joint return in and with it out?

Mr. SULLIVAN. Yes, sir; we would.

Senator BARKLEY. Would you mind doing that?

Mr. SULLIVAN. No; we would be very happy to.

Senator BARKLEY. I would like to have it myself.

Senator DANAHER. Mr. Chairman, on that point, and to make it perfectly clear, the Treasury has not recommended to this Senate committee any new tax or any change in the taxes appearing in the House bill to replace the $300,000,000 lost by the House elimination of the joint return provision.

Mr. SULLIVAN. Yes; I think the Secretary this morning made six specific recommendations as to that, sir.

Senator DANAHER. That are new to us?

Mr. SULLIVAN. That are new to you, and the additional bill which is now pending before you, Senator Danaher.

Senator DANAHER. And were they contained in his recommendations to the House committee?

Mr. SULLIVAN. Some were and some were not.

Senator DANAHER. I asked him if there was any plan, new plan, to tax the income of insurance companies. I notice from your statement at the bottom of page 8 and the top of page 9 a plan to increase the tax on corporation income 5 percent on the first $25,000 of surtax net income and 6 percent on the balance, the increase being intended to reach partially tax-exempt securities which are held by banks and insurance companies.

Mr. SULLIVAN. That is correct.

Senator DANAHER. So there is a new plan on that particular phase, is there not?

Mr. SULLIVAN. Oh, yes; and there have been conversations in the Joint Committee staff, and among my staff, and between the two staffs on the insurance problem.

Senator DANAHER. Yes. I notice the Secretary said "not that he knew of" in answer to my question. I just wanted the record to show that there was a discussion on that.

Mr. SULLIVAN. Those were general discussions. I think the Secretary said he was not prepared to make definite recommendations.

Senator DANAHER. Yes.

Mr. SULLIVAN. As a matter of fact, some of the work done by my staff and I think by Mr. Stam's staff—correct me if I am wrong—has been done at the request of members of your committee.

Senator DANAHER. Yes. Thank you.

The CHAIRMAN. Are there any other questions that anyone desires to ask Mr. Sullivan?

Senator BROWN. Mr. Sullivan, would the tax that this bill imposes on motor vehicles, the $5 tax, the tax on bowling alleys, billiard tables, and so forth, be very much like the general property tax imposition in the State of Michigan and in a great many other States in the Middle West? While I presume they would be called excise or occupational taxes, it seems to me they are pretty much in the line of property taxes. I think they are legally and constitutionally sound, but I would like to see a memorandum from the legal department of the Treasury as to the constitutional basis for that kind of a tax.

Mr. SULLIVAN. Just those three, sir?

Senator BROWN. Well, any of a similar nature.

Mr. SULLIVAN. We will get it for you.

Senator CONNALLY. Does this bill tax slot machines, and things of that kind?

Mr. SULLIVAN. Yes. The bill taxes coin-operated machines, if they are not vending machines.

Senator CONNALLY. I am talking about the ordinary slot machine, where you can drop a quarter in and get 3 pennies back.

Mr. SULLIVAN. Everything is taxed except the 3 cents that you get and I know you will report that on your income tax.

Senator CONNALLY. I do not fool with them. I see a lot of people just chuck their money into the slot machines. What do you tax? The sales price of the machine? There are so many already out I think you ought to get those that are already out.

Mr. SULLIVAN. Each one of those machines, sir, is taxed $25 each year under this bill.

The CHAIRMAN. A use tax?

Mr. SULLIVAN. That is correct, sir.

Senator DANAHER. If they should pay out, let us say, a box of aspirin, would you tax them?

Mr. SULLIVAN. No.

Senator DANAHER. There would be no tax?

Mr. SULLIVAN. No tax.

Senator DANAHER. You need aspirin after you use some of those slot machines.

Senator GERRY. Has the Treasury suggested any other excise taxes than those that are in the bill?

Mr. SULLIVAN. Oh, yes; we suggested an additional tax of a cent and a half on cigarettes, which are now taxed 6½ cents a package. We suggested an additional tax of half a cent a gallon on gasoline. We recommended an additional tax of $1 a barrel on beer.

Senator GERRY. Is that all?

Mr. SULLIVAN. Those three.

Senator GERRY. Those are the only ones you suggested?

Mr. SULLIVAN. We also suggested a bank-check tax, and a tax on candy and chewing gum. I think that is about all.

Senator GERRY. How does that compare with the excise taxes in the last war, in the 1917–18 act?

Mr. SULLIVAN. In the 1917–18 act there were more retail taxes than there are in here, and many of them, such as the tax on sporting goods, have been very much improved in the present draft.

The CHAIRMAN. Are there any other questions of Mr. Sullivan?

Senator CONNALLY. Let me ask you a question. Does this musical instrument tax reach sheet music, or anything like that?

Mr. SULLIVAN. No.

Senator CONNALLY. It includes phonograph records, though?

Mr. SULLIVAN. Yes, sir.

Senator CONNALLY. I think it ought to include sheet music.

Senator GUFFEY. Does the advertising tax apply just to billboards?

Mr. SULLIVAN. That is all, sir. That was not a Treasury recommendation.

Senator CONNALLY. It applies to radios, does it not?

Mr. SULLIVAN. I beg your pardon. There are two distinct taxes. I think the tax Senator Guffey was referring to was the tax on outdoor advertising, and I think you have in mind the tax on radio-broadcasting stations and networks.

Senator BYRD. Did the Treasury recommend that?

Mr. SULLIVAN. No; they did not.

Senator CLARK. Somebody stated here the other day in an executive session of the committee that the tax, as it came out of the House, only raised $1,700,000. What would it cost to collect that tax?

Mr. SULLIVAN. I hope we never have to find out, Senator Clark.

Senator CLARK. What I am getting at, I have always been opposed to taxes where the cost of collection was so great and the returned revenue was so small that it was practically no revenue for the Government and at the same time was a tremendous burden and nuisance on the people engaged in industry.

Mr. SULLIVAN. You see the bill as now drafted applies only to concerns that advertise for somebody else. The self-advertiser is not taxed, and I do not think we have to be very far-sighted to anticipate if this passed, at least in this form, that the companies that are manufacturing and selling articles will buy the boards.

Senator CLARK. And do their own advertising.

Mr. SULLIVAN. And do their own advertising, and they will be free from the tax as it is drafted in its present form.

Senator CONNALLY. Don't you think it would be a mistake for Congressmen and Senators to vote a tax on self-advertising?

Mr. SULLIVAN. I think that is the best opportunity I have had to say nothing since I got here this morning.

Senator CONNALLY. Why not tax them?

Mr. SULLIVAN. That is something I do not care to express an opinion on.

Senator GUFFEY. Do you have an increased tax on cigars in your recommendation?

Mr. SULLIVAN. We did originally, and then we changed that merely to a reclassification of the types of cigars.

The CHAIRMAN. Is there any other member of the Treasury that you wish to call?

Mr. SULLIVAN. No, sir. The entire staff is at the disposal of the committee for any information that you want to get and that we are able to give you.

The CHAIRMAN. If there is any additional information that is desired of the Treasury by way of estimates, it would be a very good thing for the members of the committee to make that request of the Treasury as early as possible, so you may not be delayed in getting it in. I make that suggestion to the committee.

Senator DANAHER. Mr. Chairman, it may be that Mr. Sullivan can answer this question now. At the top of page 9 of your prepared statement, you talk about the increase in the form of surtax to reach a substantial part of the interest from more than $20,000,000,000 of partially tax-exempt securities which are held by corporations, principally banks and insurance companies. What yield do you expect to get from that item?

Mr. SULLIVAN. $31,600,000 from individuals and corporations.

Senator DANAHER. Thank you.

Senator WALSH. I move we adjourn, Mr. Chairman.

The CHAIRMAN. If there are no other questions of Mr. Sullivan or any other member of the Treasury staff, we will adjourn until Monday morning at 10 o'clock.

(Whereupon, at the hour of 12:45 p. m., the committee adjourned until 10 a. m., Monday, August 11, 1941.)

REVENUE ACT OF 1941

AUGUST 11, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order, please.

In arranging for the appearances of the taxpayers or representatives of the taxpayers who wish to be heard on this tax bill, the committee will appreciate it if you will avoid duplication as much as possible, and likewise condense your remarks as much as possible. You realize that you have got a somewhat bigger problem than you had in the way of paying taxes through any one particular theory. You want to exercise the right, of course, to be heard, and the committee wants to hear you. We have two very simple suggestions that we would like to have adhered to. Where there are a half dozen witnesses on one particular point, if you will consolidate your remarks and have them presented by one witness, unless there are peculiar circumstances that compel the presentation of more than one phase of the matter, you will greatly expedite the hearing and greatly assist the committee in trying to prepare the bill for a report to the Senate.

Now, in arranging the witnesses, day by day, if there should be failure on the part of any witnesses to appear and there should be an opportunity here of anyone else who is here on any other question before recessing or adjourning for the day, the committee will supplement the witnesses on the list so as not to lose any time.

The first witness this morning is Mr. Dockweiler of Los Angeles, Calif.

Mr. Dockweiler.

STATEMENT OF ISIDORE B. DOCKWEILER, REPRESENTING REPAIRERS OF AUTO ACCESSORIES AND PARTS, LOS ANGELES, CALIF.

Mr. DOCKWEILER. Mr. Chairman and gentlemen of the committee, we appear on behalf of the repairers of automotive parts and accessories, not manufacturers of parts and accessories, and we respectfully request the committee to amend on line 20, page 49, of the House bill, immediately after the words "parts or accessories (other than tires and inner tubes and other than radios,"—here insert the following words, "and other than repaired, overhauled, or rebuilt parts or accessories, when sold as such)" and then continue, "for any of the articles enumerated in subsections (a) or (b), 5 per centum."

I wish to state to the committee that we arrived too late to effectively present our matters to the House Ways and Means Committee, and that is why we are here presenting our proposed amendment. We find that because of confusion in the administration of the act, the old act, which confusion will probably accompany this act unless the clarification that we request is made, that the difficulties that we have had with the Internal Revenue Department will not only exist but will increase.

Now, I will ask, with the consent of the chairman and the members of this committee to have my associate, Mr. Einzig of Los Angeles, present a few remarks and marshal the witnesses. We will be just as brief and as quick as possible in the presentation of our case.

(Mr. Dockweiler submitted a memorandum as follows:)

Repairers of automotive parts and accessories urge an amendment by insertion of the words "other than repaired, overhauled or rebuilt parts or accessories, when sold as such)" at page 49, lines 19-20-21 of H. R. 5117, immediately after the words, "parts or accessories (other than tires and inner tubes and other than radios" [here] for any of the articles * * *" and so forth.

This section has been misinterpreted by the Internal Revenue Department in administration and therefore needs clarification. The excise tax in the present act (3403, subsec. (C) of U. S. Code) was intended and so reads that it shall be upon manufacturers, not repairers.

Originally, the custom was that if a generator, distributor or any accessory of an auto became damaged, the garageman took this part out and repaired this unit, in his own shop, and replaced the same unit, absorbing several hours in this operation, thereby preventing the use of the auto for such length of time, while the repairs were being made.

However, because of time lost, and inexperience of garage mechanics, the present custom now is to take out the damaged unit, in the garage, and immediately substitute a second-hand accessory, previously repaired and overhauled. Garages send this damaged unit to the specialty repairer, who exchanges the damaged unit for repaired unit, thus saving time and enabling auto owners to resume their journey without delay.

Cost of repairing is the only charge made by the repairer in the above illustration, but if the repairer does not receive the damaged unit immediately, he imposes a deposit charge until this damaged accessory is delivered to the repairer and then the deposit charge is canceled against the garageman.

Internal Revenue Department concedes that garagemen are not subject to excise taxes but insists that repairers must pay excise taxes as it contends the repairer is a manufacturer because he repairs more than one accessory at a time, although the operations are identical.

For example, the repairing charge for a distributor is $1.10 and if the damaged unit is not received at the time of the transaction, a $5 deposit is charged, yet the Internal Revenue Department assesses a tax on the $6.10, although the repairer receives only $1.10 because the $5 deposit is credited back to the garageman when the damaged unit is delivered to the repairer.

Repairers do no casting, or manufacturing, but repair only used units.

Strange as it may seem, no uniformity exists throughout the United States in making tax assessments. In many Internal Revenue districts the repairer has been informed no charge can be made, and yet in only a few districts the Internal Revenue collectors are insistent upon payment of the excise tax upon the alleged ground that the repairers are manufacturers, although used units were once taxed when new.

Therefore such repairers are respectfully urging the addition of the following 14 words, printed in italic, to the present bill, at page 49, line 19, H. R. 5117, to read as follows:

"Parts or accessories (other than tires and inner tubes and other than radios *and other than repaired, overhauled, or rebuilt parts or accessories when sold as such*) for any of the articles enumerated * * *" and so forth.

STATEMENT OF BEN WHITE EINZIG, REPRESENTING REPAIRERS OF AUTO ACCESSORIES AND PARTS, HOLLYWOOD, CALIF.

The CHAIRMAN. Will you state your name for the record?

Mr. EINZIG. Ben White Einzig.

The CHAIRMAN. Of Hollywood, Calif.?

Mr. EINZIG. Yes.

The CHAIRMAN. Representing whom?

Mr. EINZIG. The repairers of auto accessories and parts of Los Angeles.

The CHAIRMAN. Is it clear that the House bill intended to impose the tax that you are now complaining of, or is it a question of interpretation?

Mr. EINZIG. It is a question, I believe, of clarification.

The CHAIRMAN. Is there anyone here representing the Treasury or the staff?

Mr. RAY (George E. Ray of Office of the Legislative Counsel of the Treasury). Yes, sir.

The CHAIRMAN. Was it intended to cover in this bill the repairs about which these gentlemen are complaining?

Mr. RAY. No; the intention of the bill was not to cover repairs, but in certain cases transactions which might be construed as repairs or sales are confusing, and in such cases the Bureau of Internal Revenue has prescribed rules to determine what constitute merely repairs and what constitutes accessories.

The CHAIRMAN. All right. You may proceed.

Mr. EINZIG. Mr. Chairman, the act specifically provides that there shall be a tax in the old bill of 2½ percent upon manufactured parts and accessories. We contend that these repairers do no manufacturing whatsoever. There is an exchange that takes place, and upon that exchange a repair is made. These individuals do no manufacturing or casting of any kind, they merely exchange the old unit, repair the old unit, and then again give it back to the garageman.

We have been told heretofore by the Treasury Department that we can have this matter adjusted by the administration, but the fact remains that in the State of California, especially in Los Angeles, the collectors of internal revenue say that the tax shall be paid because these gentlemen are manufacturers. Four hundred miles away in San Francisco the same operators have been told that the operations are repairing, therefore there is no tax. In Denver, Colo., the same thing exists, there is no tax; they have been told that they are not taxable; and in Chicago they have been told that they are not taxable.

The CHAIRMAN. This would get right down to the point, and you will help us by answering this: Do you want us to insert an amendment here that will clarify that? Is that the idea?

Mr. EINZIG. Mr. Dockweiler has presented that amendment. There seems to be some difficulty with the Treasury Department as to whether we are manufacturers or not; we have therefore brought three gentlemen who are repairers, who have the parts, the old parts, and I believe can demonstrate within the period of 3 or 4 minutes what we do.

Senator TAFT. Do you mean you do not want a tax on remade parts or accessories? Is this business a sort of remade parts and accessories, or are they just repairs?

Mr. EINZIG. It is strictly repairs. We have to have an old unit as an exchange. You see, the old unit we exchange, we repair the unit and hold it for the next one.

Senator TAFT. Your amendment is "rebuilt parts or accessories". That implies the sale of second-hand parts that have been repaired.

Mr. EINZIG. It is an exchange plus a repair charge.

Senator TAFT. It may not be. Under this amendment it may be no exchange at all.

Mr. EINZIG. When sold as such; when sold not as a used unit.

Senator TAFT. You are talking about exchanges and repairs. It is the suggestion that the repaired work, according to this amendment, would be excepted?

Mr. EINZIG. Yes; that is correct.

Senator TAFT. Does not that apply to all second-hand parts, practically, where any work is done?

Mr. EINZIG. That is correct. In this situation, however, the price of the repair is usually $1 or $2, plus the fact that on the exchange they place a deposit until we get the old unit back, until we make the repair, and we keep the money for the repair and we must refund the deposit.

Senator TAFT. I do not see what that has got to do with this amendment; if you feel to do that you have got to treat it in some other way. This covers the second-hand repairs, no matter whether it is an exchange or not.

Mr. EINZIG. There seems to be tremendous confusion in the Treasury Department whether we should or should not pay on those items. The only purpose of this particular amendment is to clarify that particular point. If there are no other questions, I should like to have Mr. Van Alen, a repairer of Los Angeles, to bring forth a generator.

The CHAIRMAN. Suppose you bring him around as a witness? You do not need to make any exhibit, because I think we can understand what you are getting at.

STATEMENT OF RALPH A. VAN ALEN, REPRESENTING THE REPAIRERS OF AUTO ACCESSORIES AND PARTS, LOS ANGELES, CALIF.

The CHAIRMAN. Will you please give your name?

Mr. VAN ALEN. Ralph A. Van Alen, Los Angeles, Calif.

The CHAIRMAN. How do you describe your business, Mr. Van Alen?

Mr. VAN ALEN. Mr. Chairman and members of the committee: We are in the business of repairing used automobile parts and accessories, to provide a faster and better service for the car owner, the truck owner, or the tractor owner.

The CHAIRMAN. Do you sell any new parts?

Mr. VAN ALEN. We do not sell new parts, we do not make any new parts, and we must have the old part repaired or we could not continue in business. The process of the business is all for the purpose of saving time for the owner of a piece of equipment repaired if the unit is repairable, or for the purpose of saving time for the owner of a car or a truck or tractor. A repaired unit is available so that when the garageman wants one he does not have to tie up the piece of equipment for several hours either while he is doing the work on that car or while he is doing work on some other car. All of the units that we furnish are made from old units, such as will be returned to us.

The process of the business, the flow of trade, is that if we have such a unit on hand, the garageman may call upon us for a generator, or pump, to fit a certain model of car, and we will send it out to him, receiving in return the one that he has removed from that car on which a tax was paid, and then we will repair that unit so that it will be available for the next one.

Senator TAFT. The title passes in each case? You acquire title to the one you get back?

Mr. VAN ALEN. Yes, sir; we do.

Senator TAFT. You sell the other piece to him?

Mr. VAN ALEN. We sell the piece on which a tax has once been paid. If that unit was taxed every time it came into our hands it may imply taxation six or seven times in a couple of years on the same article. We do not make any new articles, we could not make any new articles, we must have the old one to work on, we must have the one which has come from that automobile as a complete unit to work on. The part that we placed in that unit, if parts are required, if it is more than labor and adjustment, those parts are purchased from factories who pay taxes on those parts and who pass the taxes on to us. In many cases the parts we use are offered to the car owner for doing the same work that we do. In fact, in some instances they are put up in packages and labeled "Repair kit," so that the car owner in the remote territory may purchase such a kit and make his own repairs.

In our case what happens is we may get a unit such as this, a Ford distributor, sent in to us, which is very dirty, which needs to be cleaned, which needs to be adjusted, and probably needs a new set of contact points. When we receive it we will take it apart, we will wash it completely and check the parts in it, see what parts, if any, are needed, and if such parts are needed they will be replaced with tax-paid parts.

The Revenue Bureau has consistently and repeatedly told us if we put that unit back on the same automobile there would be no tax on it, because it would be a repair job, but if it went into some other automobile it would be considered manufacture, although, frankly, the work is identical in either case. We do not know where to draw the line.

They have also told us if we wash one of these at a time it is a repair job, but if we wash 2, 5, or 10 at a time it becomes manufacture. For the purpose of improving our service we will wash several at one time, because we can wash 5 or 10 at a time faster than we can wash 5 or 10 individual pieces.

They have told us in some instances the item is not taxable, and in other instances such an item is taxable.

In every case the unit we sell has come from a tax-paid automobile, and the unit we work on is a complete unit. We cannot make any parts in the unit; we must have all of the parts to work on. When it goes back it is exactly the same kind of unit that we received. We have not created anything new or different.

If we have received an armature, as sometimes happens, a man wants an armature, such as this article [indicating], or a shaft with this particular armature gone, where the commutator is all dirty or sooted or carboned up, it is not making a good contact or performing properly, or it may be that the shaft is bent and sprung from service. In such a case we would clean up the commutator and make certain it was round before we put it back, or we might straighten the shaft

by pounding it, and it would have a complete contact bearing surface and performing in good order. It would look like this [indicating]. It is still the same article when we get through, but the Revenue Bureau has said it would be a manufactured armature in a great many instances.

Senator TAFT. Mr. Chairman, may I ask the Treasury what happens if a second-hand automobile is extensively repaired, because the car is broken up in an accident, and then sold as a second-hand automobile?

Is there a tax on that?

Mr. RAY. There is no tax on second-hand automobiles.

Senator TAFT. No matter how much repair is done on them?

Mr. RAY. No.

Senator VANDENBERG. Is this problem localized in California?

Mr. VAN ALEN. No, sir; the problem exists throughout the country.

We have objected to the Revenue Bureau interpretation by taxing us and not taxing someone else. They said, "Maybe the collector in that district is not on the job as well," but they will get around to him. We say, "We do not know which of these units we are expected to pay a tax on and which we are not," and then he says, "You better have Congress clarify the law for you." They have come in to us and told us, at one time or another, that certain articles are not subject to the tax, and then after several years they come back and make another assessment of the tax upon us based upon different values. Sometimes they tax the work we do only, on the repair charge, and in other cases they have done this, they have said, "You have exchanged that to a man for a dollar"—perhaps I can explain better with the distributor. They said, "You have exchanged that to a man for a dollar, you have given him this new article in place of one which is not new, but is second-hand, the exchange man ordered this from you before he took the old one, maybe, from the car." Now, maybe the man wants to keep his car running, so when we send it out to him we bill him $1 for the repair service and $5 for a deposit, so we will get the old unit back. If we did not get the old unit back we would not have another to work on for the next customer. We would be out of business if we were to do that. The Treasury Department has taxed us on the basis of $6 in this instance, although our total income was just the $1. They have told us the tax applied, they have repeatedly held to the ruling that the tax applies to the value of the repair plus the old article taken in.

The CHAIRMAN. If you buy any new parts from the dealer, the wholesaler, or the factory, you have to pay a tax on it?

Mr. VAN ALEN. If we buy new parts from a manufacturer or wholesaler, those parts have been taxed at the point of manufacture, and in most cases the invoice states specifically, at the bottom of the invoice, "excise tax," or "manufacturer's excise tax, 2½ percent."

Senator CONNALLY. What about the old parts that you take out from a knocked-down automobile?

Mr. VAN ALEN. You mean if we use them? You mean if we rebuild and recondition such a part?

Senator CONNALLY. No. A fellow comes along and he wants a new part, you are going to repair his car, you need a part, and instead of giving him a new part you give him a part out of another car.

Mr. VAN ALEN. He does not order a new part from us, because we are not in that business, but in such an instance what would happen——

Senator CONNALLY (interposing). I understand what would happen. The question is: You take the car to the shop to be repaired, it needs a certain part and instead of using a new part you use a used part off of some car that has been junked; then what?

Mr. VAN ALEN. I do not know what you mean by "Then what?" but that circumstance would not occur very frequently.

Senator CONNALLY. I did not ask you that. Supposing it did occur, what would happen? Don't you do that at all? Don't you use any used parts in repairing the automobile?

Mr. VAN ALEN. Sometimes they might; yes, sir.

Senator CONNALLY. That is what I am asking you.

Mr. VAN ALEN. Yes; sometimes they might.

Senator CONNALLY. Do they pay any tax?

Mr. VAN ALEN. Those parts had taxes paid on them when they were put in the automobile.

Senator CONNALLY. Do you pay any tax on them?

Mr. VAN ALEN. Not in that case.

Senator CONNALLY. That is going a long way around to get the question answered.

Mr. VAN ALEN. Not in that case. What has happened is this: This is an exact case. We received a telegram from down in Arizona that they needed a starter for a certain automobile. We did not have such a starter on hand, so we went to looking around here and there for a suitable starter. We went to the wrecking yard and bought a starter. The wrecking yard would have sold it as a second-hand starter and there would be no tax, there would be no assessment made on that second-hand starter. We bought it, we brought it to the plant, washed it up a bit, got to working on it, tested it to make certain that it worked properly, and shipped it out. In a few days we got back the old starter from the car in Arizona, which we then fixed up to go out on the next call for such a unit. Some day the Treasury Department will come along and go over our billing and charge us a tax on the starter even though we never touched it, even though we did not open it up, simply because we handled it in a different manner than the wrecking yard, or because it went into a different car from the one that it came out of.

Senator RADCLIFFE. Mr. Van Alen.

Mr. VAN ALEN. Yes.

Senator RADCLIFFE. Do I understand the part from the damaged car is used in substitution for the repaired part, the idea being that the damaged part will then be put in condition, repaired if necessary, cleaned, and put in a condition to be available for some subsequent transaction?

Mr. VAN ALEN. That is right, sir.

Senator RADCLIFFE. That presupposes, I suppose, that the damaged part can be repaired and fixed up?

Mr. VAN ALEN. Yes.

Mr. RADCLIFFE. I would assume in many cases it could not be done, and in that event there must be a need for second-hand parts that would not come through that transaction.

Mr. VAN ALEN. I do not know of any cases when that damaged part could not be repaired, when it would be sent in to us or accepted and handled by us. If it could not be repaired there would be no benefit in sending it in.

As a matter of fact, in a distributor like this [indicating], where an essential part of the unit such as the housing is broken, and where we cannot make or create any housing, we definitely refuse to accept that distributor from the customer. The only difference between our work and the work of a garageman is that we do it for the garageman instead of he doing it for himself. If he did the same work in his place, there would be no tax assessed upon him.

An instance that I know of was where a gentleman had a Packard automobile and he needed another armature for it. When he went to the service station he had had to wait several hours for that armature. In order to avoid that loss of time again, and I believe with several hours included running overnight, he procured another armature that the garageman told him "will fit that automobile," that he might use as a part, the same as a spare tire. He took that back to his garage and kept it on hand as a spare. It was not a manufacture, it was simply the same as his own that had been repaired. When it was originally installed in the car, a tax had been collected upon it.

Senator RADCLIFFE. When you take a spare part of an automobile and fix it up so it may be available for a subsequent transaction—that is what you mean?

Mr. VAN ALEN. Yes.

Senator RADCLIFFE. Suppose the old part cannot be fixed up, or that the damages to it in many cases would be so serious that it could not be fixed up; in that case where do you find your source of material in order to meet a new transaction?

Mr. VAN ALEN. In instances where we do not have a part on hand we have to buy a new part at a higher price than we would sell the repair service for. When new models come out and there are no used parts available, as for instance the 1941 models of automobiles, we buy a number of new ones so as to start this rotation. We start with a new one on the first call and receive the used one back, which we recondition.

Senator RADCLIFFE. Could not you buy those parts from second-hand dealers who wreck cars?

Mr. VAN ALEN. Sometimes we could, but we could not find the miscellaneous parts for the later model cars.

Senator TAFT. Are not there a lot of people in the business who supply old parts from junk yards and recondition those parts?

Mr. VAN ALEN. I do not believe so for the purpose of selling them outright, because the only place that the good business is, is on this exchange of parts. People do not buy second-hand parts to put on the shelf and maintain them there.

Senator TAFT. You say you do not buy junk parts. Who does buy all the junk parts that come from junk yards?

Mr. VAN ALEN. We sell a lot of junk parts, if we have salvage material, at so much a pound.

Senator TAFT. Are not a lot of the parts in the junk yards salvaged and reconditioned?

Mr. VAN ALEN. Yes, sir. Many of the parts are salvaged.

Senator TAFT. Now, is a person in that business taxed under the present law or not?

Mr. VAN ALEN. In the wrecking yards he is not. This is what occurs: An automobile may be in a fire or may be wrecked and the radiator and front wheels might be burned up, but the generator, or the rear end, might be just as good as it was before. The wrecking yard might get the automobile and throw away the parts that are wrecked and take out the parts that are not wrecked, which are still usable as second-hand parts. There is no tax applied to the sale of second-hand parts, but if we go to the wrecking yard and buy it and then sell it and pass it on, and take an old one in trade for it——

Senator TAFT (interposing). I do not care what the business or the trade does with it, but the important question is the work that is done on the old part.

Mr. VAN ALEN. Yes.

Senator TAFT. And anybody in that business might be called a manufacturer conceivably.

Mr. VAN ALEN. He is called a repairman.

Senator TAFT. Is anybody taxed except your particular kind of business?

Mr. VAN ALEN. I do not think anyone except our class of business is taxed. I know people in our class of business are taxed, and I do not think Congress intended to tax the repair work in the old law.

Senator TAFT. How would you distinguish your business from a man buying a second-hand automobile, reconditioning the automobile which was not taxed?

Mr. VAN ALEN. I could not distinguish it from that, except we also will do repair work for anybody.

The CHAIRMAN. Is there anything else?

Senator RADCLIFFE. A dealer who wrecks an old car and, as you say, discards the parts which are of no value and retains those which have some value, of course, in many cases, those parts have to be put in condition, he has to repair them, and then he sells them as a second-hand dealer, or as other second-hand dealers in parts do; does he pay any tax?

Mr. VAN ALEN. He does not pay any tax, any more than a man who sells second-hand clothing pays tax on manufacturing. There must be people who buy and sell second-hand clothing.

Senator RADCLIFFE. He is disposing of a second-hand part which he may or may not repair?

Mr. VAN ALEN. That is correct, but he does not pay any tax on it.

Senator VANDENBERG. Mr. Chairman, in connection with this witness' testimony, I would like to have printed in the record, if I may, a letter from the Michigan Engine Rebuilders Association of Detroit, which indicates that the need for clarification, at least, in the law is so pressing, because the tax is being collected retroactively, and in many instances in the Detroit area the accumulated back assessments total more than the value of the business.

Mr. VAN ALEN. That is quite true.

Senator VANDENBERG. I would like to have that printed in the record, if I may.

The CHAIRMAN. Very well.

(The letter referred to is as follows:)

MICHIGAN ENGINE REBUILDERS ASSOCIATION,
Detroit, Mich., July 30, 1941.

The Honorable ARTHUR VANDENBERG,
Senate Office Building, Washington, D. C.

DEAR SIR: In confirmation of our telegram of this date, regarding the tax on repaired automobile parts and accessories, we wish to submit these facts regarding a deplorable situation which has arisen and which we believe was never contemplated by Congress.

Subsection C of section 3403 of the United States Codes placed a tax on the sale by the manufacturer, producer, or importer of automobile parts or accessories. The administrative interpretation which has been placed on this section has resulted in every parts jobber, dealer, garage, machine, and repair shop that repairs, overhauls, or rebuilds and sells any used automobile engine, part, or accessory being taxed as a manufacturer, even though he advertises the fact that they are repaired, overhauled, or rebuilt.

This interpretation has resulted in thousands of parts jobbers, dealers, garages, machine, and repair shops becoming taxable as manufacturers, simply because they have repaired and sold some used automobile engine, part, or accessory. The Commissioner of Internal Revenue is now applying this principle retroactively, resulting in enormous assessments being placed against small businesses, which do no manufacturing whatsoever, and resulting in liens being filed and bonds demanded to insure payment. In many instances these assessments far exceed the entire worth of the businesses, which can only result in ultimate confiscation. It is unthinkable that the Congress ever intended such vicious and wholesale destruction of otherwise valuable small taxpayers.

The interpretation, which has been placed on the act as it now stands and which will continue if the act is not clarified, has resulted and will continue to result in assessments of large sums of money, which, in fact, will never be collected, due to the inability of these small businesses to liquidate for the amounts involved.

The act as now interpreted has not only defeated itself by assessing uncollectible taxes, but also threatens ruin for those that have been assessed. The result is the destruction of the small taxpayer who constitutes the backbone of the present defense-tax structure.

The simplest clarification is to immediately amend subsection C of section 3403, United States Codes [by inserting the words printed in italic], to read in part as follows:

"(C) Parts or accessories (other than *repaired, overhauled, or rebuilt parts or accessories when sold as such, and* tires and inner tubes) * * *."

We appeal to your sense of justice and fair play to lift this threat of destruction from the small one-man businesses scattered throughout our land, all operated by loyal and industrious Americans.

Yours very truly,

THOMAS V. LOCICERO,
Executive Secretary.

Mr. VAN ALEN. If I may add, I would like to say in Los Angeles, there are 10 or 11 people in the style of business I am in, and not less than 3 of them have said to me, "If you want to assume the tax bill that is presented to me, I will give you my business, because it is really far more than the business," and one man has said, "Although the Revenue Bureau is willing to take my bill in settlement, it means for the next 4 years I shall be working for nothing."

The CHAIRMAN. I think we get your point. Is there anything else?

Mr. EINZIG. We have one more witness, Mr. Thompson, of New Jersey.

The CHAIRMAN. Covering the same ground, Mr. Thompson?

Mr. THOMPSON. No; now, just to show how the Internal Revenue Bureau has collected the taxes in the past. I am not going into any detail about the articles.

STATEMENT OF ROBERT R. THOMPSON, REPAIRERS OF AUTO ACCESSORIES AND PARTS, OF NEW JERSEY

The CHAIRMAN. Give the reporter your name. We have given you 30 minutes on this matter. It is a very simple matter.

Mr. THOMPSON. It will just take 2 minutes.

The CHAIRMAN. What we want to see is the regulation of the Treasury— that it will be put into the record. I wish you gentlemen would provide the regulation of the Commissioner of Internal Revenue.

Mr. RAY (George E. Ray, principal attorney, Office of the Legislative Counsel, Treasury Department). Yes, sir.

The CHAIRMAN. I want to ask you just this one question: When the tax is imposed upon people who engage in the work that these gentlemen are engaged in, is it on the theory that they are manufacturers?

Mr. RAY. Yes, Senator. Fundamentally, that is the theory.

The CHAIRMAN. I suppose so, on the theory that they are manufacturers. If you put that regulation in the record, I think we can understand the whole case.

(The memorandum from the Treasury Department referred to is as follows:)

Re: Manufacturers' excise tax on the sale of automobile parts and accessories.

The following provisions of Regulations 46 (1940 edition) have a direct bearing on the tax status of rebuilt generators and other automobile parts and accessories:

"SEC. 316.4. *Who is a manufacturer.*—The term 'manufacturer' includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

"Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

"A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys, and assembles a taxable article from, such component parts."

* * * * * * *

"PARTS AND ACCESSORIES

"[SEC. 3403. *Tax on automobiles, etc.*]

"[There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:]

* * * * * * *

"(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. For the purposes of this subsection and subsections (a) and (b), spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, any of the articles enumerated in subsection (a) or (b), shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. This subsection shall not apply to chassis or bodies for automobile trucks or other automobiles. * * *

"SEC. 316.55. *Definition of parts or accessories.*—The term 'parts or accessories' for an automobile truck or other automobile chassis or body, taxable tractor, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (c) any article the primary

use of which is in connection with such vehicle or article whether or not essential to its operation or use.

"The term 'parts and accessories' shall be understood to embrace all such articles as have reached such a stage of manufacture that they are commonly or commercially known as parts and accessories whether or not fitting operations are required in connection with installation. The term shall not be understood to embrace raw materials used in the manufacture of such articles.

"Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, automobile truck or other automobile chassis, taxable tractors, or motorcycles, are considered parts of or accessories for such articles whether or not primarily designed or adapted for such use.

"SEC. 316.56. *Rate of tax.*—The tax is payable by the manufacturer at the rate of 2 percent (2½ percent for the period July 1, 1940, to June 30, 1945, inclusive) of the sale price as determined under sections 316.8 to 316.15, inclusive.

"EXEMPT SALES OF PARTS AND ACCESSORIES

"[SEC. 3403. *Tax on automobiles, etc.*]

"(c) * * * Under regulations prescribed by the Commissioner, with the approval of the Secretary, the tax under this subsection shall not apply in the case of sales of parts or accessories by the manufacturer, producer, or importer to a manufacturer or producer of any of the articles enumerated in subsection (a) or (b) If any such parts or accessories are resold by such vendee otherwise than on or in connection with, or with the sale of, an article enumerated in subsection (a) or (b) and manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the parts or accessories so resold.

"SEC. 316.57. *Parts and accessories sold to manufacturers.*— No tax will be imposed upon parts or accessories sold to a manufacturer of automobile truck or other automobile chassis, bodies, taxable tractors, or motorcycles, provided the vendor obtains from the purchaser, and retains in his possession as provided in section 316.21, a certificate of the purchaser establishing that the purchaser is a manufacturer of such articles.

"Under section 3442, sales of parts or accessories to another manufacturer of parts or accessories for use in the manufacture or production of parts or accessories are likewise exempt, when supported by exemption certificate as provided in section 316.21.

"If the purchaser uses or resells parts or accessories purchased by him tax free, he shall be considered the manufacturer, and must pay the tax thereon or in the case of resale establish by exemption certificate on file that his sale was tax free.

"Jobbers or dealers and others who are not manufacturers of taxable articles are not entitled to purchase tax free. In case a manufacturer of both taxable and nontaxable articles uses parts or accessories purchased tax free under certificate in the manufacture of a nontaxable article, he is liable for tax on the parts or accessories so used based on the fair market price determined as provided in section 316.15."

Mr. THOMPSON. My name is Robert R. Thompson, Mr. Chairman. I wish to outline my experience with the Internal Revenue Bureau on the excise tax.

When this excise tax began in June of 1932 we consulted our attorney as to whether we were taxable, and he informed us that our business was of a repair nature and therefore, we were not taxable. This same contention was held by other concerns in our locality.

In 1934 two deputy collectors from the Newark office called on us and inspected our books and our method of operations. They told us that they would explain our business to their superior in Newark and advise us whether we were subject to this tax. Upon their return, they informed us that our business was repairs and not one of manufacture and we were not taxable.

In July 1937 two different deputies from the New York office called on us and advised us that we were subject to this tax. They assessed us from June 1932 to July 1937, basing their figures on the exchange prices, which means the actual receipts received by us for repairing.

During the course of the next year we had many conferences with the Bureau, but no settlement was arrived at. In August 1938 another deputy from the Newark office audited our books for the year July 1, 1937, to July 1, 1938. The basis of the audit was the same as made by the New York deputies. Before leaving, this deputy drew up a work sheet computing the tax due for the month of July 1938. Commencing with that month we have filed and paid taxes exactly as shown us by the deputy. As we were not in a financial position to pay the total amount of back taxes assessed against us, the Bureau, in November 1939, accepted an offer in compromise of approximately 50 percent. Even this reduced amount was a great hardship for us, but we managed to make a final payment in December 1940.

In March 1941, an agent of the Bureau, working directly out of Washington, called on us, and after examining our books, told us, much to our surprise, that we were not correctly computing the amount of taxes due, as we did not include, for tax purposes, the value placed on the old unit taken in exchange, but were paying only on the actual amount received by us to cover the cost of repairs. This agent then proceeded to set up additional taxes for the period, July 1938 to February 28, 1941.

In March 1941, at a conference before Deputy Agents Leopold and Garwin here in Washington, I protested strongly against this proposed additional tax, as I felt the Bureau was not consistent or justified in their ways of taxing our articles. My protest was to no avail and the additional tax was assessed.

This, gentlemen, I want to bring out to you, that we have all these methods of taxing our articles. First, there was no tax. Then a tax only on the repairs, and now a tax on the repairs plus the value of the articles received in trade.

The CHAIRMAN. Is there anything further?

Mr. DOCKWEILER. Mr. Chairman, may I say a few words? I want to explain our postion here. We came up to Washington here, we came to see Assistant Secretary Sullivan, we explained our position and explained to him that the work done by these repairers was repair work and not work of manufacture. He sent us to Mr. Helvering, and Mr. Helvering sent us to Mr. Christie. Mr. Christie had some gentlemen, who were supposed to be experts. Well, finally, Mr. Christie sent us to two gentlemen who went into it in detail and we explained the operations, and so forth. I am not quoting anybody, but we went away with the impression that everything was all right.

Later on, the Bureau and Mr. Sullivan seemed to be of the opinion that this matter could be arranged by regulation, an Internal Revenue regulation.

Now, Mr. Chairman, we want protection against regulation in this matter. If it is possible at all, if it is fair and just and proper, we want this amendment, or if the language of the amendment is inappropriate in any detail, we would like to have the appropriate language inserted, just as radios are excluded and as tires and inner tubes are excluded, we want this special repair work to be definitely excluded by legislative action.

In California, in my district at Los Angeles, the collector of Internal Revenue, a splendid public official, is however, imposing a tax upon some of these people. They are going back on their books 4 or 5 years,

6 years, and if this method that is being exercised in our district is followed all over the United States, the United States Government will have, as owners, a lot of repair shops; throwing out of business two or three or four or five men in each shop who are earning a living for themselves and their families.

In the San Francisco district, the repairers there are informed by the Internal Revenue Bureau officials that there is no tax to be imposed, for the reason that these repairers are repairers and not manufacturers. Of course, they have the correct attitude. In other sections of the United States, in only a few as compared to the balance of the United States, the imposition of taxes has been made, and in the majority of districts there has been so far no imposition of the taxes. This affair, dealing with the repairers, that is the alleged law or regulations, has been unfairly and improperly—I am not ascribing any improper motive, but it has been unfairly handled.

Senator CONNALLY. May I interrupt you, Mr. Dockweiler?

Mr. DOCKWEILER. Yes, Senator.

Senator CONNALLY. Do they tax them just on the cost of the particular part that goes into the repairs?

Mr. DOCKWEILER. They impose a tax in one case on the $1.10 charged for repair, and then the $5 deposit, which is immediately returned or credited to the garageman upon the return of the old and disabled part. That would mean, say, 5 percent, 5 times 6 that is 30, and we are paying 30 percent instead of 5 percent on $1.

Of course, I would like to hear the answer of the Treasury Department. We are at a disadvantage in not being able to find out what their attitude and position is, but we think that the case is sufficiently grave to justify the enactment of an amendment to this statute so that the law and the procedure is already laid down for the gentlemen in the Internal Revenue Bureau.

Now, you all realize better than I do, that the American people are going to be obliged to pay taxes such as their fathers and grandfathers and great-grandfathers were never called upon to pay, and therefore, it is most important that the administrators of our tax assessments, of our tax legislation, should be fair and courteous and kind and considerate to the people who pay, and that a rule should not be enforced in one district which is not enforced in another district. We feel that, under the circumstances, this amendment, or some other appropriate language, should be used to protect the repairers.

The CHAIRMAN. We have your point, Mr. Dockweiler.

Mr. DOCKWEILER. Thank you.

Mr. EINZIG. Thank you very kindly.

The CHAIRMAN. Mr. Harcourt Amory.

STATEMENT OF HARCOURT AMORY, BOSTON, MASS., CHAIRMAN, COMMITTEE ON FEDERAL TAXATION, INVESTMENT BANKERS ASSOCIATION OF AMERICA

The CHAIRMAN. Will you give your name to the reporter?

Mr. AMORY. Harcourt Amory of Boston, representing the Investment Bankers Association of America.

The CHAIRMAN. Have you a prepared brief?

Mr. AMORY. I have, sir.

The CHAIRMAN. Do you wish to read it or put it in the record?

Mr. AMORY. I would prefer to read it.

The CHAIRMAN. How long will it take you to cover it?

Mr. AMORY. It will take us about 20 minutes, sir, I think. We will try to make it as brief as possible, but as it is a general plan, it is a little hard to condense it much.

The CHAIRMAN. Will you state exactly to what point in the act you are speaking, so we may follow you?

Mr. AMORY. We are speaking to the general act. We have a general tax proposal.

Senator CONNALLY. A complete substitute for the bill?

Mr. AMORY. Not a complete substitute for the bill, but it covers all factors in the bill, sir.

The CHAIRMAN. It covers all the taxes?

Mr. AMORY. No; but in a general way, it does, Senator.

Senator GUFFEY. How much revenue does your plan raise?

Mr. AMORY. It raises about $600,000,000 more than the House, it raises $3,800,000,000.

Senator CONNALLY. Is that a sales tax?

Mr. AMORY. Something along that line, sir.

Senator CONNALLY. I suspected that.

Mr. AMORY. It has got a different name.

The CHAIRMAN. Proceed. Make it as brief as you can. Since you have a written brief, you could put it in the record and simply talk to us offhand about your program.

Mr. AMORY. I will delete, wherever I can, Senator George.

The CHAIRMAN. Yes.

Mr. AMORY. The Investment Bankers Association of America, represented by its Committee on Federal Taxation, respectfully submits a tax program. The association has no special axe to grind and has taken the broad view that what is, over the long pull, good for the Government, will, over the long pull, be good for the taxpayer and business, including the investment banking business.

1. *Income tax on individuals.*—Our association believes in graduated income taxes on individuals and is of the opinion that this tax should be one of our principal sources of revenue in normal times. However, experience has shown that in times of severe depression it cannot always be one of the principal sources of revenue.

For example, although on the average, income-tax rates were approximately doubled in 1932, nevertheless for the fiscal year ending June 30, 1933, the total revenue collections from individual income taxes (including back tax collections for prior years) were only $352,573,620. In this same fiscal year the Federal Government collected from tobacco taxes alone, $402,739,059 or $50,165,439 more than was collected from individual income taxes.

Senator BARKLEY. You are just $300,000,000 off on the tobacco taxes. The tobacco taxes are $723,000,000.

Mr. AMORY. This is for the fiscal year 1933, sir.

Senator BARKLEY. I beg your pardon.

Mr. AMORY. On the other hand, in a time of high national income, like the fiscal year 1929, even at low-income tax rates, the Government collected from individuals more than three times the revenue it collected in 1933, and income tax collections from individuals were over 2½ times tobacco-tax collections.

In view of the extreme fluctuations which take place in Federal income tax collections, depending largely on and magnifying fluctuations in national income, the Investment Bankers Association believes that a scientific schedule of income tax rates and surtax rates should be worked out for normal times based on a reasonable cost of running the Government in such times, including interest costs, costs of maintaining our Army and Navy at proper effectiveness, and costs for a conservative amortization of the National debt. In preparing such a standard schedule of rates, we believe careful regard should be given to preserving the profit motive of our citizens, thus giving them the incentive to work, invest and produce. Consideration should also be given to broadening the base of our income tax by lower exemptions.

Senator CONNALLY. Right there, how low do you want to put it?

Mr. AMORY. The Treasury Department suggested $750 for individuals and $1,500 for married couples. That would seem to be a reasonable base.

Senator CONNALLY. I was just wondering. You said you were going to substitute a bill. You would not put it any lower than that, eh?

Mr. AMORY. I do not believe you could do it at this time, sir. No.

Senator CONNALLY. Hardly.

Mr. ARMORY. Great Britain has, for many years, used an income tax system with a broad base with the results that proportionately more revenue has been secured and the tax has been much more stable in yield through good times and bad. For example, a comparative study of the British income tax revenue and our Federal income tax revenue, made some years ago during peacetimes, showed, during the 11-year period 1923 to 1933, inclusive, that British income tax revenue varied from a minimum of $1,436,000,000 to a maximum revenue of $1,936,000,000, while in the United States, the minimum revenue secured in this 11-year period was $747,000,000 while the maximum revenue amounted to $2,842,000,000. In other words, in Great Britain the maximum revenue was only 35 percent above the minimum revenue, while in this country the maximum revenue was 280 percent above the minimum revenue.

Thus we are certain that broadening the income tax base would not only result in more revenue, but would make the yield from this source more stable. We believe that stability is greatly to be desired. Our association is also of the opinion that persons having net incomes of from $2,000 to $10,000 annually could pay considerably more tax than proposed in the bill. It should be noted in this connection that the Treasury Department has recommended higher taxes on such incomes.

Having set up a standard schedule of rates, it is suggested that additional revenue requirements be met, so far as individual income taxes are related to the total tax burden, by adding to the tax computed at the standard rates, a certain percentage in times of need, or by subtracting from such standard tax a certain percentage when the Government does not require as much revenue as this standard schedule of rates are imposed should also be standardized.

Such a policy, if carried out, would give certainty, and certainty is one of the cardinal principles of sound tax legislation. This is especially true if we are to have, as we have had during recent years,

taxing statutes which are retroactive over a period of from 5 to 9 months.

2. *Income taxes on corporations.*—According to the Budget message of the President, total income taxes in the fiscal year ending June 30, 1942, will amount to $4,509,500,000 under the law as amended by the Revenue Acts of 1940.

Leaving out of account back tax collections, declared-value excess-profits tax and unjust enrichment tax, the income tax on individuals was estimated to yield $1,604,000,000 and the income and excess profits taxes on corporations, $2,614,000,000. The House bill proposes revisions in rates and in provisions affecting the tax yield which are estimated to result, over a full year of operations, in added revenue from individual income tax of $829,000,000 and from corporate income and excess profits taxes of $1,322,900,000. Thus, under the House plan, our tax system is estimated to yield $2,433,000,000 from income tax on individuals and $3,936,900,000 from income and excess profits taxes on corporations. From the above, the importance of income taxes on corporations is evident since such taxes are expected to yield over 1½ billion dollars more than the income taxes on individuals.

It appears to us that the Federal income tax system applying to corporations is entirely too complicated and places a tremendous burden of expense on corporations in the way of accounting costs and expert advice.

If the existing law is revised as proposed by the House bill, there will be the following taxes of general application imposed on corporations:

1. Normal tax 24 percent.
2. Surtax 5 and 6 percent.
3. Excess profits tax, graduated 35 to 60 percent.
4. Special 10 percent tax based on relation between current year earnings and base period earnings.
5. Declared value excess profits tax, 6 and 12 percent.
6. Defense tax (10 percent added).

In addition to the above, corporations must generally live under the fear of the heavy tax imposed under section 102 in the case of an unreasonable accumulation of surplus (rates 25 and 35 percent). There are, as well, other more specialized income taxes besides numerous excise taxes. Thus, the tax burden on corporations is much heavier than would appear from the consideration of income taxes only.

A corporation is an artificial person. It does not of itself have a heart, or a soul, or feelings, but its stockholders have all of these things. Corporations represent cooperative enterprises and their existence has made it possible for our citizens of small means to invest their money in business, whether those businesses be large or small. The citizens of small means are more likely to invest in the securities of large companies than in those of small ones. This is not an assumption; it is a fact borne out not only by the records of members of our association, but by the experience of various investment services.

In view of this, while our association does not wish to criticize, we are at a loss to understand why the present excess-profits tax has dollar brackets instead of percentage brackets. It seems clear to us that the present system reacts more unfavorably on the small investor than on the large investor. For example, under the proposed bill, if a corporation has an adjusted excess-profits tax net income of

$100,000, it will pay a tax of $41,500, or an average rate of 41.5 percent. On the other hand, if a corporation has an adjusted excess-profits net income of $1,000,000, it will pay a tax of $554,000, or an average rate of 55.4 percent. This will occur in spite of the fact that both realize the same percentage of profit on their invested capital and in spite of the fact that the first corporation may have only one stockholder and the second hundreds of stockholders.

The list which has been given shows that there are six income taxes of general application imposed on corporations. We have no suggestions to make with respect to the normal tax upon corporations and believe this tax should be adjusted to account for the main portion of the revenue yield expected from corporations. We think it would have been better to have imposed a uniform tax on corporations of 30 percent, than to have arrived at practically the same result through the surtax, which appears to have been designed principally for the purpose of placing a tax on partially tax-exempt interest from Government securities.

We now come to the excess-profits tax first imposed by the Revenue Act of 1940 and subsequently amended and now proposed to be again amended. This is probably the most difficult tax of all taxes to design in a manner which will produce equitable results. However, we recognize the Government's need for revenue and also the desirability of preventing profiteering during this period when we are concentrating on enormously increasing our defenses. We can only say that we think this tax should be made as equitable as possible by means of relief provisions, by retaining both the average-earnings method and the invested-capital method of computing excess-profits tax, and, as before stated, by changing the brackets from dollar brackets to percentage brackets. We also think it should be made plain, in view of the unsatisfactory nature of the tax, that this is a temporary tax to be eliminated when the present emergency is over.

With respect to the declared-value excess-profits tax, we believe that this tax should be simplified and, in view of the fact that there is now another excess-profits tax to take care of profiteering and extraordinary profits, that the rates imposed by such declared-value excess-profits tax should merely be high enough to insure the declaration of a fair capital stock tax value, thus avoiding too high a penalty on a wrong guess as to future profits. We believe that the rates established in 1933 accomplished this purpose.

As to the defense tax, which is computed by adding 10 percent to certain other income taxes, we do not think that this is objectionable because it is so easily computed.

Finally, we believe it would be of great benefit to standardize provisions dealing with the computation of net income so that there would be certainty at least as to method in the case of corporate taxes. The importance of maintaining such a standard method of computing taxes, we believe, cannot be overestimated. It will give business the courage to go ahead.

3. *Estate and gift taxes.*—The estate- and gift-tax rates have been substantially raised during the last 8 years and it is now proposed to make a still further increase in rates. It is difficult to see why a man should be penalized for dying in a depression or in a national emergency. We endorse the estate tax and the gift tax, but believe that they should be imposed at rates which could be kept practically

constant. Your attention is also drawn to the fact that the estate tax is ill-adapted for use in an emergency. This is because the tax is not due until 15 months after the date of the decedent's death, and the Commissioner is empowered to grant extensions of time for the payment of the tax, allowing as much as 10 years from the due date for such payment.

We oppose the new rates on gifts, believing that the high rates proposed would discourage gifts and therefore that we will secure less money from this source than if more reasonable rates are retained.

Senator BARKLEY. Of course, that deferred payment may be for some time on the books, but we would gain by the taxes we raised even before the 10 years expired.

Mr. AMORY. Well, we have a suggestion to cover that a little later on here.

4. *Capital stock tax.*— This tax is practically a capital levy, although technically it is an excise tax on the privilege of doing business. The tax is imposed on all corporations doing business whether or not they have any net income. It is dangerous and unfair to raise the rate imposed by this tax to too high a level. The present rate is $1.10 per $1,000 of declared capital stock tax value. The rate now proposed is $1.25 per $1,000. In view of the estimate of only $22,300,000 from this increase, our association believes the present rate should be retained.

Senator CONNALLY. Your association generally deals in stocks?

Mr. AMORY. Sir?

Senator CONNALLY. You deal in stocks? You sell bonds and stocks, do you?

Mr. AMORY. Yes, sir. Bonds and stocks.

Senator CONNALLY. All right.

Mr. AMORY. 5. *Taxes on tobacco and tobacco products.*—These taxes are on nonessentials and while they are now high, they are very much lower than the taxes imposed on such items by most countries. Tobacco taxes are very productive of revenue. The tax on cigarettes alone is estimated to yield $638,000,000 in the fiscal year 1942, even though the House bill proposes no rate increases on tobacco or tobacco products.

Senator CONNALLY. Do you advocate an increase?

Mr. AMORY. We do. We are coming to specific suggestions a little later.

Senator BARKLEY. You are advocating an increase. Do you take into consideration the fact that tobacco and tobacco products, which constitute a very considerable portion of agriculture in this country, are the only products, or the only items in the old tax system that continued to bear the World War taxes after the World War was over, and that that reflected upon the grower of this product whose price is frequently beaten down because the purchasers of it say they cannot pay any more because of the tax? Have you taken that into consideration?

Mr. AMORY. We have, sir. We are not recommending increases of taxes on cigars or chewing tobacco, but we believe, particularly, under the present conditions in this country, where the average fellow is pretty well fixed, working in defense industries, he is not going to question at all paying a slight fraction more for cigarettes.

Senator BARKLEY. I am not going to argue that with you now.

Mr. AMORY. 6. *Liquor taxes.*—Here again we have taxes on nonessentials and we believe the tax rates should be adjusted, as in the case of tobacco. The House bill proposes to increase the taxes on distilled spirits and wines but does not increase the tax on beer. There are revenue possibilities in a further increase in these taxes.

7. *Manufacturers' excise taxes.*—At the present time, we have a fairly reasonable list of excise taxes on specific items such as gasoline, lubricating oil, tires and tubes, electrical energy, cosmetics, and so forth. The House bill proposes to add a considerable number of new excise taxes and also proposes to increase the tax on some of the excises now in existence. With respect to this subject, we believe that nuisance taxes on items producing only a few million dollars of revenue should be eliminated unless such taxes are necessary to put business on a fair competitive basis or to retard the consumption of materials necessary for the defense program.

8. *Miscellaneous taxes.*—We have no suggestions to make on these taxes at this time.

9. *Miscellaneous receipts.*—It is unnecessary for us to discuss receipts from Social Security and employment taxes, or from customs, rents and royalties, permits and licenses, interest, fees, forfeitures, reimbursements, sale of Government property, and realization upon assets, since no change is expected or suggested with regard to such items.

The point has now been reached where it seems advisable to summarize the total receipts of the Federal Government as estimated under existing law—the increased revenues expected from the House bill proposals, and finally, the total of these two classes, which shows the total estimated receipts from existing law as proposed to be amended by the House bill. Such a summary will be found in exhibit I, attached to this statement. A condensed tabulation of the totals shown in the summary referred to is as follows:

Kind of tax or source of revenue	Estimated revenue receipts		
	Budget estimate for fiscal year 1942	Added by House bill	Total annual revenue from revised system
Income taxes	$4,509,500,000	$2,151,900,000	$6,661,400,000
Estate, gift, and capital stock taxes	567,900,000	174,200,000	742,100,000
Tobacco taxes	716,630,000	0	716,630,000
Liquor taxes	839,500,000	127,300,000	966,800,000
Stamp taxes	39,980,000	1,000,000	40,980,000
Manufacturers' excise taxes	666,400,000	386,600,000	1,053,000,000
Miscellaneous taxes	198,925,000	365,200,000	564,125,000
Employment and old-age benefit taxes	961,300,000	0	961,300,000
Total, internal revenue	8,500,135,000	3,206,200,000	11,706,335,000

Our association has the following comments to submit with respect to the proposed tax burden:

First. With respect to income taxes, the bill is drawn so as to be retroactive to the 1st of January 1941. It seems generally conceded that the bill will not pass and become law until September 1941. This means that the bill will be retroactive over a period of nearly 9 months. During this period thousands of business transactions will have taken place and the taxpayer will be in the dark as to how he is to be taxed thereon. Doubtless, other thousands of transactions

will be delayed and, in many instances, never take place on account of the uncertainty which exists. Thousands of individuals living on a salary, not realizing the degree to which their taxes will be increased, will fail to put enough aside to meet their tax payments March 15 next. Corporations will be afraid to spend money in plant expansion when they do not know how much of that money must be retained to meet tax payments. Moreover, new features have been added to their tax troubles, such as the reversal of the present system of crediting normal tax against excess profits tax net income, and such as the new 10 percent special tax. The average tax increase proposed in all income taxes amounts to almost 48 percent.

In view of the above, with full realization of the fact that the Government must substantially increase its revenue, our association believes that the increase in income taxes is too sudden, especially in a retroactive law, and that it would be better to be satisfied with a total increase from income taxes of 40 percent instead of the 48 percent proposed. Of course, this would reduced the increased yield from income taxes proposed in the House bill from $2,151,900,000 to $1,803,800,000, or a loss of $348,100,000. However, we believe this loss can be made up with less disruption of our national economy from other sources. Moreover, we recommend lowering the personal exemptions so as to bring in more taxpayers and increase tax consciousness and also recommend increasing to some extent surtax rates up to $10,000 which we believe are somewhat too low in the House bill. Reasonable changes in exemptions and rates as suggested should account for $100,000,000 of additional revenue, really giving us, instead of $348,100,000, the sum of $448,100,000 with which to make improvements in the bill. The main features which we believe should be modified in this bill and which we believe can be accomplished with the 448,000,000 just mentioned are as follows:

1. The proposition of computing the excess-profits tax on the entire net income and then computing the normal tax on such net income after the deduction of the excess-profits tax seems illogical and reverses the rule of present law which is believed sound.

2. The excess-profits-tax brackets should be expressed in percentages instead of dollars as previously explained.

3. The surtax schedule should be revised and standardized as before mentioned.

4. Reasonable expenses in the management of property should be allowed. Such allowances were granted by the Treasury Department for many years, but since the *Higgins case*, the policy has been changed and the deductions disallowed. If our concept of a fair base of taxation is net income rather than gross, then we should certainly allow expenses necessary in the production of net income.

5. Numerous minor adjustments should be made in the computation of net income in order to produce greater equity. For example, consideration might well be given to alimony payments, a substantially greater credit for earned income, and an extension of the $400 credit for dependents to cover children between 18 and 21 attending college.

Second. Turning our attention now to estate, gift, and capital-stock taxes, we find (by reference to exhibit I) that it is proposed to increase the estate-tax burden by 39 percent, the gift-tax burden by 49 percent and the capital-stock-tax burden by somewhat over 11

percent. There is a real danger in breaking up going and well-managed businesses through the operation of too heavy an estate tax. We suggest, during the present emergency, keeping the rates as in the existing law and adding 30 percent to the tax as computed under such rates with a maximum limit to prevent confiscation. However, we believe the estate should be entitled to receive for this additional 30 percent tax 10-year nonnegotiable Government bonds bearing 2 percent interest. This would be something like the British plan of compulsory loans from taxpayers brought about through the power of taxation. We suggest the same with respect to the gift tax.

Senator CONNALLY. You mean if you tax them 30 percent, you would pay it back in 10 years?

Mr. AMORY. Yes, that answers the question that Senator Barkley asked earlier.

Senator CONNALLY. You would not get much money out of it.

Mr. AMORY. I hope we would have a reservoir of capital in 10 years which might be very useful to the country at that time.

Attention has already been called to the fact that too high rates will result in an embargo on gifts and no money will come into the Treasury in such a case. The unfairness of a high capital-stock tax rate has already been discussed and we believe the present rate should be retained. The loss of present revenue from these changes should not exceed $50,000,000 over the House bill proposals.

Third. With respect to the taxes on tobacco and tobacco products, these are expected to yield $716,630,000 in the fiscal year 1942. The House bill makes no increases in these taxes. In our opinion, these taxes could be increased at least 7½ percent on cigarettes (that is, to 7 cents per package of 20) without coming anywhere near the point of diminishing returns. If this were done, we would secure about $48,000,000 more than is proposed by the House bill from this source.

Fourth. With respect to the taxes on liquor, wine, and beer, these are expected to yield, after the increases proposed by the House bill, $977,600,000. We believe distilled spirits could easily be taxed $1 per gallon more in addition to the $1 per gallon increase proposed in the House bill. This change would bring in about $100,000,000 of additional revenue. We also believe the tax on beer, ale, and so forth, could be increased $1 per barrel without any harm being done, in spite of the fact that the House bill proposes no addtional tax on these products. This would bring in a total of about $50,000,000 of additional revenue. The total added revenue from the suggested changes in rates on distilled spirits and beer would therefore amount to about $150,000,000 more than the House bill proposes to obtain from this source.

Fifth. With respect to stamp taxes estimated to yield $40,980,000 we suggest no changes. The only change made in the bill is an increase in the stamp tax on playing cards.

Sixth. Attention is now drawn to manufacturers' excise taxes. These taxes as proposed by the House bill are expected to yield $1,053,000,000. This represents an increase over existing law, on account of the increased rates and new items proposed of about 60 percent. We suggest eliminating a few of the new nuisance taxes yielding less than $19,000,000 and hardly paying for the cost of their administration.

The gasoline tax is the most productive tax in this group of manufacturers' excise taxes. A tax increase of 1 cent per gallon would raise nearly $260,000,000. We suggest this increase in spite of the heavy taxes imposed on this product by the States because we do not believe either the industry or the consumer will be seriously affected.

Senator TAFT. One cent instead of a half cent in the bill.

Mr. AMORY. A tax increase?

The CHAIRMAN. There is no increase.

Mr. AMORY. There is no increase in the present bill.

Seventh. We have no comments to make with respect to miscellaneous taxes expected to yield $564,125,000 under the proposed bill.

Let us now compare the receipts expected from the House bill plan with the receipts expected from our plan as so far presented.

Kind of tax	Estimated revenue receipts	
	House bill plan	Investment Bankers Association plan
Income taxes	$6,661,400,000	$6,313,300,000
Estate, gift, and capital-stock taxes	742,100,000	692,100,000
Tobacco taxes	716,630,000	764,630,000
Liquor taxes	966,800,000	1,116,800,000
Stamp taxes	40,980,000	40,980,000
Manufacturers' excise taxes	1,053,000,000	1,294,300,000
Miscellaneous taxes	564,125,000	564,125,000
Employment and old-age benefit taxes	961,300,000	961,300,000
Total, internal revenue	11,706,335,000	11,747,535,000

Thus, our association plan produces more than $41,000,000 in excess of the House bill. It is true that the Ways and Means Committee bill produced $323,000,000 more than the sum provided for by the House. This came about through the elimination of the compulsory joint return—a change which we strongly endorse. The Treasury recommended, as an amount necessary to raise through additional taxation, the sum of $3,500,000,000.

That was the Secretary's estimate here Friday, I believe.

To accomplish this purpose, we make a serious suggestion which we believe will produce the required amount and much more without disturbing our national economy.

We suggest a purchase tax similar to the one now employed by Great Britain. What is this tax? Perhaps the best general idea can be gained by quoting as follows from a report to the Joint Committee on Internal Revenue Taxation on the subject of British and Canadian Tax Systems, prepared by Mr. B. C. Brown of its staff and approved by Mr. Colin F. Stam, Chief of Staff, under date of May 21, 1941:

The purchase tax.—The United Kingdom incorporated a purchase tax, or general sales tax, in its taxing system in September 1940. Prior to that time, the British had relied upon the so-called ability to pay taxes, customs and excise taxes on selected articles, for revenue.

Its adoption was based on the "urgent and imperative need both to limit civilian consumption and also to obtain a new source of revenue." It was considered necessary to levy a tax on personal expenditure, or upon the ability to buy, to supplement the existing taxing structure.

The tax was imposed on the transfer from registered dealers (generally wholesalers) to unregistered purchasers and was based upon the wholesale value. Thus the tax falls but once and pyramiding is avoided.

The principles of its application were clearly indicated. Goods were classified into three categories. In the first class, which was to be entirely exempt from the tax, were placed the goods which were considered absolute necessities for people with very limited buying power. This classification includes such expenditures as those for rent, food, gas, electricity, education, domestic wages, coal, children's clothing, machinery and equipment used for farming, and certain medicines and medical appliances. It was considered that these were goods that everyone must acquire.

The second classification was subjected to a reduced rate of 16⅔ percent of the wholesale price, which is said to represent about 12 percent of the retail price. The goods included in this category may be said to fall between the classification of necessities and the luxury classification. It was designed to include goods not in the category of luxuries but which, to acquire, necessitates greater ability to buy than that possessed by the lower income groups.

The third category was designed to include goods in the nature of luxuries, or goods the replacement of which could be postponed until better times. Such goods are likely to be acquired during the war emergency chiefly by people with ample ability to buy. Such goods as furs, real silk, china, jewelry, toilet preparations, and cosmetics were included in this classification, which was subjected to a full rate of 33⅓ percent of the wholesale price, said to represent about 24 percent on the retail price.

Thus it was expected that the tax would constitute a source of considerable revenue and at the same time restrict consumption of those goods most likely to compete with production for the war effort.

It was estimated by the Government that of a national income of approximately $20,000,000,000 only about 20 percent would be affected by the tax, and would produce annually 110,000,000 pounds or about $440,000,000.

The national income for the United Kingdom for the year 1940–41 has been officially estimated at $22,344,000,000. For the period 1941–42 the national income of the United States has been officially estimated at $95,000,000,000. Thus, the national income of the United States is four and one-fourth times the national income of the United Kingdom. We believe that the receipts from the purchase tax would be practically in proportion to the national income.

Senator CONNALLY. If you tax them as heavily as the English, 16⅔ percent——

Mr. AMORY (interposing). No, sir; we do not plan that.

Senator CONNALLY. It would not be four times as much.

Mr. AMORY. The national income is four and one-fourth times as much.

Senator CONNALLY. I know.

Mr. AMORY. If we use the same rate, we get four and one-fourth that is what I say.

Senator CONNALLY. You say four and one-fourth times?

Mr. AMORY. That is right.

Senator CONNALLY. All right.

Mr. AMORY. Inasmuch as the British tax is estimated to produce £110,000,000, or $440,000,000, it seems that we could expect from the same kind of tax here, levied at the same rates, a revenue of $1,870,000,000.

Of course, we would not recommend at present adopting such high rates as are used in Great Britain. However, if we should adopt a standard rate of 10 percent, corresponding to the British rate of 33⅓ percent, and a rate of 5 percent, corresponding to the British rate of 16⅔ percent, we could still figure by means of a purchase tax to obtain additional revenue of $561,000,000. Thus, we would obtain from our plan previously outlined, together with a purchase tax, levied at rates of 5 and 10 percent, $602,200,000 more than is provided for under the House bill, or a total increased revenue of approximately $3,800,000,000.

We believe such a tax is practical and would be beneficial in curtailing civilian consumption, especially of materials and services necessary for the defense program.

Senator VANDENBERG. Would this be in addition to the excise taxes on the same commodity?

Mr. AMORY. It would during the present emergency, Senator Vandenberg; yes.

Before concluding, we also respectfully suggest that you give study to the possibilities of an excess-profits tax on individuals. This might be properly levied on wage and salary increases after the date of the enactment of the act. Such a tax placed at 10 percent of the annual net income increase, would be a substantial revenue producer and would make those individuals fortunate enough to benefit directly or indirectly from the defense program contribute a small share of the benefits received to the Government. The unusual profits of corporations due directly or indirectly to the defense program are taken care of by an excess-profits tax. Profits of individuals and partnerships of any substantial size are taken care of by heavy surtaxes, but the average wage earner contributes under the proposed bill little, if anything, toward the defense program from which he benefits. A reasonable tax on wage increases during this emergency period would, we believe, be justified and would not decrease the wage earner's standard of living since it is only proposed to put a moderate tax on the increase in his annual income.

Senator VANDENBERG. Let me ask you a question at that point.

Mr. AMORY. Yes, sir.

Senator VANDENBERG. I think that is the way to most directly reach the person who has surely the benefit from the defense program, is it not? By exploring the subject with the Treasury Department and with the Joint Comimttee staff, we run into numerous administrative problems. Let me ask you what you would do about this, because I think it is fundamental: What would you do with individual excess-profits taxes? How would you apply them to the wage earner who has no previous wage-earning record?

Mr. AMORY. We suggest an average date on the enactment of the act which gives us a base. This would not apply until salary increases were made in September, from next month on.

Senator VANDENBERG. The new wage earner would just come in, but we would have no previous experience.

Mr. AMORY. I do not see how we could possibly get him, Senator Vandenberg, unless you try some method of having him make a declaration of income under oath, which would be pretty loose, I should think.

Senator BARKLEY. How would you apply it to a man whose employment is not regular, even though he is working in some industry benefited by the defense program?

Mr. AMORY. Such as a carpenter, for instance, Senator Barkley?

Senator BARKLEY. Yes.

Mr. AMORY. We think it should apply to him definitely. He is making, perhaps, three times his normal income.

Senator BARKLEY. If he works all the time, that is true?

Mr. AMORY. If he works all the time?

Senator BARKLEY. Suppose he only works part of the time and you compare the amount of employment and wages with the previous

amount of wages and employment, how could you figure that out? I can understand where a man, working every day, or substantially all the time in 1940, and works all the time in 1941 and gets an increase. I can understand how you could estimate it.

Mr. AMORY. I think there are a lot of difficulties.

Senator BARKLEY. Suppose he works only half time in 1941, or two-thirds of the time, or three-fourths of the time, in either of those years, 1940 and 1941, how are you going to estimate the amount, as to whether that represents the excess salary or earnings?

Mr. AMORY. Would not you have the total amount for the year? Supposing he gets $1,500 in 1940 and $4,000 in 1941, whether he works continually or not, could not you estimate that?

Senator BARKLEY. I assume that would be the difference; it would be a substantial difference, but suppose he got $2,000 in 1941 and maybe $2,500 or even $1,500 in 1941, based upon the number of days or months that he worked, you would find administrative difficulty there.

Mr. AMORY. I think so, Senator. We are making this as a general suggestion for study, because there are obviously a lot of hitches in the plan. I assume you would have to make exemptions for civil-service employees who are on an annual step-up. They are going to be caught up by the income tax anyway by reducing the exemption, broadening the base. It does not seem quite fair to tax them on their increases. We also have definitely in mind, if this can be accomplished, the entire inflationary results it would produce.

Senator VANDENBERG. I might say I have explored this with the Treasury at some length. They said they throw up their hands in the face of the administrative conundrum that they are confronted with.

Mr. AMORY. You do not think it is practical, Senator?

Senator VANDENBERG. That is it.

Mr. AMORY. I think the idea has merit, though, and it should be studied.

Senator VANDENBERG. It certainly has.

Mr. AMORY. Our association also is strongly in favor of curtailing as much as possible expenditures not connected with the defense program and in eliminating unnecessary waste and extravagance in the defense program itself. A dollar saved is equivalent to a dollar of additional revenue. On the question of nondefense expenditures, Secretary of the Treasury Morgenthau made the following statement in his testimony before the Ways and Means Committee on this bill under date of April 21, 1941:

> It seems to me, using round figures, it is possible to cut the nondefense items to the extent of $1,000,000,000.

It is difficult to understand why such a cut is not made, since it would have the same effect on Federal finances as raising $1,000,000,000 of additional revenue.

In conclusion, we would reiterate that there is great need for certainty in our taxing system and also that we believe it most important to design such a system so that it will fairly distribute the tax burden, be not too oppressive on business, and be not so severe as to remove incentive and the profit motive.

(The exhibit submitted by Mr. Amory in connection with his statement is as follows:)

EXHIBIT I.—*Estimated revenue receipts for first full year of operation of revised tax system*

Kind of tax	Budget estimate for 1942	Added by House bill	Total annual revenue from revised tax system
Income tax on individuals (current)	$1,604,000,000	$829,000,000	$2,433,000,000
Income-and excess-profits taxes on corporations (current)	2,614,000,000	1,322,900,000	3,936,900,000
Income-tax collections for prior years	260,000,000		260,000,000
Declared value excess profits tax	29,000,000		29,000,000
Unjust enrichment tax	2,500,000		2,500,000
Subtotal, income taxes	4,509,500,000	2,151,900,000	6,661,400,000
Estate tax	341,700,000	135,900,000	477,600,000
Gift tax	32,500,000	16,000,000	48,500,000
Capital-stock tax	193,400,000	22,300,000	215,700,000
Subtotal, estate, gift, and capital-stock taxes	567,900,000	174,200,000	742,100,000
Tax on cigarettes	638,000,000		638,000,000
Tax on all other tobacco products	78,630,000		78,630,000
Subtotal, tobacco taxes	716,630,000		716,630,000
Distilled spirits	446,200,000	122,300,000	568,500,000
Wines	14,900,000	5,000,000	19,900,000
Beer, ale, and malt liquors	312,700,000		312,700,000
Miscellaneous liquor taxes	35,700,000		35,700,000
Subtotal, liquor taxes	839,500,000	127,300,000	966,800,000
Stamp taxes (total)	39,980,000	1,000,000	40,980,000
Manufacturers' excise tax on gasoline	389,200,000		389,200,000
Other manufacturers excise taxes imposed by existing law	277,200,000	185,700,000	462,900,000
New manufacturers' excise taxes proposed		200,900,000	200,900,000
Subtotal, manufacturers' excise taxes	666,400,000	386,600,000	1,053,000,000
Admissions tax	74,200,000	60,000,000	134,200,000
Telephone and telegraph messages	29,300,000	26,600,000	55,900,000
Sugar tax	60,100,000		60,100,000
Other miscellaneous taxes (old)	35,325,000	4,500,000	39,825,000
New miscellaneous taxes proposed		274,100,000	274,100,000
Subtotal, miscellaneous taxes	198,925,000	365,200,000	564,125,000
Total employment and old-age benefit taxes	961,300,000		961,300,000
Total, Internal Revenue	8,500,135,000	3,206,200,000	11,706,335,000
Customs	295,000,000		295,000,000
All other miscellaneous receipts	176,600,000		176,600,000
Total receipts, General and Special Accounts	8,971,735,000	3,206,200,000	12,177,935,000
Deduct appropriations for Federal old-age benefits, etc.	696,300,000		696,300,000
Total net receipts, General and Special Accounts	8,275,435,000	3,206,000,000	11,481,635,000

Senator CONNALLY. May I ask if you are in the investment-banking business personally?

Mr. AMORY. Yes.

Senator CONNALLY. You are not representing the Investment Bankers' Association as an attorney?

Mr. AMORY. I happen to be the chairman of the Federal taxation committee of the association for the current year.

Senator CONNALLY. Thank you very much.

Senator BAILEY. Now, you are asking us to decrease the rates of taxes on capital-stock transactions and increase the rates on purchases.

Mr. AMORY. That is what it amounts to.

Senator BAILEY. What is your firm?

Mr. AMORY. Smith, Barney & Co.

Senator BAILEY. You might try to apply that purchase tax to stocks and bonds.

Senator CONNALLY. Yes.

The CHAIRMAN. Any other questions?

Senator CONNALLY. What would you say as to a little transaction tax on the sale of securities?

Mr. AMORY. I don't think you would get any money from it.

Senator BAILEY. Well, there has been a substantial increase in stock sales on the market in New York; I believe they are a million shares over last year.

Mr. AMORY. They are still at a very low level.

Senator BAILEY. Well, 3,500,000 shares----

Mr. AMORY. I think the volume is about one-third of what it was 5 years ago.

Senator BARKLEY. You designated this a "purchase" tax in order to get away from the old word "sales"?

Mr. AMORY. No; we didn't. You will notice we didn't strike out the word "sales"; but the British have referred to it as a purchase tax and that is why I used that term.

Senator BAILEY. Well, there isn't any difference between a purchase and a sales tax, is there?

Mr. AMORY. No; it is simply a matter of wording.

Senator CONNALLY. Seriously, you advocate a purchase tax for the reasons you have given; why shouldn't you tax a man when he buys a bond, too? He buys it because he has some surplus capital. If he purchases some article you want to tax that transaction and yet if he buys a bond and it is an investment, you don't want to tax him. Why is that?

Mr. AMORY. There is a certain amount of risk in buying any kind of security, Senator Connally.

Senator CONNALLY. Yes; there is a hazard, too, in buying automobiles or anything else which you agree should be taxed. If you get out on the road and have a wreck there is some risk in that, too.

Senator BARKLEY. One is physical and the other financial, I suppose.

Senator CONNALLY. Yes; one may kill you, and the other may let you live. Is that it?

(No response.)

The CHAIRMAN. Mr. Willever, do you wish to be heard?

Mr. WILLEVER. Yes.

STATEMENT OF J. C. WILLEVER, FIRST VICE PRESIDENT, THE WESTERN UNION TELEGRAPH CO.

Mr. WILLEVER. Mr. Chairman, my name is J. C. Willever, and I am first vice president of the Western Union Telegraph Co.

I am speaking for the telegraph industry as represented by my company, the Western Union, the Postal Telegraph Co., the Commercial Cable Co., the Mackay Radio Cos., and All-America Cable & Radio, Inc., in urging some modification of the tax proposed to be imposed upon telegraphic communications, domestic and foreign.

All of the companies mentioned are desirous of the closest cooperation with the Government in all matters and particularly in the vital matter of national defense. In common with many other concerns

they have long borne without complaint the very substantial burden of collecting and accounting for the taxes assessed against their product. They recognize the imperative need for large additional sums of money to be raised by taxation, and they have no disposition to shirk their part in the necessary money-raising program.

But they do ask that the added taxes assessed against their product shall not be out of line with the increases in other items, and for this very definite and important reason:

An efficient and dependable domestic telegraph and overseas written communication service is an indispensable adjunct to the national defense and it has been so recognized in the composition of the National Defense Board. Anything which tends to impair the efficiency of these services should be avoided at this particular time.

Both services are dependent on volume for prosperity. Western Union in 1926, with a gross operating revenue of $134,000,000, had a net income of $15,000,000. In 1932, with a gross of $83,000,000, it operated at a deficit of nearly $1,000,000. In 1940, with gross revenue of nearly $100,000,000, it had a net income of $3,600,000.

In other words, in 1940 Western Union out of $100,000,000 revenue made $3,600,000 net while, in 1926, with revenue only one-third greater, it made $15,000,000, or five times as much. Nothing could show more clearly than these figures do the importance of volume in the telegraph industry and the disastrous effect of even a moderate shrinkage in revenue.

The present tax is 5-percent on domestic messages and 10 cents each on cablegrams. The proposed law imposes graduated taxes beginning at 5 cents for messages which cost from 25 to 50 cents and increasing to 25 cents for messages which cost between $2.01 and $2.50, plus 5 cents for each additional 50 cents or fraction thereof. We have applied these increased taxes to taxable traffic originating on July 23 at Atlanta; Boston; Chicago; Cumberland, Md.; Dallas; Denver; Grand Rapids, Mich.; Green Bay, Wis.; Harrisburg, Pa.; Lexington, Ky.; Richmond, Va.; Salt Lake City; San Francisco; Springfield, Mo.; and Tacoma, Wash. These places represent, in general, one large, one medium, and one small-sized place in each of our operating divisions.

The volume embraced in the study represents 14 percent of the total volume throughout the country, thus constituting a reliable sample. We find that the percentage increase in the tax on domestic messages ranges from 134 percent at San Francisco and Tacoma to 168 percent at Lexington. The average increase is 151 percent and it is safe to say that this average will apply to our domestic traffic as a whole. The increase in the case of cablegrams is 346 percent.

A study which has been made shows that the proposed tax as applied to domestic telegrams is equal to 13.1 percent of taxable tolls and on Western Union cablegrams is equal to 10.5 percent of the gross through charges. Actually, as a percentage of the tolls retained by the American companies on overseas messages, the tax amounts to 20 percent in the case of Western Union and in the case of Postal, which participates only as to land-line charges, it is in the neighborhood of 80 percent.

In the case of the radio companies, which customarily split on a 50-50 basis with foreign stations, the tax is in the neighborhood of 20 percent.

It is the considered opinion of the industry that the traffic will not stand so heavy an impost and that if the tax is increased to the extent proposed in this bill there will be a further diversion of traffic to the air mail, which, in addition to being heavily subsidized by the Government, is not subject to any tax.

Notwithstanding the heavily increased traffic in 1940 due to abnormal conditions, Western Union made only $3,600,000. Postal operated at a loss. The cable business, except to South America, is badly shot, due to conditions overseas. None of the other companies which I represent is making a fair return upon its investment, notwithstanding the present temporary bulge in traffic.

Like industries generally, all the companies which I represent are under pressure from their labor for more money. If wages are increased and if as a result of excessive taxation the business does not hold up, necessary retrenchment measures will injuriously affect the service. Some of the companies may be driven to the wall.

As to the effect of excessive taxation on volume, I quote as follows from a letter written by President Chinlund of the Postal Co. to Chairman Doughton of the House committee in reference to this bill. I may say in passing that that letter, like a similar letter written by my chief, unfortunately did not reach the committee until after it had disposed of the bill.

The CHAIRMAN. Were you represented in the House?

Mr. WILLEVER. No; we were not represented there at all.

I am now quoting from the letter:

> In 1937 the Federal Communications Commission, in denying a rate increase to the telegraph companies, stated as one of the reasons for such denial that "we are not satisfied that the anticipated increase in revenues would not be offset by the permanent loss of traffic to lower-cost services of the petitioners and to competing carriers."

It is urgently suggested that the tax on telegrams should be fixed at not more than 10 percent or double the present tax and that the tax on overseas messages should be fixed at 5 percent, which would be double the present tax and would represent around 10 percent on that proportion of the tolls on such messages which accrue to American carriers.

Senator CONNALLY. Why is it suggested that the tax on domestic telegrams be so much more than the tax on overseas messages?

Mr. WILLEVER. That proposal has in mind the fact that the charges of the connecting lines beyond this country sometimes are two or three times that of the American companies.

The CHAIRMAN. All these charges are passed on to the public.

Mr. WILLEVER. Yes.

The CHAIRMAN. But your point is that you reduce your volume of business thereby?

Mr. WILLEVER. That is the point, sir.

Senator VANDENBERG. What is the revenue under your proposal as compared with that of the House?

Mr. WILLEVER. I haven't figured that. It is three-thirteenths of what is anticipated. For all the companies, about $3,000,000, my associate tells me.

Taxes so established would have the merit of progressing proportionately with the cost of communications, while the proposed tax as applied to domestic messages ranges from 20 percent to 10 percent, decreasing percentagewise as the cost of the communication rises.

Such a result cannot possibly have been in contemplation by the persons who drafted the tax measure, and it is strikingly shown on the chart which I exhibit and a copy of which is now before you.

While it has nothing directly to do with the case, it is perhaps not out of place to call the attention of the committee to the fact that the telegraph companies are carrying a heavy burden of contributions to the Government by being paid for a preferential service only about 60 percent of their regular rates.

This burden is increasing rapidly as the volume of telegraphing done by Government agencies expands with increasing activity in defense measures, to say nothing of the heavy telegraphing of private contracting concerns operating under cost-plus contracts which are claiming Government rates on their messages with the support of the Government agencies involved.

What this 60-percent rate means will be better appreciated if it is understood that about 63 cents of each dollar of telegraph revenue is disbursed for wages, social-security taxes, pensions, and other employee benefits. As contrasted with this reduced rate on its telegrams the Government pays the telephone companies 100 percent of their regular rates for telephone service, which is another principal competitor of the telegraph service.

Incidentally, the teletypewriter service of the telephone company, which is a written-message service competitive with the telephone companies', as well as the tax on its leased wires, which is another form of written service, is, under the bill under consideration by your committee, subject to a tax of 5 percent as against the proposed 13.1 percent on the traffic of the telegraph carriers. Obviously the tax, at whatever figure it is fixed, should be the same for all carriers and for all forms of written service in the domestic field. Under the present law this condition exists.

The plight of the telegraph industry and the reason why the volume of its traffic should not be needlessly curtailed by excessive taxation thereon has probably never been better stated than by Chairman Fly of the Federal Communications Commission in his recent testimony before a special subcommittee of the Senate Committee on Interstate Commerce holding hearings under Senate Resolution No. 95, which statement is as follows:

> Competition and other facts have driven the two major telegraph carriers to the point where their very existence is in jeopardy. The national defense, the interests of employees, and other considerations make it undesirable that we should permit either to be forced to the wall * * *.
>
> Here, to sum up, we have a picture of two telegraph companies competing desperately with one another and simultaneously faced with overwhelming competition from the telephone, radio-telegraph, air mail, and Bell System telegraphic services.

In conclusion I draw attention to the fact that except on special occasions such as Christmas, New Year's Day, and so forth, fully 90 percent of all telegrams or cablegrams are of a business nature. The same consideration which prompted omission of a tax on freight shipments because they are so largely made in pursuance of business should supplement the plea of the telegraph carriers that the tax on telegrams and overseas messages shall not be unduly increased lest their traffic be so affected that they will be unable to function in an adequate and satisfactory manner.

The study that I have referred to is reflected in a synopsis attached to this statement. In addition we have brought with us and will leave for the consideration of the committee or Treasury Department the details of the study so that you may be satisfied our computations are correct.

Senator VANDENBERG. How much does it mean to the Government to enjoy this 60-percent preferential rate?

Mr. WILLEVER. What it means depends on the volume. It is very substantial, I know. In the cable field, where it was minor, it has now become major. In the domestic field, where the Government gets 60-percent preferential, the amount involved is very large and runs into the millions of dollars.

Unfortunately, I am not prepared to answer the question exactly.

Senator VANDENBERG. I should think it would be a very good figure for you to present to help your own cause.

Mr. WILLEVER. I will be glad to supply it.

(The information requested is as follows:)

U. S. Government domestic and overseas traffic handled by major telegraph, cable, and radio companies at preferential Government rates, 12 months ended June 30, 1941 (Radio Corporation of America communications for year ended Dec. 31, 1940)

	Domestic traffic including land-line tolls on overseas traffic	Overseas traffic beyond borders of United States	Total
Estimated revenues calculated at commercial rates	$3,695,031	$1,048,892	$4,743,923
Revenues charged for at preferential Government rates (average about 60 percent for domestic messages and 50 percent for overseas messages)	2,271,661	524,446	2,796,107
Estimated amounts saved by the U. S. Government through application of preferential Government rates, which amounts are lost to the record communication companies	1,423,370	524,446	1,947,816

This data represents the aggregate results submitted by the Western Union Telegraph Co.; Postal Telegraph, Inc.; All-America Cables & Radio, Inc.; the Commercial Cable Co.; Mackay Radio & Telegraph Co. (Delaware); Mackay Radio & Telegraph Co. (California); Radio Corporation of America Communications, Inc.; the Commercial Pacific Cable Co.; and the Mexican Telegraph Co. Companies not included are: French Telegraph Cable Co.; Globe Wireless, Ltd.; Northern Telegraph Co.; Press Wireless, Inc.; Radiomarine Corporation of America; Tropical Radio Telegraph Co.; and U. S.-Liberia Radio Corporation, and certain smaller companies whose annual operating revenues do not exceed $50,000.

Senator CONNALLY. What rate does the Government get on commercial business?

Mr. WILLEVER. Fifty percent.

Senator CONNALLY. What salary does the president of Western Union receive?

Mr. WILLEVER. $60,000.

I made a statement awhile ago which was erroneous; I stated that the changes in the bill proposed by us would effect a difference in the amount involved. It is $1,600,000 instead of the larger figure I mentioned.

Senator GUFFEY. How does the tax on telephone transactions compare with that on telegrams?

Mr. WILLEVER. It is the same.

Senator GUFFEY. When does the tax start?

Mr. WILLEVER. Twenty-five cents or twenty-four cents, and runs indefinitely.

Senator GUFFEY. And where does the tax on telephone service start?

Mr. WILLEVER. The same as telegrams, the difference being that the telephone companies are very prosperous and extraordinarily so at the present time and their business can stand a tax that under the present conditions the telegraph companies could not.

Senator CONNALLY. Do you make any money on Government business with foreign countries?

Mr. WILLEVER. I don't think so, but that was an obligation imposed on American carriers by Great Britain when the cables were laid between the United States and Great Britain, and although at that time we were under no obligation to extend the benefit to the American Government we felt we should put the American Government on a most-favored-nation basis and not treat it any different from the Government of Great Britain.

Senator CONNALLY. With this increase in Government business you ought to know whether you are or are not making any money as a result of it.

Mr. WILLEVER. We are losing money on the cable business as a whole; there is no question whatever about that. At the 50-percent rate the Government business is on substantially a parity with the commercial business, which is largely made up of business on the deferred rate, so that the Government business, which is not, is therefore about on an average with the commercial business.

Senator TAFT. Don't you feel that by reason of the reduced rate Government officials use more words?

Mr. WILLEVER. I don't know that that is so; I think they are quite liberal users of the service. I don't know that they pay much attention to the use of words.

Senator VANDENBERG. Government officials always use more words; don't they?

Senator CONNALLY. They don't handle the Senate debates.

The CHAIRMAN. Anything else?

(Mr. Willever submitted the following tables and chart for the record:)

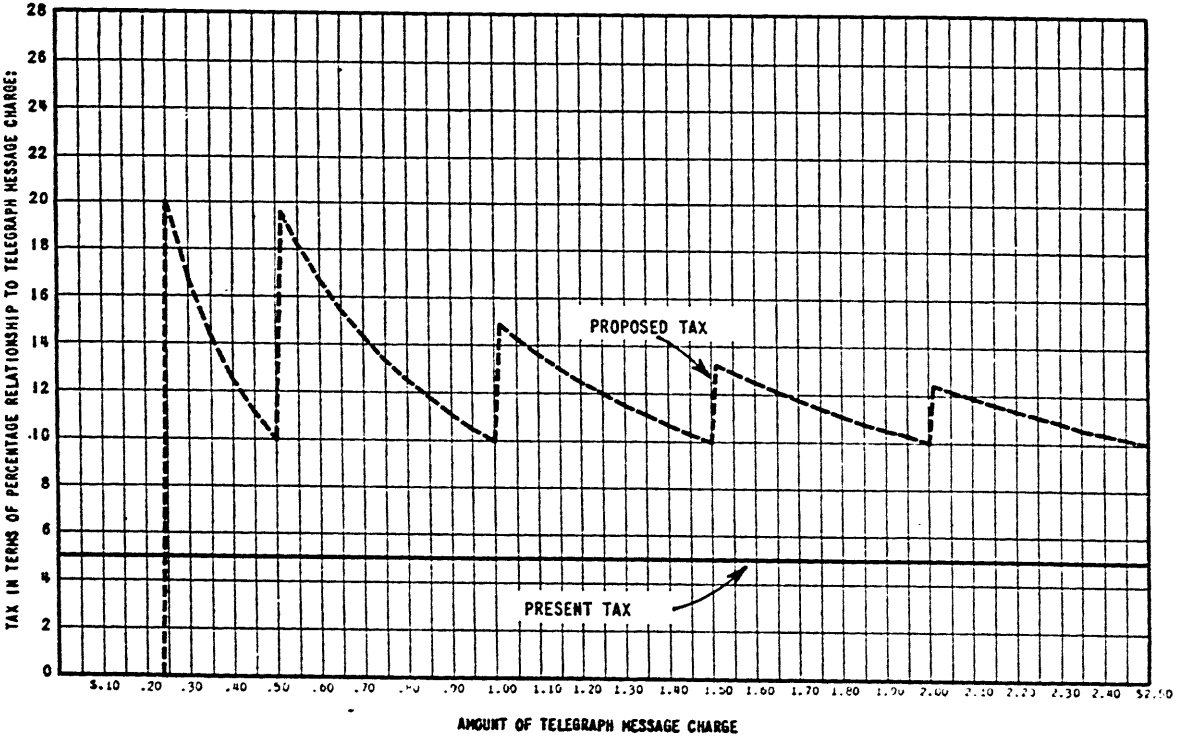
Summary of exhibits showing by offices listed telegraph message charges and present and proposed message tax thereon for traffic dated July 23, 1941

Exhibit binder No.	Office	Taxable telegraph message charges (commercial telegraph tolls)		Tax under present law		Tax under proposed law			Increase in proposed law	
		Present law	Proposed law	Amount	Percent to taxable charges	Amount	Percent to total telegraph charges	Percent to taxable charges	Amount	Percent
1	Atlanta, Ga	$2,786.45	$2,753.78	$143.09	5.1	$366.60	13.2	13.3	$223.51	156.2
2	Boston, Mass	5,230.09	5,147.09	270.83	5.2	692.50	13.2	13.5	421.67	155.7
3	Chicago, Ill	15,193.75	14,899.61	776.32	5.1	1,971.20	13.0	13.2	1,194.88	153.9
5	Cumberland Md	77.41	73.41	3.98	5.1	10.00	13.0	13.6	6.02	151.3
1	Dallas, Tex	2,432.41	2,407.23	125.26	5.1	311.80	12.8	13.0	186.54	148.9
5	Denver, Colo	2,280.18	2,268.55	117.90	5.2	289.90	12.7	12.8	172.00	145.9
5	Grand Rapids, Mich	605.56	597.26	31.27	5.2	82.55	13.6	13.8	51.28	164.0
5	Green Bay, Wis	152.71	150.45	7.88	5.2	20.55	13.5	13.7	12.67	160.8
5	Harrisburg, Pa	320.25	316.25	17.14	5.4	44.05	13.8	13.9	26.91	157.0
5	Lexington, Ky	241.47	241.23	12.47	5.2	33.45	13.9	13.9	20.98	168.2
5	Richmond, Va	827.13	813.91	42.99	5.2	111.40	13.5	13.7	68.41	159.1
5	Salt Lake City, Utah	949.51	944.16	48.98	5.2	121.65	12.8	12.9	72.67	148.4
4	San Francisco, Calif	5,163.01	5,092.90	263.85	5.1	617.40	12.0	12.1	353.55	134.0
5	Springfield, Mo	178.35	177.31	9.13	5.1	24.45	13.7	13.8	15.32	167.8
5	Tacoma, Wash	347.90	345.00	18.08	5.2	42.30	12.2	12.3	24.22	134.0
	Total	36,786.18	36,228.14	1,889.17	5.1	4,739.80	12.9	13.1	2,850.63	150.9

Summary of exhibits showing by offices listed cable message charges and present and proposed message tax thereon for traffic dated July 23, 1941

Exhibit binder No.	Office	Cable message charges (cable tolls)	Tax under present law		Tax under proposed law		Increase in proposed law	
			Amount	Percent to charges	Amount	Percent to charges	Amount	Percent
6	Atlanta, Ga	$18.35	$0.50	2.7	$1.90	10.4	$1.40	280.0
6	Boston, Mass	484.78	12.90	2.7	51.50	10.6	38.60	299.2
6	Chicago, Ill	713.68	13.90	1.9	74.25	10.4	60.35	434.2
6	Cumberland, Md	3.84	.10	2.6	.40	10.4	.30	300.0
6	Dallas, Texas	215.60	3.90	1.8	22.35	10.4	18.45	473.1
6	Denver, Colo	30.22	1.10	3.6	3.30	10.9	2.20	200.0
6	Grand Rapids, Mich	2.10	.10	4.8	.25	11.9	.15	150.0
6	Green Bay, Wis							
6	Harrisburg, Pa	3.10	.10	3.2	.35	11.3	.25	250.0
6	Lexington, Ky							
6	Richmond, Va	41.74	1.10	2.6	4.40	10.5	3.30	300.0
6	Salt Lake City, Utah	11.30	.30	2.7	1.20	10.6	.90	300.0
6	San Francisco, Calif	869.73	22.80	2.6	91.90	10.6	69.10	303.1
6	Springfield, Mo							
6	Tacoma, Wash	26.62	.20	.8	2.70	10.1	2.50	1,250.0
	Total	2,421.06	57.00	2.4	254.50	10.5	197.50	346.5

COMPARATIVE CHART SHOWING TELEGRAPH MESSAGE TAX IN TERMS OF PERCENTAGE RELATIONSHIP TO TELEGRAPH MESSAGE CHARGE, UNDER PRESENT AND PROPOSED REVENUE ACTS.



The CHAIRMAN. Mr. Hyman.

STATEMENT OF ARTHUR B. HYMAN, NEW YORK, N. Y.

Mr. HYMAN. I may be alone in my class here. I don't speak for anybody; I represent no one. I come to give the views I have developed out of long experience in the practice of the law and particularly one which has been devoted to practice before the Treasury Department.

I have had a very considerable experience in the matter of taxation and I am not prepared to submit in final form a memorandum which I started the preparation of last week and which I have added to in the last few hours.

I shall try to be as brief as possible. I want to make my position clear at the very outset because the impression might arise that I was in favor of curtailing expenditures for the national defense; nothing of that kind is on my mind.

On the contrary, it would not make a particle of difference to me if the necessity were five times as great; I would still think that necessity ought to be met and that whatever funds had to be raised should be raised to meet the necessity.

But there are several things that enter into that consideration and the first, it seems to me, is that when we started to and signified our willingness and readiness to accept any sacrifices that must be faced in the emergency, we have the right to expect that the cost of the defense program will be borne in the soundest manner and that we won't be called upon to make sacrifices that are not absolutely necessary.

In other words, what I wish to convey is that every consideration be accorded to us who must bear the burden, and I have heard so much from members of this committee as well as from members of the House committee to the effect that we must raise all the money that is possible, but I have not yet heard anyone say that we ought not raise any more than is absolutely necessary.

Now, having that in mind, it seems to me that we have gotten off to a wrong start. When we came to consider financing the cost of this defense program we started with the notion, I believe, that it should be financed in the proportion of two-thirds by taxation and one-third by borrowing.

I suppose that is an arbitrary figure and no one could give us any good reason why so vast a part of the expenditures necessary should be raised by direct taxation.

If, as I am informed, we proceeded on another theory in the World War and financed our expenditures by raising one-third by taxation and two-thirds by borrowing, I cannot see any reason why we should not follow that procedure at this time.

Senator BAILEY. At the start of the World War the Government began owing very little; now it has a debt of $44,000,000,000 or $45,000,000,000.

Mr. HYMAN. I appreciate that, but it still seems to me, as a matter of common logic, that there is a point you must consider in this connection, and that is: How much ought, in good conscience, to be borne at this time and how much spread over a longer period of years and be faced in the future?

In other words, you reach a point where you just cannot take it; the tax burden becomes so heavy you cannot handle it; it bogs down. And in the meantime you have suffered very seriously.

Senator BAILEY. The Secretary of the Treasury fixed the ratio of two-thirds and one-third on the proposition that was necessary to present inflation.

Mr. HYMAN. I wonder if that is a proper approach to the problem. I have never considered that a bill to raise revenue was anything but a bill for that purpose; I do not think it should be punitive or that fears, such as the fear of inflation, should be primarily considered.

Senator CONNALLY. You don't think any economic considerations ought to enter into it?

Mr. HYMAN. Oh, in a remote sense; yes.

Senator CONNALLY. Then, in the interest of the time allotted to you, I suggest you get down to cases and tell us what you want to do.

Mr. HYMAN. All right; I will do that.

When I prepared the memorandum I had no intention of discussing the joint returns. I supposed that anything that appears to me quite so pernicious and indefensible as that, after it had been deleted by the House, would not come up again for consideration by the Senate.

Senator CONNALLY. You are bringing it up; it hasn't been mentioned.

Mr. HYMAN. The Secretary of the Treasury brought it up and said a good deal about it and that is what impelled me to make a memorandum on the subject.

I don't want to take up time unnecessarily, but I do want to advert to the arguments that have been advanced. Senator Barkley brought up one of them; he pointed out that we had been striving for many years to establish the independent status of a man and his wife and such a tax goes contrary to that tradition.

It goes more than that; it violates the idea that an income tax should be levied on the person who received the income, not to be measured by the income received by someone else.

Now, I pass that. He recommended and I have heard recommended here also a reduction in exemptions. It has been my theory that exemptions, general exemptions, personal exemptions, are unsound in themselves. They are a matter of grace, representing a luxury the Government might indulge in when there is no great emergency threatening us and when we are endeavoring to reach tremendous sources of income for Government purposes.

In my opinion the Treasury has not gone far enough, nor the gentleman representing the American bankers, the Investment Bankers Association. My own notion is that exemptions should be entirely abolished; that we cannot afford them; and that such money is a sound way of raising income.

Senator CONNALLY. How much would you tax a person getting $10 a month?

Mr. HYMAN. Oh, I suppose there are cases in the United States where men are earning $10 a month.

Senator CONNALLY. Well, some are not earning anything at all.

Mr. HYMAN. That is right; but they won't pay anything, either. We should start with a minimum of 1 percent. Starting low enough, it is not going to hurt anyone very materially.

For example, take a man earning $1,000 a year.

Senator CONNALLY. We are going to tax him under this bill.

Mr. HYMAN. Yes; after an exemption of $750. I say that exemption is not sound and I say it should be either abolished completely or substantially reduced. There have been two arguments advanced against that, one political and the other economic.

That it would be difficult of collection. I don't think that is a sound argument. We have had experience with withholding the tax at the source and I think we can reach all sources of income by the proper application of that principle.

The CHAIRMAN. Excuse me.

For the benefit of the members present, the leader, Senator Barkley, advises me that he will call the calendar, so that, when we recess, around 12 o'clock, we will come back at 2 o'clock.

All right. Proceed.

Mr. HYMAN. Now, there is another thing which I call luxury under the present circumstances that we are indulging in and which I think ought to be eliminated, and that is the exemption for earned income.

I think that the fundamental difference between earned income and income from other sources is not so important or so great that we should perpetuate it; I think it could be well eliminated and we could wait for happier times to grant such exemption.

Now, no one has taken up the question of excess-profits taxes, assuming, suppose, that the House views will be followed in the Senate.

I have only to say that I think the alternative method of computing excess profits is a very sound one. It eliminates many of the unfortunate experiences we had under the act of 1918 and it will not leave those so unfortunately placed as to be amenable to it to the tender mercies of the collecting authorities.

The CHAIRMAN. Do you agree to the principle of the 10 percent as contained in the House bill?

Mr. HYMAN. I don't know as to that specifically; I was speaking of the fundamental question of taxation.

The CHAIRMAN. Your theory is that this is a sound or at least an advisable method?

Mr. HYMAN. Yes; it is.

The CHAIRMAN. Of course, you have to have some standard.

Mr. HYMAN. Yes; but the alternative method, it seems to me, does pay some attention to what really constitutes excess profits.

Now, another thing which has not been touched upon here: I suppose I am going to be on very controversial ground again when I ask the committee of the Senate to explore again the capital-gains tax. I think there is a source of revenue that we have not nearly begun to explore, and I think the difficulty lies in the fact that we have always taxed them on too high a rate. I have entertained that view and expressed it more times than now. I have written before to the Senate Finance Committee and the House Ways and Means Committee.

I think the capital-gains tax is helping to defeat its own purpose. Just taking a glance at the record of transactions on the New York Stock Exchange, alone, it seems to me, will bear out that notion.

In my opinion, 350,000- and 400,000- and 500,000-share days on the New York Stock Exchange are just as abnormal as 8,000,000-, 9,000,000-, and 10,000,000-share days were in the panic of 1929 and 1930, and transactions in securities are being very much curtailed.

There is no doubt that the high tax rate is a serious deterrent to such transactions.

Senator BAILEY. The same is true, is it not, of transactions in real estate?

Mr. HYMAN. Yes. I use this only as an illustration. Two or three of these types illustrate to me better than anything else the old theory that you can defeat your desired end of raising revenue by putting excessive taxes on the transactions.

I say that there is nothing so conducive to the prosperity of this country, and that means conducive to the raising of additional revenue, as open trading to the utmost possible limits.

Now, if we could get what appears to me, just as a guess, normal trading of about 2,500,000 or 3,000,000 shares on the New York Stock Exchange daily, which many people think would be quite normal, the revenue raised from the capital-gains tax, if it was reduced two-thirds, say, would produce revenue, in my opinion, beyond the wildest dreams of the most optimistic.

Not only is that so but there is a tremendous amount of money being lost in stock-transfer transactions both by the Federal Government and State governments, estimated by the New York taxing authority at $200,000,000 a year. Whether that is extravagant or not I do not know, but I know this:

We haven't a thing in the world to lose by adopting the theory of reducing the tax on capital gains to see if, in 1 year, we do not realize the promises made in that connection.

In my memorandum I suggested the outright repeal of this tax but I know at this time, under the conditions existing, that such is not possible, and I therefore suggested, as a compromise, we try the reduction in the rate of tax on capital gains.

When you have an active market those securities pass from hand to hand so many more times and each time the transaction produces revenue.

Senator BAILEY. Would you make a distinction between a speculative transaction and an investment?

Mr. HYMAN. I would not; there isn't any difference. Every time anyone purchases a security he does it, of course, for purposes of sound income, which involves stability; but there is an actuating motive all the time, which is the profit motive.

He thinks that this is a fine stock and some time that stock is going to be worth, 25, 50, or 100 times more than when he bought it; so the speculative element is there anyway.

Therefore, why say if you buy and sell a stock within 12 months you have engaged in a speculative transaction whereas, if you keep it for 2 or 3 or 5 years, you have not? They should be put on a parity and a flat rate levied upon them.

Now, the next proposal I wish to make is one already adverted to; that is in regard to gift taxes. And almost the same thing might be said as to it that was said of the capital-gains tax.

We presumably levied a gift tax in 1932 for the purpose of deriving revenue from that source; at least, it was so said.

The CHAIRMAN. It was to make the estate tax effective.

Mr. HYMAN. Of course, it was needed as a complement to prevent the avoidance of any estate tax whatever, but they put a three-quarter tax on gifts in relation to the tax on estates for the purpose, so it was said, of realizing revenue by the Government.

Senator BAILEY. With the gift tax abolished and your proposal on the separate-returns question, every man would immediately give one-half of his income to his wife. Now, where would you get your revenue?

Mr. HYMAN. Are you asking me on the basis of adopting or failure to adopt the joint return?

Senator BAILEY. Staying where we are now, when a man has an income of $75,000 and you have abolished the gift tax——

Mr. HYMAN. Oh, no.

Senator BAILEY. You do not propose to abolish the gift tax?

Mr. HYMAN. No; I want to maintain it. But what I do say is the gift-tax revenue has bogged down. And why has it? Because it is almost impossible for a man to make a taxable gift today without he makes a complete delivery and divests himself of every incident of ownership.

Now, if you want to have the revenue from gifts, why do we not put a lower rate than presently maintained and why don't we tax every kind of gift whether in trust, revocable, or irrevocable, or any other kind?

And if, in one instance that I visualize, the trust is so drawn that the corpus finds its way back into the hands of the settler, make provision that upon his death proper credit may then be given.

I wouldn't think it was a serious matter even if you kept the rate; I only believe a lower rate will increase the revenue.

At any rate, the object I am after is—and if you just read the gift-tax statute and the estate-tax statute, supposed to be complementary of course, you will find, whereas you intended to encourage gifts, you have made it practically impossible to have them; you will find the wealth of litigation which has developed from them.

The Supreme Court, the circuit court, and the Board of Tax Appeals are busy day after day trying to solve the problems created by penny chasing, and that is what I call the habit of the Department; penny chasing; always worried lest somebody escape with $10 that he might have paid for a gift tax.

You will find that; and I could demonstrate it to you in scores of ways. There has been this constant rush to the House and Senate for amendments because some individual was ingenious enough to get away with a little tax.

I say if you will broaden out the gift tax and make it apply to all transactions you will encourage gifts. By so doing you will derive the revenue which you are not getting now. And I tell you that many people would welcome an opportunity to put their houses in order instead of facing the chaos which they know will be present at the time of their death.

Now, some years ago I suggested that the most effective method of taxation, in my opinion, would be based upon income and sales. This gentleman called it a purchasing tax, a distinction, I think, without very much difference. But the point of the matter is that if we had those two basic methods of raising revenue I think we would be in a position where we could go on without constant revision and constant upping of tax rates, constant unsettlement which business suffers from this sort of thing; we would establish a stable system of taxation based, on the one hand, on income, and, on the other, on sales.

Now, there may be lots of arguments made against it, partly economic and partly political, but it seems to me that a very low rate of tax applied to sales would produce a tremendous amount of revenue without upsetting our system or shocking it in the slightest degree.

Sometimes it is said if we are going to tax on the ability to pay that is not one of the forms we should adopt. Not, that is not true because we overcome any objections of that kind by a graduating of the scale. Therefore those two systems, if worked together, would be effective as compensating each other.

If our incomes were down and thus revenue from that source were lowered, it would be upped from the sales side; whereas, when we are prosperous and revenue from income or other form of taxation is sufficient, the rate on sales could be lowered.

In other words, the two seem to me to be natural avenues of revenue.

Senator BAILEY. You would put that tax on food and clothing?

Mr. HYMAN. No; I would exempt food. I would want to give consideration to clothing. But food, medicines, and those things that are absolutely necessary, I think, should be exempt.

After all, we are paying a terrific sales tax already and the poor are getting it as well as the rich every time they buy anything in the long list of things that are subject to excise taxes, which are sales taxes under another name.

Senator BAILEY. The sales-tax revenue now is something better than $2,000,000,000.

Mr. HYMAN. Yes; and it could be made much greater, and it would be easy to collect; and that is certainly one objective to be sought. Then, furthermore, I think one of the members of the Ways and Means Committee remarked that you were coming to it anyway, probably next year, when further revenue would be necessary; and, if that is so, I don't see any reason why we should postpone that day. If it is to come eventually, why not now? In my opinion, it should have come many years ago.

I think I have covered the major things that I wanted to present. If I may have the privilege, I would like to complete the memorandum and submit it.

The CHAIRMAN. You may do that.

(The memorandum submitted by Mr. Hyman is as follows:)

MEMORANDUM ON PROPOSED REVENUE ACT OF 1941

By ARTHUR B. HYMAN

To the Finance Committee of the United States Senate:

We approach the consideration of a new tax bill again under the pressure of an emergency. Hasty and ill-advised legislation might reasonably be expected under such circumstances, but since emergency legislation has come to be the rule rather than the exception, we should by this time have acquired the virtue of being able to give calm and considered judgment to this subject.

At the outset, I wish to make my position clear. We are engaged in an all-out program of national defense. Whatever price we have to pay is not too great, but when called upon to make the sacrifices that are necessary (and they will be very great), the people are entitled to have their representatives approach this subject not, as seems to be the case, with the idea of raising all the money that is possible, but, rather, with a fixed determination to raise no more than is absolutely necessary, and even that in a manner that will least affect their well-being.

It is almost a truism to say that the most desirable method of raising revenue is that which occasions the least shock to the economic system. There was a time when Congress considered that objective to be paramount. Under the

pressure of constant emergencies, however, it has apparently been relegated to the background, although lip service is paid to the concept (Ways and Means Committee Report, p. 3).

The Ways and Means Committee expresses the hope that the immense burden of the new levies will be met cheerfully by the American people, and that the people realize that the risk to life and property from inadequate preparedness would make a much heavier burden attractive by comparison.

The latter of these observations is fully justified, and there is no doubt that the American people will accept whatever burdens may be properly imposed upon them for the purpose of financing the program. They have the right to demand, however, that the burden be properly distributed, that is to say, that a fair proportion of the cost be raised by taxation and a fair proportion by borrowing.

Expenditures for defense have reached astronomical figures. Their necessity is not questioned. In a program of such magnitude, however, it is obviously impossible to raise the sums required by any reasonable method of taxation. The question, therefore, immediately arises: How much of the burden can be carried by taxation without oppression, or, perhaps, how much of it can be carried by taxation without injury to the economic system?

Prior to our embarkation upon the defense program, expansion of governmental activities had tremendously increased the burden of taxation imposed upon the people. Their willingness to meet these new exactions was inspired by a thorough realization of their necessity. This spirit should not be imposed upon, nor will it endure in the face of a realization that they have been saddled with an unnecessary burden or one greater than they should be called upon to bear.

The Revenue Acts of 1940 made the prior impositions pale into comparative insignificance. It is now proposed to further increase this burden by raising, through taxation, an additional 3½ billions of dollars. If this is necessary, the people will bear it cheerfully. But the Congress must not mistake their attitude or suppose that they will permit themselves to be oppressed or exploited. There is no convincing evidence of the need for raising the additional sum sought by the administration. It is a matter of great concern that Congress has reached so complacent a state of mind in regard to expenditures that unlimited sums are made available upon the mere request of the administration. Something is obviously wrong with the picture.

In 1939, President Roosevelt declared in his Budget message to Congress that Treasury figures, based upon the proposals then before the Congress, indicated that if the Nation's income reached $90,000,000,000, the yield would be $10,600,000,000.

Since that time, approximately 1½ billions have been added under the Revenue Act of 1940. The Treasury estimates that the national income will reach $90,000,000,000 this year. On that basis, the yield will be only a few hundred millions less than the amount which the Treasury estimates require. Why, then, should the Congress impose upon the people's patriotism by adding further to burdens already becoming too onerous? It would be a national calamity to destroy the confidence of the people that their representatives will at all times zealously guard them against profligacy and call upon them for sacrifices only when the need for such sacrifices arises.

A further and most important consideration also enters into the situation. In the report of the Ways and Means Committee, it is pointed out that the expenditures in the World War were financed one-third by taxation and two-thirds by borrowing. The defense program is not for the benefit of this generation alone. There is no sound reason why it should bear a disproportionate part of the expense of it. If the financing of the World War was accomplished by taxation and borrowing in the proportions of one-third and two-thirds, respectively, why, in the face of the heavy burden already imposed by the act of 1940, should those proportions be practically reversed in connection with a program far more extensive and for more enduring?

Justification is sought for this in the fact that our national debt at the beginning of the World War was unimportant in contrast to that which now exists. That is a factor that must be taken into consideration, but it falls very short of adequacy to justify the imposition of so great a burden of taxation upon the present generation of taxpayers. There is obviously a limit beyond which taxation cannot go without actual oppression. The cost of our defense program must be spread over a sufficient period of years so that its economic impact will not be destructive.

It has often been said that excessive rates of taxation defeat their own purpose. I think we shall presently find this to be true, for, in the aggregate, there will be a

tremendous reduction in incomes subject to the tax, and this will be the result of the operation of the law itself. Recent reports of corporations will serve to throw considerable light upon this subject. Some of them show taxation per share many times the amount paid out to stockholders, or even available for such purpose; and, already, impelled by sound financial considerations, corporations have begun to cut and to suspend action on their dividends. This practice will undoubtedly grow, for the policy of the Government seems to be to curtail profits and, at the same time, to take as large a share as possible of those which corporate taxpayers are permitted to earn. Individual incomes from this source will steadily decrease and, as a consequence, the national revenue from this source will suffer curtailment.

The reluctance to accept the theory that excessive rates of taxation result in diminishing returns has persisted in political circles despite its demonstrated soundness. This attitude has, beyond doubt, retarded our recovery. If our efforts had been devoted to increasing the national income, the needs of the Government could be readily met without taking an unconscionable part of it.

Business and industry feed upon the constant flow of capital. Investment and reinvestment are their lifeblood. The withdrawal, through taxation, of vast sums of capital which would otherwise be plowed back into business and industry cannot but retard recovery and expansion. It may seem rather extraordinary to speak of recovery in the face of income figures that are being released from time to time. Nevertheless, it is clear that we have not recovered from the economic depression, and while the aggregate of income in the United States is steadily mounting, it is mainly due to the defense program, and it is restricted and limited; accumulated capital is still in hiding, and there is little incentive for its reemployment.

If these considerations do not lead to the conclusion that it would be sounder policy to raise by borrowing the sums required beyond those which will be received under the Revenue Acts of 1940, maintaining a ratio of raising, let us say, 40 percent of requirements by taxation and the balance by borrowing, attention should be turned to other means of increasing the revenue by taxation.

I had not intended to discuss the subject of joint returns. I had thought that the proposal was so pernicious and indefensible that the action of the House would relegate it to the limbo of forgotten things. However, the Secretary of the Treasury has brought it to the fore again. His arguments in support of it are utterly illogical. In the first place, he attempts to justify it by the suggestion that it would raise a very large sum. That argument might be advanced to support any tax, no matter how heinous. It seems not to matter to him that it completely violates the conception of separate estates of husband and wife for which we have been striving for generations, nor that it violates the American concept of laying imposts only on the income of him who receives it. When Senator Barkley called the attention of the Secretary to our long history of endeavor to create an independent status for married women, the Secretary answered that many had taken advantage of that attitude.

Upon what theory may a husband be condemned for establishing a separate estate for his wife, an objective heretofore thought to be desirable? None suggests itself.

The Secretary's argument, in detail, will not stand analysis. For example, it takes no account of the time when such separate estate was established, nor of the possibility that it existed prior to the creation of the marital status, nor, again, of the fact that, if established by the husband, it may have had no value, or only a nominal one, at the time of its creation and have developed value subsequently, and, finally, that if more recently established, very large imposts have been levied upon him for the privilege. The Secretary has not suggested even that these taxes be returned.

The fact emphasized heavily by the Secretary—that in several community States, the husband's earnings are, by law, equally divided between husband and wife, thus bringing about preferential treatment in contrast to that accorded residents of other States—hardly justifies the further maltreatment of the less fortunate. If the good fortune of those living in community States is deplorable from the Federal tax standpoint, why not endeavor to remedy that situation by a provision which ignores that status created by State statutes in regard to the earnings of a spouse. That, perhaps, would be too simple, and that it is not the Secretary's true objective is quite obvious.

If the argument is made that such a provision is of doubtful constitutionality, the same may be said with equal force of the joint-return proposal.

ELIMINATION OF EXEMPTIONS

Considerable argument has taken place concerning the advisability of reducing exemptions and thus broadening the base of ordinary income taxation. Exemption from taxation is unsound in principle. Every person enjoying the benefit and protection of his Government should contribute to the expense of its maintenance. While individual contributions from this source may be small, in the aggregate they would be substantial.

The opposition to the proposal is twofold. One is political, the other economic. The former is entitled to no consideration. A political approach to a purely economic conception is indefensible, and as long as it persists we cannot have a sound fiscal system. On the economic side, it is asserted that the cost of collection is prohibitive. That argument does not appear to be tenable, and until reliable statistics are furnished to support it, we should proceed on the contrary assumption. We have already adopted the principle of withholding at the source. That system seems to have worked well enough in practice. If exemptions are entirely abolished and a low rate of tax is applied, collection can be assured by a provision requiring the withholding of the tax on that income at the source. A $10 impost upon a $1,000 salary works no hardship, and there is no reason to believe that the recipient of such an income is less willing to share the expense of his Government than those in the higher brackets. And it perpetuates a principle which seems to be salutary, that is, equitable distribution of the cost of government among all recipients of income, the enjoyment of which is made possible by the Government.

It is proposed to reduce exemptions from $800 to $750 for single men, and from $2,000 to $1,500 for married ones. This, it seems to me, is a rather feeble gesture in the right direction. If taxation upon incomes is a thoroughly sound method of raising revenue, which one no longer doubts, why do we hesitate to apply it completely. Why seek other and more controversial methods when a thoroughly acceptable one is at hand? The abolition of exemptions for both single and married men will bring in a very large amount of revenue. The reduction proposed will accomplish nothing of comparative value.

Another exemption calls for reconsideration in the present emergency. It is the earned-income exemption. It is a luxury which, perhaps, we cannot now afford and which we ought to forego. The distinction between earned and unearned income is not so fundamental that it needs to be perpetuated. In happier times it may be restored.

REPEAL OF THE CAPITAL-GAINS TAX

There is another source of revenue which has not been fully or properly exploited; namely, income derived from the sale of capital assets. The capital-gains tax has been the subject of controversy ever since its enactment. Its proponents urge that the profit derived from the sale of capital assets has no just claim to exemption from taxation imposed upon other forms of income. The fundamental differences between income derived from labor or capital and that derived from the sale of capital assets have been discussed frequently and exhaustively. They are recognized in the complicated provisions of every act passed since that of 1921, where the subject was first dealt with.

There is very persuasive evidence that the taxation of profits from such sales was not originally contemplated under the sixteenth amendment. For a long period of years it has constituted a part of our system of raising revenue, but it still remains to be determined whether its continuance as a part of that system is justified and, if so, whether it cannot be made to produce revenues far in excess of those which are currently being realized.

Year after year repeal or modification of the capital-gains tax has been urged by eminent authority. All arguments in support of its repeal have fallen on deaf ears. In the present emergency, any effort to procure a repeal of the capital-gains tax appears to be foredoomed to failure regardless of the merits of such a proposal.

That such taxation is not economically sound, has been amply demonstrated. Nothing is more conducive toward prosperity than the encouragement of free trading. Whatever tends to limit or retard such trading puts the brakes on business in the broadest sense of the term. It checks individual activity, reduces employment, curtails the circulation of money, and shuts off the flow of capital into productive enterprise. There is no doubt that the panic of 1929 resulted in no small measure from the high taxes imposed upon profits derived from the sale of securities. The natural reluctance to realize such profits created by the heavy impost thereon resulted in a curtailment of supply which otherwise would have been available to meet demand. An inexorable economic law forced prices to heights which had no regard for actual valuations, and this continued until the

whole structure toppled over like a house of cards and brought disaster to the entire country.

As a producer of revenue, this form of taxation has been a complete and ghastly failure. In years of great business activity, substantial sums may be collected. They will be given back, however, in subsequent periods when the trend has been reversed. While, as pointed out before, there is great reluctance to sell in a period of rising prices on account of the punitive taxation, there is no such reluctance when it becomes desirable and possible to take losses. Any method of taxation which is so undependable as a source of revenue is manifestly unsound. Its instability as a revenue producer seriously affects the orderly administration of governmental affairs and creates a situation that should be avoided at all costs.

The repeal of the provisions of the law dealing with the subject would not cause a loss of revenue to the Government. Its repeal would so accelerate trading in securities that the revenue to be derived in the form of stock-transfer taxes would far exceed the annual revenue realized through its continuance. The New York State taxing authorities estimate that the capital-gains tax has caused a loss of revenue in excess of $200,000,000 per annum. Here, again, the reluctance of the Congress to take action appears to be political, resting upon its fear that a repeal or a drastic modification of the capital-gains tax will create the impression among their constituents that they are favoring the so-called Wall Street element. The tax, of course, bears upon all who have possessions. Indeed, it probably affects those in the middle class to a greater extent than any others, and it may well be doubted that its repeal will evoke any criticism. The arguments which have been advanced from time to time against this form of taxation are now fairly well known throughout the country, and if the results of repeal accord with promise, such action will bring unstinted approval.

MODIFICATION OF THE CAPITAL-GAINS TAX

In spite of the views of many well-informed persons that the revenue would be increased by the repeal of the capital-gains tax, it is not to be expected that in the present emergency efforts in this direction, which have failed in less parlous times, can succeed now. Since this is so, and since we are faced with the desirability of increasing the revenue with as little economic dislocation as possible and with the greatest possible advantage, we suggest that transactions involving the sale of capital assets be treated separately; that the net profits realized from such transactions be taxed at a rate low enough to encourage, rather than restrain them, and that where losses exceed gains the rate be applied to the excess and allowed as a deduction against the tax on ordinary income.

The record of dealings on the New York Stock Exchange speaks eloquently of the curtailment in security trading which has taken place in the last few years. Not all of this, of course, is due to the capital-gains tax, but that the tax has played a great part in reducing such activities to their present level, is generally asserted. Three-and-four-hundred-thousand-share days are as abnormally low in this country today as the eight-to-ten-million-share days were abnormally high during the panic of 1929. If a flat rate of 5 percent were applied, it is obvious what the normal share day would do in augmenting the revenue from this source and from the increase which would be derived from stock-transfer taxes.

The present revenue act continues the system of taxing capital gains upon the basis of the length of time during which the assets involved are held by the taxpayer. The implication inherent in this is that profits earned in capital transactions during the first 13 months are speculative. This has no basis in fact. The difference between speculation and investment cannot be determined by any such standard. Every investment, in fact, every transaction entered into for profit, is more or less speculative in character. One invests in sound securities not for the purpose of holding them indefinitely, and not alone for stability of income. Inherent in the act of purchase is the hope also of enhancement. If a substantial enhancement should take place within the year of purchase, sound judgment may dictate the advisability of realizing the profit, but that profit is no more to be placed in the speculative category than if it had been taken in the second, third, or tenth year. A low, flat rate of tax, applied to all capital transactions, is sounder and simpler and takes away the incentive to delay the taking of gains and the stimulation to realize losses. It encourages trade and consequently increases revenue. It has been contended that there is no justification for a lower tax on a speculator than on an individual receiving like income from salary or

business. The hazard in the one case makes the distinction and justifies the lower rate. One who renders services has a reasonable certainty of compensation; one who invests capital in speculative transactions runs a serious risk not only of making no profit, but of losing one's investment.

No one will gainsay that the present method of taxing capital gains has not been satisfactory. If there be doubt that the proposal made herein will produce the asserted results, there is still no reason why we should not try the experiment for at least 1 year. We are certain that there will be no loss in revenue resulting from the adoption of the proposal. There is every reason to hope for a gain that may reach proportions beyond the most optimistic expectations.

GIFT TAXES

The search for additional revenue will be rewarded by a revision of the provisions of the present revenue act imposing estate and gift taxes.

In 1932 Congress imposed upon property passing by gift taxes at the rate of approximately three-quarters of those imposed upon property passing by death. These taxes were levied, of course, for the purpose of increasing revenue, and the differential was established, or so it was said, for the purpose of encouraging the making of gifts.

The preaching and the practice are at variance. It is almost impossible to incur gift-tax liability except by an outright transfer and delivery of property to the donee. The statement is made in this form for the purpose of emphasis.

The changes in the law made at the suggestion of the Treasury Department and their attitude in regard to these two methods of raising revenue emphasize the criticism made at the outset of this memorandum.

The imposing provisions of title III of the act of 1932 are as follows:

"(a) For the calendar year 1932 and each calendar year thereafter, a tax * * * shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

"(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.

"(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or income therefrom * * *."

Under section 302 of the estate-tax law, there must be included in the gross estate of every decedent:

"(c) Any interest of which the decedent has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death, or for any period which does not in fact end before his death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

"(d) Any interest of which the decedent has at any time made a transfer, in trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death."

These provisions of the Gift Tax Act and the Estate Tax Act show clearly the inconsistency between the avowed purpose of encouraging the making of gifts, with the consequent enhancement of current revenues, and the evident purpose of subjecting almost every gift that one can make to estate taxation.

This inconsistency is emphasized by the provision authorizing a credit for a portion of the gift taxes paid if it should happen that the Commissioner of Internal Revenue subsequently decides that the money which he has taken for gift taxes was erroneously collected. It is idle to pretend that this credit was for the benefit of the taxpayer. Its purpose was to relieve the Commissioner from the responsibility of determining whether the transfer came under the gift tax provisions or estate-tax provisions of the act, notwithstanding the statement of the Supreme Court in *Burnet* v. *Guggenheimer* that a choice must be made as to whether the gift shall be taxed at the time of the creation of the trust or at the death of the settlor.

If the impost on gifts inter vivos was designed to raise revenue, it is difficult to understand why Congress has permitted that design to be frustrated. The Treasury Department seems to be entirely unsympathetic to the Congressional will. This has been amply demonstrated on many occasions, and is illustrated by what has happened in relation to the two forms of taxation now under discussion. The agility with which the Treasury has placed itself upon opposite sides of the same question and the avidity which it has displayed in seeking judgments which it must afterward regret are truly remarkable. The incentive to the making of gifts established by the differential has been completely destroyed.

There should be a reversion to the purpose of the Gift Tax Act. The act should not be encumbered with a mass of fine distinctions and restrictions. Every transfer in trust or otherwise should be subjected to the tax, and further encouragement should be offered by reducing the rate of taxation on such gifts. Provision can readily be made for those cases of transfers in trust in which the corpus finds its way back to the donor or to the settlor and is in his hands at the time of death. In such cases, the corpus should be subjected to estate taxes and credit given for the full amount of the gift tax paid.

How substantial the increase in revenue to the Government would be, it is impossible to estimate, but there is little doubt that many would welcome this opportunity of setting their affairs in order during their lives, rather than to have those who come after them face the chaos that has become all too frequent in the administration of substantial estates. The adoption of these suggestions would also be in the interest of simplification in a field in which litigation has assumed enormous proportions.

Of course, if the Government persists in the policy of having its cake and eating it too, these proposals will have no appeal. If the need for revenue is as great as we are led to believe, and it is desirable to raise it in the least oppressive manner, these suggestions embody one of the ways of accomplishment.

INCOME AND SALES TAXES

Some years ago, we suggested the adoption of a fundamental system of taxation based upon income and sales. Working in combination, these two methods could probably be counted upon under all circumstances to raise whatever sums might be needed to finance the operations of the Federal Government. Having the two primary methods of raising revenue, both of them reasonably flexible, would enable us to dispense with many other imposts. In the years in which the yield from income taxes is high, the rate of tax on sales could be low. The rate of tax on sales could be increased in the years in which the yield from income taxes is unsatisfactory.

Much can be said, of course, in opposition to this suggestion, and we are not unmindful of the objections. It will be said, for example, that in years when the yield from income taxes is unsatisfactory, it will not be feasible to raise the rate of taxation on sales. If the sales tax is made comprehensive, a very low rate will produce a very large return, so that it will never become necessary to raise it to a point where it can become oppressive.

In any event, the matter of raising revenue is simplified by using income and sales taxes as basic and complementary, and we believe they constitute the most reliable means of raising revenue.

Here again, political considerations appear upon the stage. It is continually asserted that sales taxes impose an inequitable burden upon those in the lower-income brackets. As a matter of fact, while they are being persuaded to the contrary, those in the lower-income brackets are being very heavily taxed as a result of the multitude of imposts already laid. We think a sales tax would lighten their burden, rather than increase it, and they would have the satisfaction of knowing what they were paying. While the aggregate of such taxes would be tremendous, individual contributions would not be great. On the other hand, if it be argued that the obligation to contribute toward the cost of Government should be based upon ability to pay, that claim is satisfied by the graduated levies of the income tax.

Experience has demonstrated that sales taxes are easily collected. The resulting flow of funds into the Treasury would be constant. Complications are present, but they present no difficulty comparable with those experienced in the development of income and excess-profits taxation. The assumption that the imposition of a general sales tax would meet with resistance does not appear to be valid in the light of the acceptance by the people of excise taxes on the innumerable items which have been subjected to it. No pretense can be made that this tax is not paid by

those in the lower brackets as well as by those in the middle and upper ones. Poor and rich alike are contributing vast sums in the form of excise taxes which are sales taxes under a different title. Why maintain the deception?

In the last analysis, the common sense of the American people can be counted upon to appreciate and approve any system of taxation which is simple in operation and not discriminatory or oppressive.

In discussing the subject of taxation, one of the members of the House Ways and Means Committee recently predicted that next year we would be faced with the necessity of resorting to this form of taxation. We were very close to its adoption not so long ago, and, in our opinion, its acceptance by Congress was prevented only by an intense campaign waged against it. We do not believe an attempt to muster such opposition would, under present circumstances, be successful.

We believe that the soundness of this form of raising revenue is becoming more and more appreciated. If that is so, there is every reason for action upon it now. The need for speed in the enactment of a new tax bill is not so great as to justify the exclusion from consideration of the proposal for a general levy on sales.

The Secretary of the Treasury urges the Senate to adopt a proposal, defeated in the House, for limiting the computation of the excess profits tax by consideration of invested capital only. The unfairness of this has been thoroughly exposed. Here, again, the motive seems to be to get revenue without regard to equity. That is not an appealing consideration. It will expose us again to the experience under the 1918 act and leave those unfortunately placed in the matter of invested capital to the tender mercies of the collecting authority. That is not a consummation to be wished. The alternative method, now a part of the law, has regard to the true meaning of excess profits and should be retained.

In conclusion, we contend that the necessity for raising additional revenue by taxation has not been demonstrated and does not appear to exist; that if the contrary conclusion is reached by Congress, such additional money be raised by other means than an increase in income or profits taxes and by resort, among other things, to elimination of exemptions from income taxation, including that for earned income; by a repeal or reduction of the tax on capital gains; by changes in the estate and gift taxes and by the imposition of a general sales tax.

In passing, let us say that the habit of spending money is easy to acquire. This applies with particular force when other people's money is involved, and especially so when it comes from the pockets of 130,000,000 people. We are engaged in an all-out effort to safeguard our security and our way of life. No price is too great to pay for it. In the course of our efforts, there will be some waste and extravagance, but we should not permit ourselves to be carried off our feet by wild, and perhaps irresponsible, estimates of the cost of our program. The time has come for Congress to scrutinize the demands of the Government with the utmost care and also to have in mind that there is a limit to what can be taken from the national income without destroying that income itself.

A final word will not be amiss. The obligations imposed upon the people have their origin in a welter of words, the meaning of which eludes even the expert in such matters. The difficulty of ascertaining one's responsibilities under them is little less burdensome than the obligations themselves. No greater service could be rendered to the people than the complete review and revision of our method of raising revenue. Even an expert approaches the solution of problems presented to him by taxpayers with a feeling of futility and resentment at his inability to answer with reasonable assurance the questions presented to him from time to time. A tax law so complicated is an abomination which ought not to be tolerated for a moment longer than is absolutely necessary.

Respectfully submitted,

ARTHUR B. HYMAN.

AUGUST 8, 1941.

(At 12:05 p. m. the committee recessed until 2 p.m.)

AFTERNOON SESSION

(Pursuant to adjournment, the committee resumed the hearing at 2 p. m.)

The CHAIRMAN. Is Mr. R. J. Price here?

STATEMENT OF R. J. PRICE, BOSTON, MASS.

The CHAIRMAN. Mr. Price, give you name to the reporter.

Mr. PRICE. R. J. Price, Boston, Mass.

The CHAIRMAN. You may proceed.

Mr. PRICE. I have not prepared a formal brief to submit to the committee. I have merely come down to speak a few words on behalf of some of the smaller taxpayers who are going to bear quite a burden this year. I am the head of my own accounting firm, and in the past couple of years we have had increasing numbers of small taxpayers come to us for advice and counsel on tax problems. Consequently, we have gotten quite an insight into their reactions to the proposed measures and just how the tax bill might affect their personal welfare.

In one sense, I am a reporter in that we have found that the Congress is in a rather unique position this year. The people want to pay taxes.

The CHAIRMAN. I am not so sure they want to pay as much as some people have said in the past.

Mr. PRICE. That may be.

The CHAIRMAN. I think they want to pay reasonable taxes.

Mr. PRICE. They want to pay their equitable share.

The CHAIRMAN. They want to pay what they are able to pay. I am inclined to think that a good many of them would say that they are not going to be able to pay except what is in the bill at least.

Senator VANDENBERG. They do not want to pay any tax except this particular one.

Mr. PRICE. I thought I would mention that, because I know we have had quite a bit of talk about ability to pay or wanting to pay in a big way. Some of us are inclined to discount it. There is so much newspaper talk about it. We do know most of them feel that they should bear an equitable proportion of the national-defense expenses.

Senator VANDENBERG. They are going to get their wish.

Mr. PRICE. Yes; I think they will, Senator. In that connection, I might say I will speak briefly on the mandatory joint return, on broadening the tax base, and the excise taxes.

The CHAIRMAN. Are you in favor of the mandatory joint return?

Mr. PRICE. I am not, Mr. Chairman. My reason for that is that I believe it is inequitable. I believe it jeopardizes the right of the individual. I believe our whole constitutional concepts are based on the superiority of the individual; that an individual cannot be arbitrarily merged with another individual, and that he, as an individual, has every right before the law, and where you arbitrarily merge them, as this proposal tends to do, you are jeopardizing the right of either the husband or the wife as an individual, you are making each one as an individual paying a higher proportion of taxes on his or her own individual income than someone else who is making a similar amount of money. I think that that is a rather tricky proposal. I spent quite a bit of time going through the reasoning of the House Ways and Means Committee on it, and I have broken it down, I have taken it step by step as we found they set it forth.

First, they say that "each spouse," I am quoting here, "is required to pay a tax only upon his or her separate income." That is all right to there. The intent here is to treat the husband and wife as

separate taxpayers and as individuals. Now they go on and say that there is no imposition of liability upon one person for the taxes payable by another.

I assume here they mean simply each spouse will be held liable only for the tax liability accruing to each individual income.

Now they wind up and say that there is only an increase of tax upon the individual income of each spouse. The only conclusion you can draw there is that they are not going to treat individuals like, after all. We are going to impose a higher rate on some individuals than others, even though, as individuals they are earning the same amount of money. It is almost the same as saying that one plus one if married, equals one, and one plus one, if not married, equals two. It is probably justified psychologically, that one plus one equals one if married, but practically it is not so. I think you cannot abridge the rights of the individuals, just because they have entered into some contractual legal partnership.

Senator VANDENBERG. How often does it happen that all of the income belongs to one spouse and they just split it for the sake of evading the tax?

Mr. PRICE. I would not say that they were seeking to evade the tax, Senator.

Senator VANDENBERG. Do you think it is all right, if the income all belongs to one spouse, to divide it?

Mr. PRICE. To divide it between the two?

Senator VANDENBERG. Yes; to divide it for tax purposes.

Mr. PRICE. No; I do not. If one earns it he should pay on what he earns, but if both earn it, they should pay a rate on what each earns. I do not say that you can merge the individuals into one. You have set up a family unit, they have set up a concept of the ability to pay as a family unit. I think you are confusing the family with the individual. Under that I cannot see where you cannot include everyone in the family, if you had several children in the family, I cannot see why you could not add them altogether.

Senator VANDENBERG. In your experience as tax consultant, do you find it is used for the purpose of tax evasion?

Mr. PRICE. I will have to admit in some cases that is true, particularly with reference to partnerships.

Senator VANDENBERG. Could we close up the loopholes?

Mr. PRICE. The only way I could see that you could close a loophole on a partnership—I do not know whether you could do it by legislation, I think it is a matter of the tax boards and the courts using a little better judgment in determining whether a partnership between a man and wife is evading the spirit of the law, because they can, technically, of course, appear to be within the law and very often actually evading the spirit of it. I should think the court would have jurisdiction there to determine whether they evade the spirit of the law or not. I think, in many instances, they do.

Senator GUFFEY. Mr. Price, have you analyzed the tables on pages 15 and 16 of the report of the Ways and Means Committee by Mr. Doughton?

Mr. PRICE. Is that the one, Senator, where he mentions the number in 1938 who filed jointly?

Senator GUFFEY. Yes.

Mr. PRICE. Yes, I did.

Senator GUFFEY. What conclusion did you draw from them?

Mr. PRICE. I drew this conclusion, that back in 1938 we had a much lower tax rate, and there probably would not be much of an advantage to anyone to file separately then, and furthermore, I think in many instances, the small individual taxpayer did not know whether he ought to file jointly or singly, so he filed whichever way popped in his mind that he thought was the easiest.

Senator GUFFEY. Do you think the 2,866,000 married couples in the United States who filed jointly did not know what they were doing and 175,000 who filed separately did know what they were doing?

Mr. PRICE. I do not go so far as to say that. Did you say the larger number filed jointly?

Senator GUFFEY. Yes; 2,866,000, something like that.

Mr. PRICE. All right. I think, in most instances, it was a matter of convenience and not a matter of seeking to lower the taxes, because I think you will find that the greater number of taxpayers are in the low-income group. I notice the committee talked a good deal of $5,000 and $10,000 incomes. I do not think you will find that those people are in that elegant income group; I think you will find they are in a low-income group.

Senator GUFFEY. In my State 261,722 filed joint returns for that year and 9,518 filed separate returns.

Mr. PRICE. I think that that was more a matter of convenience, Senator, than to seek to lower the taxes. What State are you from, may I ask?

Senator GUFFEY. Pennsylvania.

Mr. PRICE. Pennsylvania is a very rich State.

Senator GUFFEY. They wanted to pay their taxes. They were not trying to dodge them. I will say that 9,000 are making a lot of fuss now about it.

Mr. PRICE. I think it goes further, Senator, than just the question of whether you are going to get additional income from these people or not. I think it strikes fundamentally at the right of the individual as such to have equality before the law.

Senator GUFFEY. Do you have any theory, any program here to raise the $3,000,000,000?

Mr. PRICE. Yes. I agree with Secretary Morgenthau that the base should be broadened.

Senator GUFFEY. What?

Mr. PRICE. I agree with Secretary Morgenthau that the base should be broadened, at least by lowering the exemptions.

Senator GUFFEY. He did not cut out the joint returns.

Mr. PRICE. No, no. I said I agree with him on the broadening of the base. I think that would raise part of it. I would not be so presumptuous as to estimate how much additional revenue it would raise.

Senator GUFFEY. Do you have the kind of program that puts the taxes on somebody else?

Mr. PRICE. No; I do not have that kind of program.

Senator GUFFEY. I am sorry for the interruption.

Mr. PRICE. I was going to mention that I believe Senator Barkley mentioned the other day that he had some question in his mind about reviving the concept of the common law, that what a woman earns

or has belongs to her husband. Now in the process today, we do not recognize that, and I wonder if it would not be well to consider possibly that we have been viewing the common law as a static thing when it should be viewed as dynamic. As you know, originally, the common law came about as the early judiciary decided in each section, what was actually done in that section and they decided accordingly. Today we commonly look upon a woman as absolutely equal to a man. Could not we change the common law? Would not a liberal court interpret it to mean that she has absolute equality before the law? If you deny the woman the right to hold that income herself, would not that carry over to deny her the right to hold property that has been transferred to her?

I notice quite a section in the House report relative to property transferred to wives.

The CHAIRMAN. Now, Mr. Price, that is not involved. There is not but one thing involved. Of course, the question of policy is a very big one, but one legal aspect of the whole thing, that is, whether or not it is reasonable or sensible or a justified classification of taxpayers by simply saying that those who occupy the relationship of husband and wife, who live together, may be treated as one taxpayer.

Mr. PRICE. Thank you for setting me straight, Mr. Chairman.

The CHAIRMAN. Do not worry about the other part. We have the jurisdiction anyway, if it was involved in it.

Mr. PRICE. My opinion still stands then; that it does jeopardize the right as an individual and I think it is very unfair.

The CHAIRMAN. That is a question of policy.

Mr. PRICE. Yes.

The CHAIRMAN. The question of justice, of course, is involved.

Mr. PRICE. That is a question that only the conscience of the committee and the Senate can decide, as you have no restrictions as to how much or in what manner you will levy your income tax.

I had started to mention about the broadening of the base. I have not figured any estimates on it, because, as I said before, I do not think any one of us in a private capacity, has the resources that would enable us to make an estimate such as the Treasury Department can make. My purpose in favoring the broadening of the base, in other words, lowering the exemption, is because I believe it will drive home to the individual taxpayer his financial responsibility to the Government in addition to raising additional revenue. I think that there is a tendency in recent years—we have been talking of billions of dollars of appropriations and the average man has been inclined to think, "Well, that does not affect me. They have been borrowing money. I do not understand billions anyway." I think if you drive it home to him by reducing the exemptions, he will take a greater interest and realize he actually has financial responsibility to the Government, and it will bring in that lower income group who, I believe do want to make some contribution.

In that connection, I think the simplified set-up as suggested by Secretary Morgenthau is very good. I might add you might give them the alternative of computing their tax, the same as anyone else would, if anyone thinks they might be inequitably treated.

The CHAIRMAN. What the Secretary proposed there was simply an option of a short form, that is all. It is not binding.

Mr. PRICE. He did make it optional?

The CHAIRMAN. Oh, yes.

Mr. PRICE. I have often felt that some simple method should be devised, because so many people are turning to other individuals and they pay money to assist them in paying taxes. I do not think the low income group have to pay anybody to help them make out the taxes that they pay to the Government; they ought to make it themselves.

There is one other point on the excise, or the nuisance taxes. I do not see that you have to contract that right away. I do not think that will answer the problem. I think you should be a little bit careful in how many additional taxes you add on, because it conceals the true cost of the Government to the people. In the cases where the taxes are actually labeled, they get some idea but in most instances the taxes are hidden and the cost of government is hidden and most people pay without realizing it. I think they should know how much the Government is costing them to run. They are entitled to know that.

I think the problem, as far as the smaller taxpayer is concerned, divides itself into the equity of the bill and the equity of its administration. As to the equity of the bill, of course that rests within the conscience of the Congress. As to its administration, you will have to delegate the administration of the bill to the Treasury Department, and I have been somewhat concerned with the burden that is placed on some of the collectors of the offices when it comes to the matter of handling refund claims of small taxpayers.

I know they have had lots of them in the past, and there is no unifying the agency similar to a small-claims court that could give them a final and equitable decision. It is too expensive for the small man, who, perhaps has overpaid $30 or $50 to try to fight that through the tax board, so if he is turned down, he hasn't got someone to go in between for him, he just lets it go, but it engenders a misunderstanding between the individual taxpayer and the Treasury Department. If anything could be worked out for him in that respect, it would be a good thing. I think it would redound to the benefit of the Government.

I think there has been a tendency today, on the part of some witnesses, to divorce the revenue measure from the war economy that we are operating under. I recall one witness mentioning something about increased taxes acting as a deterrent on inflation. I think that the Congress, in levying the tax, has every right to levy a tax in every way that will benefit the economic welfare of the country, but I do not think the higher taxes alone would act as the deterrent that some think it might. I think it is tied up with that also, considering the integration of a price-control bill with it. It is not the purpose of this hearing to discuss price control, or the price-control bill, but I think it might be borne in mind that you have got to integrate those two aspects of your fiscal problem, you have got to realize the fact that the tax alone will only go part way, and unless you enact the other, you will not get the desired effects.

I am going to close as I have overrun my time. I am just going to say one word about the excess-profits tax. As nearly as I can judge, the theory of the Treasury Department is that they are seeking a fair return on the capital during the period of the emergency. Some have been worried about it destroying the incentive for capital to

become invested in business enterprise; under war economy, I do not think you have to worry about incentive of capital to be invested in new enterprise; all you have to be worried about is that the existing enterprise will return to war production. If we need to establish new plants for war production, the defense corporation is very glad to furnish the money, and you have been very generous in providing the amortization clause, which is a sufficient incentive for anyone who is entering war production.

I believe that there is one possible objection to merely a rate of return on invested capital, and that might be in the cases of smaller corporations where it is difficult to determine the amount of their invested capital. There are some very small ones who have very little invested capital and yet perform essential services. There is one inequity that will have to be considered and you will have to see if there is some way around it. The only advice I can give to anyone on that is if you should penalize, to some extent, say $100,000, you might as well dissolve your corporations and make them a partnership. I believe that is all.

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

Mr. Robert B. Skinner.

STATEMENT OF ROBERT B. SKINNER, OF NEWARK, N. J., LAUNDRY MACHINERY MANUFACTURERS' ASSOCIATION, LAUNDRY AND CLEANERS ALLIED TRADES ASSOCIATION, AND AMERICAN INSTITUTE OF LAUNDERING

Mr. SKINNER. Mr. Chairman and gentlemen of the committee, I have, in my hand here, a statement of our position in connection with the phase of the bill at hearing that we object to, and if it meets with your consent, I would like the privilege of reading that statement. It is very short.

The CHAIRMAN. You may proceed.

Mr. SKINNER. After that, if you wish to ask any questions, of course, I shall be glad to answer them.

My name is R. B. Skinner, a laundry owner whose business is situated in the city of Newark, N. J. I have the honor of having been appointed to speak for the American Institute of Laundering, the national association for the laundry industry, whose members process approximately 75 percent of all of the laundry work done in this country; and also for the Laundry Machinery Manufacturers' Association and the Laundry Allied Trades' Association, each of which does 95 percent of the total sales in their respective fields.

The purpose of our appearance here is to place before you our reasons for protesting the inclusion in the bill at hearing, namely H. R. 5417, a tax of 10 percent on washing machines of the kind used in commercial laundries. This tax is recorded on page 75, paragraph 8, subsection 3406 of section 552, reading as follows:

> Washing machines of the kind used in commercial laundries, 10 per centum. No tax shall be imposed under this paragraph on washing machines of the household type.

The laundry industry as you must know, is a service industry. It manufactures nothing; it simply reconditions the linens and wearing

apparel for a large part of the people of this Nation. In addition to this, however, and even far more important it serves in a very large measure to maintain the health, the well-being, and the morale of all of our people. In no sense is it a luxury industry. It serves a very vital need of all of our people. In connection with this, it might be of interest to know that the American Institute of Laundering is at the present time in conference with the Office of Production Management and the Office of Price Administration and Civilian Supply and with Secretary Ickes, as Petroleum Fuel Coordinator, requesting that the necessary supplies required by the laundry industry be placed on the priorities list because our industry is so highly essential to the health, and so forth, of our people.

During the first World War, the Priorities Board at that time declared that the laundry industry should be placed on the "Preference list of industries whose operation as a war measure is of exceptional importance."

Attached to this brief is a copy of a brief sent to the three departments mentioned before. The principal points brought out in the attached brief are summarized as follows:

1. 10,000,000 families or approximately 35,000,000 people depend upon laundries for their family washing. In addition, the laundries are essential with hospitals, hotels, charitable institutions, steamship lines, railroad lines, and many other institutions of like character.

2. Continued and uninterrupted operations of laundries will result in great savings of supplies, labor, and power during the period of the emergency as compared with home methods.

3. Laundries are essential in maintainmg public health and national morale.

4. Laundries provide regular employment to 250,000 people, of whom 70 percent are women with annual wages of $275,000,000 as against an estimated sales volume of $500,000,000.

During the last few years the laundry industry has gone through a very trying period. It was found that if prices were raised, it would lower the volume, and volume is necessary to properly operate a service organization. Prices at the present time are, in the main, even lower than before the imposition of such taxes as old-age benefits, social security, State unemployment, and so forth.

The total volume of sales is divided among 6,700 different small plants scattered throughout the United States, the vast majority of whom are operating heavily mortgaged plants with insufficient capital. The records show that the average earnings of the most successful groups in the industry are less than 2 percent of sales. We recognize that all industries are called upon to pay social-security taxes, but in the case of the laundry industry, because our pay roll amounts to 55 percent of our total revenue, it is a particularly difficult burden to bear. It seems to us, therefore, in view of the above reasons given, that the laundry industry is in no position to bear any further tax burden at the present time.

It is our contention that under this bill a tax on commercial washing machines is discriminatory in its nature principally because it fails to tax many other types of processing machines in a variety of other industries. It is not in order for us, of course, to list these numerous industries but we refer to those industries that are serving civilian

needs. In other words, why particularly should the laundry industry be singled out to bear this extra tax when many other industries serving civilian needs are not called upon to bear a similar tax.

We could not even understand this discrimination if the revenue which is to be derived therefrom would be a substantial amount. It is liberally estimated by the laundry-machinery manufacturers that their sales in commercial washing machines for 1940 amounted to about $4,500,000. On this basis, the total tax of 10 percent would yield a revenue of only $450,000 as against the estimate of $1,100,000 as reported by the House Ways and Means Committee.

For obvious reasons, the volume of sales for the duration of the emergency will probably be greatly reduced over 1940 with the result that the revenue derived from this tax will be far less than the figure here quoted.

We note with particular interest that the home washing machine is not taxed. Just exactly why, we do not know but it is our understanding that one of the principal reasons why the home washing machines are not taxed under this bill is because it is considered a device for relieving the American housewife of much of her home drudgery.

If this argument be true, how much more so it applies to the commercial washing machine. The home washing machine may relieve her of some of the drudgery but the commercial washing machine relieves her of all of the drudgery; furthermore, it is hard to understand why a tax should be placed on a processing machine that serves to keep many people in employment and no tax is placed on a washing machine going into the home that tends to decrease employment in the commercial laundry. In view of the present emergency, it would seem axiomatic for the Government to do everything possible to encourage employment and not to discourage it.

The home washing machine is a direct competitor of the commercial laundry and it seems highly unjust and discriminatory to place a tax on commercial washing machines.

Senator TAFT. Do you have any figure on the total volume of individual and commercial washing machines?

Mr. SKINNER. The sale of washing machines?

Senator TAFT. Yes.

Mr. SKINNER. I have with me Mr. Matthews, who is prominent in the field of laundry machinery manufacturing, and Mr. Matthews is able to answer the question with more authority than I.

Mr. MATTHEWS. For 1940 the report is $104,000,000, 1,456,000 units.

Senator TAFT. As compared to what?

Mr. SKINNER. As compared to $4,500,000 on the commercial washing machines. Our plea, then, is based on four main contentions: First, that we are in no sense a luxury industry but serve a very vital need in maintaining the health and the well-being of our people; second, the financial condition of laundries and machinery manufacturing companies is such that to impose this 10-percent tax on them at this time would inflict a hardship far out of proportion to the anticipated revenue from the proposed tax; third, that the tax as it now stands is discriminatory in that it singles out the laundry industry; and fourth, that it creates a condition of unfair competition by taxing

a processing machine of the laundry industry while it fails to tax in a like manner the source of our greatest competition—the home washing machine.

We, therefore, respectfully urge this committee to strike out paragraph 8, subsection 3406 of section 552 on page 75 of the bill at hearing.

(Mr. Skinner submitted the following brief:)

BRIEF CONCERNING PRIORITY AND PREFERENCE RATINGS ON LAUNDRY MATERIALS, SUPPLIES, AND EQUIPMENT REQUIRED AND USED BY THE LAUNDRY INDUSTRY OF THE UNITED STATES

Prepared by AMERICAN INSTITUTE OF LAUNDERING, Joliet, Ill., July 18, 1941

Submitted to: Harold L. Ickes, Secretary, Department of the Interior; Edward R. Stettinius, Jr., Director of the Office of Production Management; Joseph Weiner, Assistant to Leon Henderson of the Office of Price Administration and Civilian Supply

We submit that the laundry industry, especially in this period of national emergency, is essential to the health, well-being, and morale of all of the people in the Nation.

If, in the judgment of those to whom the responsibility has been entrusted, it becomes necessary to reduce the varieties and quantities of services and commodities now available to the general public, in order to expedite an all-out defense program or to prosecute a war, the laundry industry of the United States submits the following reasons in support of its contention that it is an essential industry to the public welfare, and, therefore, entitled to preferential treatment by those governmental agencies entrusted with the responsibility of allocating those commodities essential for uninterrupted operation of the laundry industry.

CONTINUOUS LAUNDRY OPERATION ESSENTIAL FOR MAINTAINING PUBLIC HEALTH

Any reduction in the Nation's standard of cleanliness and personal hygiene will contribute to an upswing of the inroads of disease and epidemics with their resultant loss of man-hours throughout our defense industries and armed forces. Everyone will recall the "flu" epidemic of the first World War and the disturbing effect it had, not only upon the Nation's military forces but also upon the civilian population and factory production. Even in those days when far fewer professional laundries were in existence than is true today, they were very useful in combatting the spread of an epidemic that admittedly was serious. The value of every present-day laundry in a similar situation should not be discounted. (Research data on the sanitary condition of the commercial laundry output will be furnished gladly.)

Within continental United States, at least 10,000,000 families are depending upon the laundry industry for the weekly washing and ironing of their linens and wearing apparel, while, in addition, the laundry industry is vital in the operation of a wide range of public and private institutions including:

Hospitals.
Asylums.
Orphanages.
Sanitariums.
Commercial and industrial cafeterias.
Army cantonments.
Naval stations.
Schools.
Work camps.
Physicians' and dentists' coat and towel supply service.
Civilian Conservation Corps camps.
Coastwise shipping.
Dining and sleeping car railway service.
Restaurants.
Hotels.
Mechanics' overall service.
Towels in commercial offices and industrial plants.
Commercial air service.
Public baths and pools.
Federal construction project camps.

Thirty-five million of our citizens, who constitute the 10,000,000 families referred to (our industry extends into every sizable city and town in the Nation), as well as the thousands of units embraced in the above enumeration of Federal, commercial, eleemosynary, and other types of institutions, depend upon the approximately 6,725 commercial laundries scattered throughout the United States for an indispensable service, any curtailment or dispensing of which would at once create a serious threat to the maintenance of public health.

LAUNDRIES CANNOT OPERATE WITHOUT SUPPLIES AND REPAIR PARTS

Although the laundry industry's chief production requirement is its labor, it does consume annually, at prevailing market quotations, approximately $75,000,000 of essential supplies consisting in the main of fuel, gasoline, soap, detergents, paper products, repair parts, and cotton goods. Any interruption in the supply of these products to the laundry industry must, of necessity, result in suspension or curtailment of laundry service, depending upon how serious the reduction of these supplies or repair parts might become. The laundry industry, in the interest of the public welfare, therefore, petitions that it be officially declared an essential industry for the duration of the national emergency, and that if and when any priorities affecting its needed commodities are declared, it be placed upon such priority list of essential industries.

We would point out that such a recognition was given on April 6, 1918, by the then Priorities Board which functioned during the days of the First World War. By the resolution creating preference list No. 1, the Priorities Board, with Edwin B. Parker as chairman, saw to it that the laundry industry received sufficient fuel and other supplies to continue its daily operations without interruption to the public and the Nation. It declared that the laundry industry should be placed on the "Preference list of industries, whose operation as a war measure is of exceptional importance." Because the ramifications of the laundry industry's service to the public have vastly increased since 1918, it is, more than ever in this present national emergency, essential in the maintenance of public health and morale.

Obviously, if the laundry industry of the Nation is to continue to serve the public, it must receive operating supplies such as fuel, gasoline, soap, detergents, paper products, cotton goods, repair parts, etc. Without these everyday operating supplies, the laundries of America can no longer service not only the public but also, as previously suggested, the hospitals, orphanages, hotels, restaurants, and other public institutions that rely on laundries in order that they in turn may operate.

There, furthermore, is one definite probability that must be considered in the study of the current problem, and that is the factor of economy. It seems obvious that laundry units especially designed for the purpose are in a better position to operate more economically in the matter of supplies than could be the case with many small widely scattered units. As an example of this point, the subject of laundry-soap consumption may well be considered. In hard-water areas, thousands, if not millions, of pounds of soap are wasted annually in home consumption with the use of hard water. Laundries in these self-same areas operate zeolite softening units that remove the hardening constituents of a water supply, thereby saving enormously in soap consumption per pound of soiled goods.

It likewise should be kept in mind that the same equipment and employees that are used to process hotel, hospital, and similar work often are used to launder work from private homes. One cannot be separated from the other. This point is so well recognized in England that the laundry industry is permitted to operate continuously, in spite of the far more serious commodity situation that England faces than does the United States.

Another factor of equal importance is the matter of power. It must be quite apparent that laundries will use far less power when washing and ironing in bulk than would be the case if this work were distributed in millions of homes (even if such a thing were possible), using an almost unlimited amount of electrical power in the home for washing machines, electric irons, etc. As a matter of record, practically every laundry generates its own power, excess steam being used to heat hot water. Thus, laundries relieve the power load on public service stations in areas in which a shortage of power might be felt.

CONCLUSIONS

The following conclusions are recognized facts:

1. Laundries are in the first line of defense against the spread of infectious disease and, therefore, of great value in maintaining public health and national morale.

2. Laundries are essential for the daily living and operation of millions of homes and public institutions, including hospitals, sanitariums, orphanages, steamships, hotels, restaurants, and other similar services.

3. Laundries are providing regular employment to 250,000 people, of whom 70 percent are women.

4. Laundries are even more essential in the modern-day operations of the United States than was the case in 1918, when the industry was declared by the Priorities Board of the day to be an industry of "exceptional importance."

Under the circumstances, the American Institute of Laundering, the national trade association of the laundry industry, respectfully urges that serious consideration be given to the matter of the continuous furnishing of sufficient laundry supplies, gasoline, and fuel to the laundries of the Nation to enable them to render a service which, while providing employment for 250,000 people, results in a service of vital importance to the Nation.

In order that this whole question of declaring the laundry industry an essential one during the national emergency may be brought to final conclusion, we respectfully request an opportunity to be heard before the proper official or officials at an early date. The American Institute of Laundering has appointed a small committee to handle this entire matter, and simply awaits your request for a conference in Washington. Be assured that it is our earnest desire to cooperate wholeheartedly with our National Government.'

NOTE.—*General statistical information.*—The American Institute of Laundering was established in 1883. Its membership processes approximately 75 percent of all laundry work done in the United States.

The CHAIRMAN. Are there any questions, gentlemen, that you wish to ask Mr. Skinner? If not, Mr. Skinner, thank you for your appearance.

Mr. SKINNER. You are welcome, Senator. I thank the committee for this opportunity.

The CHAIRMAN. Do you wish to make a statement in regard to the matter, Mr. Matthews?

Mr. MATTHEWS. I am here just to support Mr. Skinner.

Mr. SKINNER. Mr. Matthews is here simply to support me in a technical way, he being more familiar with the laundry machinery manufacturing business.

Senator DANAHER. Mr. Chairman, one question.

The CHAIRMAN. Yes.

Senator DANAHER. As to whether or not, during the period of the last war, or just subsequent thereto, your industry was taxed on the manufacture of washing machines?

Mr. MATTHEWS. I could not answer that.

Mr. SKINNER. You mean whether there was a tax on washing machines?

Senator DANAHER. Yes.

Mr. SKINNER. I would say "no." I am not 100 percent sure of that statement, however.

Mr. MATTHEWS. There is one thing I might add. The figure given of the $4,500,000 on washing machines is based on the fact that they are built out of monel and nonferrous metals. Well, we cannot get them, so we will have to build wood machines, and wood machines will sell at 40 percent, approximately, less than this figure.

The CHAIRMAN. I do not know whether my recollection is correct, but that is one of the reasons why the defense committee recommended this type, so as to prevent competition with necessary defense purposes.

Mr. MATTHEWS. It is impossible for us to get it. We are out of it and we cannot get it so we will have to go to wood, and when we go to wood, it will be 40 percent less than this, so you see you will get nowhere near the amount of taxes that you expect to get.

Mr. SKINNER. It seems Mr. Stettinius has taken care of that. He has put priority on it so we cannot get but very little monel metal; and very little steel.

The CHAIRMAN. Thank you very much.

(The following letter was received from Mr. Matthews and ordered inserted in the record:)

THE AMERICAN LAUNDRY MACHINERY CO.,
Cincinnati, Ohio, August 15, 1941.

The Honorable WALTER F. GEORGE,
Acting Chairman, United States Senate Committee on Finance,
Washington, D. C.

MY DEAR SENATOR: On Monday, August 11, 1941, I had the honor of appearing with Mr. R. B. Skinner and a group of men representing the American Institute of Laundering (a national association representing 75 percent of all work done in laundries in this country), also the Laundry and Dry Cleaners Machinery Manufacturers Association, and the Laundry and Cleaners Allied Trades Association, each of which represents 95 percent of the volume in their respective fields. The purpose of our appearance was to protest against the proposed 10-percent tax to be placed on washing machines of the type used in commercial laundries. This tax is referred to on page 75, paragraph 8, subsection 3406 of section 552, and reads as follows:

"Washing machines of the kind used in commercial laundries, 10 percent. No tax shall be imposed under this paragraph on washing machines of the household type."

You made the statement during this hearing that one of the reasons this tax was placed was due to the necessity of restricting the use of monel and nickel in the manufacture of these machines. It was pointed out it is now impossible to secure any of these materials, even though we do not have a tax at the present time.

It was expected that a revenue of $1,100,000 would be realized on the basis of a 10-percent tax on the sale of commercial washing machines. It was brought out this was in error. It was liberally estimated that during the year of 1940 not over $4,500,000 worth of commercial washing machines were manufactured in this country. In the year 1941 the amount of sales probably will be increased considerably due to the fact the Government purchased a large number of this type machine for cantonment laundries. However, the Government is not subject to tax; therefore, the revenue would be materially reduced and it would be questionable whether during the year of 1941 even $350,000 would be realized if a tax of 10 percent were imposed on the sale of all commercial washing machines.

We are faced with the necessity of substituting wood in the construction of commercial washing machines due to the fact that it is impossible for us to secure noncorrosive metals. In event we do manufacture machines of wood, the selling price would be reduced at least 40 percent over the price of those machines manufactured of noncorrosive metals, which would mean a large reduction in the estimated amount of revenue to be derived from such a tax.

Furthermore, this tax is discriminatory due to the fact, as brought out in the brief by Mr. Skinner, it taxes one type of processing machine, and many other types of processing machines bear no tax whatsoever.

The household washing machine industry, which is a direct competitor of the commercial washing machine, manufactured in the year 1940, $104,000,000 worth of household washing machines. A 1 percent tax on this class of machine would bring forth as much money as it was expected to receive from the proposed 10 percent tax on commercial washing machines.

In view of the fact that this proposed tax is so discriminatory we are asking you to support us in our plea to remove this proposed 10 percent tax on commercial washing machines from the new tax bill.

Respectfully submitted.

THE AMERICAN LAUNDRY MACHINERY CO.,
By A. MATTHEWS,
Assistant to President, General Sales Manager.

The CHAIRMAN. Mr. Hugh M. Bennett.

STATEMENT OF HUGH M. BENNETT, COLUMBUS, OHIO, REPRESENTING THE SUPERINTENDENT OF INSURANCE OF OHIO

The CHAIRMAN. Mr. Bennett, would you please give the reporter your name and address, for whom you appear here, if you appear for someone other than yourself?

Mr. BENNETT. Mr. Chairman, my name is Hugh M. Bennett and I appear on behalf of the Superintendent of Insurance of Ohio. I have a prepared statement which it is my hope you will receive in due course and permit to be placed into the record. I would rather not read the statement, I would rather speak informally to the members of the committee.

The CHAIRMAN. You may put your statement in, Mr. Bennett. We would rather approve that course, if you are ready to explain what you have in mind without reading the statement. You may give it to the reporter and it will be inserted in the record, or such parts of it as you wish.

Mr. BENNETT. The American Insurance Union is one of the old fraternal benefit societies that have rapidly passed out of existence. It had more than 20,000 members and its claims are widely scattered throughout the United States, and in fact the company was, at one time authorized to do business in 28 different States.

It became necessary to reorganize almost its sole asset, the largest office building in the city of Columbus. It is a 46-story building. For the purpose of that reorganization they used the method that all you lawyers on the committee understand, and that is, the equity foreclosure method to transfer title from the predecessor.

Senator HERRING. Some of the rest of us understand it, too, some of us who are not lawyers.

Mr. BENNETT. If you had that misfortune, that really calls for sympathy.

Of course, the old American Insurance Union issued a block of bonds to build the building back in 1927. A committee was directed to be formed by the court in Ohio to solicit the deposit of these bonds. A plan of reorganization was approved by two courts, the Federal court of Columbus as well as the Ohio Court of Appeals. As a result the plan was consummated finally by having a sale made at an upset price fixed by the Federal judge, and the sale transferred the title to the taxpayer corporation in this case. The sale was made for $1,650,000, which I submit has no bearing whatever upon the value of the property. The property cost in 1927, exclusive of the land, $8,000,000 approximately. I submit naturally that that is not its value today, nor was it its value on July 1, 1937, when the transfer of title was supposed to have taken place but which was not finally consummated, due to court involvement, until December 16, 1938.

Now, I am not down here, gentlemen, pleading the case of an individual taxpayer. I merely go into these preliminary details for the purpose of laying before you an illustrative case which applies to hundreds of corporations in this country.

The Treasury may say to you, as they said to me when I thought I might get relief without an amendment to the law, that this was an isolated transaction. There are over 15 cases today, either in the

circuit courts of appeals or the United States Supreme Court involving analogous angles, which has led to a great amount of litigation, a great amount of expense, and the Government has not received its tax. The solution is not administrative, the solution is not judicial, the solution is legislative.

The Treasury said that the solution might lay with the administration of the law. The reorganization sections are so complex that Mr. Stam himself will tell you that perhaps they are not easily understood, and I know that for the professions, either in the accountancy profession or legal profession, they are not understood at all.

Now, the immediate problem which brings me before the committee is because in last March the Congress of the United States repealed section 722 of the Excess Profits Tax Act of 1940. Section 722 vested in the Commissioner absolute discretion to give relief where there were abnormalities in invested capital. Today we do not have that privilege. I have perfect faith in the Commissioner. Some groups did not want to vest that power in the Commissioner and therefore they sought to have the section stricken out. The result is that today there is no relief where a corporation has an abnormality in invested capital, yet the excess-profits tax credit is based upon the invested capital.

I say that the revenue law now being considered by this committee, by the Senate, and by the entire Congress eventually, should provide that when a judicial sale occurs and there is a transfer of title to a new corporation, the transferee corporation should receive the same basis as the transferor whether it comes within the technical definition of tax-free reorganization or not. Why do I take that position? The Treasury very properly protected the Government in July last year by sponsoring before the Congress, and the Congress passed it as an amendment to the Chandler Act, an amendment to the bankruptcy law by which not to exceed the fair value of the property transferred through a bankruptcy reorganization could be used as a basis for the transferee, that is, the purchaser at the bankruptcy sale. But I submit, and all of you lawyers know that all corporations cannot use the bankruptcy law. Municipal corporations, insurance companies, building and loan companies, and banks cannot reorganize through bankruptcy, never have been able to do so, yet there is a gross discrimination against those corporations because they cannot seek that method of reorganization. The American Insurance Union was an insurance corporation under the insurance laws of Ohio. It could not reorganize this large office building, 46 stories in height, except in one manner, that is, through an equitable foreclosure suit.

The Treasury's purpose in having the Chandler Act amended last summer was to prevent, so it has been explained to me by the Treasury, a group of bidders who had the defaulted bonds getting together and pooling their interests through deposit with a committee, which is a usual method, or any other manner, whereby the interests are pooled, and getting an upset price fixed that was away in excess of the market value of the property at that time and using it as a base.

Let us see what might have been done. The bondholders in this case, instead of bidding $1,650,000 for this building, we have enough

bonds with accrued interest that were in default, could have bid approximately $4,000,000 for this building. There would have been no doubt that our base then, under the section 112 of the Revenue Act would have been $4,000,000, but because we only paid $1,650,000, which is an arbitrary upset price, the Treasury says and the Commissioner says:

> That is your basis, that is all you can have as invested capital, that is all you can have as a basis for depreciation. If you sell your building later, that is all you can have to compute your gain or loss.

I submit that the books are full of precedents that the fair market value has very little, if anything, whatever, to do with a foreclosure sale price, therefore I ask that in all judicial sales the basis be the predecessor basis. If there must be a limit on it, I say limit it to 50 percent of the predecessor basis. In fact, I do not see why there should be a limit at all, but if from political expediency, economic expediency, we cannot have a full predecessor basis passed on to the transferee, then put a 50-percent limit on it. I will show you in a moment why I arrive at 50 percent.

May I reiterate for a moment by saying there is no sound reason why an industrial plant, a manufacturing establishment, should have the privilege of reorganizing through bankruptcy and having the benefit of the amendment of last summer, in July, by which its basis is its predecessor's basis, but never to be more than the fair market value of the property at the time of the transfer.

If this present contention of the Commissioner in his enforcement of the law would prevail, that would destroy entirely the invested capital of this new transferee company which was created by the superintendent of insurance in Ohio to hold title to this tall building. Why would it destroy all such credit for excess-profits taxes? Because the old bondholders had to receive new bonds; those bonds were scaled down. The old bond issue face value was $3,450,000, virtually $3,500,000. They scaled it down to $2,600,000, and therefore the new corporation owes money today. The building, if it is to be valued as the Commissioner contends, is to be valued at $1,650,000, the foreclosure sales price, therefore we are insolvent when we get through with our reorganization. We owe $2,600,000 and we only have $1,650,000 of assets, but as a consequence we have no invested capital because we owe more than we ever put into the business, according to his computation. We are only allowed to use 50 percent of borrowed money for invested capital in applying the credit under the Excess Profits Tax Act.

The demand of the Commissioner, I say here in my statement, is so extreme as to be almost absurd, because we have a 46-story building completed in 1927 at a cost of a little in excess of $8,000,000 exclusive of the land, and it is now to be limited for invested capital purposes, for depreciation purposes, for gain and loss purposes to $1,650,000.

Now, there has been placed before the desk of each member a computation sheet which is marked "Exhibit A." I direct your attention particularly to columns 3 and 4, which show the unjust and inequitable result by applying the present rule as insisted upon by the Commissioner. In other words, in column 3 there is the situation which confronts this particular company and hundreds of other companies just like ours if the foreclosure sale price is the basis. In other words,

the taxable income is $113,000 annually there. Yet if the rule for which I contend, that is a sound reproduction value, is adopted by an amendment to the law, the income which would be subject to the income tax would be $56,000. You will observe, however, that if we would have the predecessor basis we would have a net loss before the reorganization, as shown in column 1, of $120,000, and in column 2, if it is a nontaxable reorganization, we would have $14,000 net loss. Well, the Government has its eye out for revenue, so naturally it construes all these reorganization cases to be taxable reorganizations, so they are denied their predecessor basis.

Senator HERRING. Mr. Bennett, what is the assessed value for real-estate taxes?

Mr. BENNETT. I do not happen to know, Your Honor.

Senator HERRING. You do not?

Mr. BENNETT. I do not happen to know.

The CHAIRMAN. Mr. Bennett, the Commissioner would not allow you to set up the fair market value of the property?

Mr. BENNETT. He is not interested in hearing us on the fair market because of the United States Supreme Court decision in the *Midland Mutual Life Insurance Co. case* (300 U. S. 216). If you would adopt the bankruptcy rule, that is the last July bankruptcy rule, the rule of last summer, in the tax law, then, of course, he would have to hear us on fair market value. His regulation, but not the revenue law, says he should hear us on fair market value, because the regulation says, I think it is in paragraph 19.23 (k) 3, if I remember my symbols properly, that any foreclosure sales price shall be determined to be the fair market value unless "clear and convincing evidence" is introduced to the contrary, but if it is a nontaxable reorganization we get the predecessor basis, and if it is a taxable reorganization we get the foreclosure sale price unless they will hear us on fair market value. It is impossible to find "clear and convincing evidence" of the fair market value of a 46-story building at a given time when there are no comparable properties sold at about the same time. I want a rule in the law by which fair market value is written into the law, but preferably a sound reproduction cost, because I submit that property of this type and character does not have a fair market value. For it, there is not such a thing as fair market value.

A 46-story building in our little city will not be sold in a quarter of a century, and I do not believe it will be sold in half a century. I do not believe there are any comparative properties from which you will find fair market value. We have in the State of Ohio only four properties with which this might be compared, and they are all in other cities. Fair market value is the most ellusive test in the world. What is fair market value for a white elephant that nobody wants? It does not have a fair market value. I want a formula used that is real, that is genuine. I want a sound reproduction cost that is capable of engineering computation and of careful computation in a court. Fair market value means nothing, Mr. Chairman, with relation to a property of this kind.

The CHAIRMAN. You have got a building reproduced in a place where there is no demand for it at all. You might have the same situation there. It might be utterly worthless.

Mr. BENNETT. Nevertheless there would be the invested capital. If somebody was foolish enough to put that building up, although they would not get a return they would have the invested capital and they would be entitled to their credit against the excess-profits taxes on that invested capital. If this is an improvident investment, that is their loss, but they should not be penalized by being deprived of the 8 percent or 7 percent on the invested capital.

Senator TAFT. Mr. Bennett, the new company in this case is a company the stock of which is owned by the State of Ohio?

Mr. BENNETT. Fifty percent of it is owned by the State of Ohio.

Senator TAFT. Fifty percent of it is owned by the bondholders?

Mr. BENNETT. By the bondholders.

Senator TAFT. And 50 percent by the State of Ohio?

Mr. BENNETT. For the benefit of the old policyholders.

Senator TAFT. The old policyholders of the old company?

Mr. BENNETT. That is right.

Senator TAFT. So it is really a continuation, largely, of the old company?

Mr. BENNETT. That is right.

Senator TAFT. Do I understand that although you may have a loss, for instance, of $120,000, a net loss for income-tax purposes, for the ordinary accounting purposes you still might have to pay a tax of $113,000?

Mr. BENNETT. A tax on $113,000.

Senator TAFT. A tax on $113,000 of income?

Mr. BENNETT. That is right.

Senator TAFT. That you haven't got?

Mr. BENNETT. That is right. Now, exhibit B to this statement of ours is now being placed on your respective desks, and that shows the result if we would use the bankruptcy rule which is in the United States Code today as an amendment of last July to the Chandler Act. If you will use a fair market value there of $4,000,000 the result is that we will have a taxable income of $66,000. Now, that is just one-half of the cost of the building alone, the $4,000,000, it is less than one-half of the entire investment in the land and building. I say that the revenue law has for many years recognized the 50-percent rule in relation to individual investors, that is in relation to individual bondholders. In other words, under the capital gains and losses provisions of the revenue laws it is provided that where bonds or other securities are held for 2 years or longer, then are sold or exchanged, the result in taxable gain or loss is taxable only to the extent of 50 percent of that actual gain or loss.

Thus, the 50-percent clause, I submit, should now be extended to corporations themselves; that is, if they are in presently taxable reorganizations. I hope that this type of reorganization will be nontaxable by amendment to the law, but today, of course, it is called a taxable reorganization according to the contention of the Commissioner. This we disputed, of course, for the matter of the record.

Now, what specifically is it that we seek? This is stated in the following language in my statement, which I ask to be included in the record. I urge that section 112 (g) (1) of the Internal Revenue Code, which now defines a tax-free reorganization, be amplified so that a transfer of substantially all the property of one corporation to

another corporation by any judicial sale will be included. Now, this will require an amendment to section 113 (a) (7), that is the basis section, so as to conform it to the amendment, if made, to section 112 (g) (1).

Why, I repeat, gentlemen, there should be all of this favoritism shown to a reorganization carried out through bankruptcy when it is impossible to have the same tax result if you carry your reorganization through equity foreclosure, through execution, sale, after a judgment, through an attachment sale, or through the repossession of property by a transfer under a trust indenture which is permitted in some States without any judicial process whatever, I do not know. Why should only bankruptcy get the preferential treatment?

Now, I say that the Government itself should have the protection which I urge should be extended to the tax law from the Chandler Act. Why do I say that? The Government requires the protection for the reason that this corporation, these bondholders, could have done the very thing that the sharp fellows could have done last July with relation to a bankruptcy reorganization. We could have bid our property at $4,000,000, we could have had that as a basis, and we could have used that in computing our depreciation, we could have used that in determining our credit against the excess-profits tax, but because we did not run up the price at the sale in 1937, before we ever thought of an excess-profits tax or invested capital, now we are penalized as we could not use the bankruptcy method of reorganization, nor can hundreds of institutions use it, or corporations, because it is barred to them, it is denied to them.

I do not see why the tax law cannot invoke the same rule that the Chandler Act has used.

The CHAIRMAN. You are going on the presumption that if you have no evidence of market value that what you gave for the land and building is to be taken into consideration, and if it were nontaxable land it should take the basis of your transferor, the original taxpayer.

Mr. BENNETT. If it were nontaxable we would get the predecessor basis.

The CHAIRMAN. You would get the predecessor basis?

Mr. BENNETT. That is right, Mr. Chairman.

The CHAIRMAN. And they have held this to be taxable.

Mr. BENNETT. They have not held anything about this yet. It is just in the state of flux.

The CHAIRMAN. Maybe it is better than you think.

Mr. BENNETT. I do not think so. I am trying to be a realist about this.

The CHAIRMAN. We get your point; I think the committee does. You think at this time this equity foreclosure proceeding through which this particular property, as an illustration merely, has gone, that that ought to be regarded as tax-free, or that some other equitable rule should be worked out rather than the application of the strict nontaxable reorganization.

Mr. BENNETT. I think wherever there has been a transfer of title by judicial sale that should be the case.

The CHAIRMAN. I understand.

Senator JOHNSON. Does your trouble all grow out of the excess-profits feature of the tax bill?

Mr. BENNETT. When section 722 was repealed then our troubles began. I would never be here if you had not repealed section 722, as it was enacted last year, in 1940, as a part of the original Excess Profits Tax Act. Then the commissioner had a right to give an adjustment for abnormality in invested capital. Here is a building that stands 46 stories high: What is our invested capital? According to the commissioner's contention it is $500, the cash paid in when the taxpayer was incorporated.

Senator TAFT. It is all in the top brackets?

Mr. BENNETT. Yes; it is in a top bracket. We reorganized to save money to the policyholders. As I say in my statement, we would have been much better off to have stayed in receivership forever, because in receivership we would have had the predecessor basis, we would have enough for depreciation, we would have enough to pay the income tax, our policyholders would get something. We have now to give our earnings, that we have tried to conserve for the policyholders, for excess-profits taxes. We do not have any war industry, we do not have any armament, defense work; we simply rent offices in a building and in a hotel, and yet we are in a top bracket, as Senator Taft points out, for the purpose of the excess-profits tax. If you cannot restore section 722, then let us have it defined, and give us a sound reproduction value as a measure for our basis.

Thank you.

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

(The brief submitted by Mr. Bennett is as follows:)

BRIEF IN SUPPORT OF RELIEF RESULTING FROM ABNORMALITIES IN INVESTED CAPITAL IN THE COMPUTATION OF EXCESS-PROFITS TAX

My name is Hugh M. Bennett. I appear here on behalf of the Superintendent of Insurance of Ohio, as an attorney-at-law from Columbus, Ohio. For the last 8 years the Superintendent of Insurance of Ohio and I have been serving as coreceivers of the American Insurance Union, which was a fraternal benefit society located in Columbus, Ohio, and organized under the insurance laws of that State. This insurance company has more than 20,000 members and claimants widely scattered throughout the 28 States in which it was qualified to do business.

The insurance company owned a 46-story office building, which is the largest building in Columbus. Exclusive of the land, the building itself cost approximately $8,000,000. Due to the financial involvement of the insurance company, it was necessary to reorganize the above office building property through the means of an equity foreclosure proceeding in the United States District Court at Columbus, and also through a quo warranto action in the court of appeals of Franklin County, Ohio, which also sits in Columbus. This reorganization was concluded in December 1938. One of the steps to consummate the reorganization was a foreclosure sale in the United States District Court in an action instituted by the trustee for the holders of mortgage bonds, secured by a mortgage on this office building. The bond issue went into default in 1932 because the insurance company was unable to pay principal installments and interest due thereon.

Bondholders' committees were organized in 1933 and 1934 to protect the holders of these mortgage bonds. These committees agreed upon a plan of reorganization which was approved by both of the above courts. This plan provided for the above-mentioned foreclosure sale, so as to transfer title from the insurance company to the present taxpayer corporation which holds title to the office building.

The superintendent of insurance as coreceiver of American Insurance Union, under the reorganization plan holds 50 percent of the outstanding capital stock of this new transferee corporation which is named Fifty West Broad, Inc.

These bondholders' committees, acting on behalf of this new corporation, which the plan proposed should be organized, bid in the property at the foreclosure sale for an upset price approved by the Federal court for only $1,650,000. This

upset price was paid for the most part in the old mortgage bonds issued by the insurance company, which bonds had been deposited with the committees by the holders thereof.

I have gone into this detailed statement of our own situation because it is illustrative of hundreds of other comparable situations throughout the United States. As many of the lawyers on the Senate Finance Committee know, this method of reorganizing a company in financial difficulties is customary and has been uniformly followed in Federal and State courts for more than half a century. The relief which should be granted to Fifty West Board, Inc., should be by means of a general provision which would bring more equitable tax treatment to hundreds of other corporations created in a similar manner because of financial difficulties.

The immediate problem which has prompted me to appear before you today was created only in March of this year by the repeal of section 722 of the Excess Profits Tax Act of 1940. Section 722 thus repealed gave to the Commissioner discretion to grant relief from undue hardship resulting from abnormalities in invested capital. Since March of this year the Commissioner has no such power or authority and the taxpayer with an abnormal invested capital is without any means of redress.

The revenue law now being drafted should afford more equitable tax treatment by means of a provision which would give to the transferee corporation, acquiring title by a judicial sale or by means of the foreclosure of an instrument of lien securing the defaulted securities of the transferor corporation, the sound value (reproduction cost depreciated), or at least the value fixed by the Chandler Act amendment in July of last year, but not less than 50 percent of the basis of the transferor or predecessor corporation. This basis should also be the measure of invested capital under the Excess Profits Tax Act. This relief provision should apply in all instances of taxable reorganization, where gain or loss is recognized, involving judicial sales such as mortgage foreclosures, judgment executions, attachment sales, sales for nonpayment of real-estate taxes, and as mentioned above, transfer of title in those States where the law permits it without judicial process, but in according with the provisions in the instrument of lien.

I do not propose that such an amendment to the Revenue Act should apply to sales in a bankruptcy proceeding because the Congress in July 1940 amended the Chandler Act to protect the Government from the scheming of taxpayers to get a very high base by having an upset price fixed by the bankruptcy court at an amount which could be bid by holders of the defaulted bonds, but, nevertheless, much in excess of the then fair market value of the property. However, I do urge that, at least, the basis for corporations resulting from reorganizations under the Chandler Act, as amended in July of last year, should be made available to all corporations resulting from reorganizations under any other procedure. The Government requires the protection, which it now has under the above Chandler Act amendment, in all other fields of reorganizations. Thus the Treasury should endorse my recommendation. Without this protection for the Government, we could have done what hundreds of other groups of holders of defaulted bonds may yet do to minimize their taxes, that is, we could have bid approximately $4,000,000 for this property and have paid the bid price in defaulted bonds. In this manner we should clearly have obtained a basis for depreciation, subsequent sale, invested capital, etc., equal to the amount bid.

The Bankruptcy Act expressly excludes insurance companies, banks, building and loan companies, and municipal corporations from taking advantage of a reorganization under its provisions. Thus those businesses are treated most inequitably. No sound reason appears why reorganizations, no matter in what manner effected, whether through bankruptcy or otherwise, should not all have the same tax result. No preferential treatment should be granted to a corporation which happens to be so organized that it can avail itself of the bankruptcy procedure. Insurance companies should not be discriminated against merely because they cannot reorganize under the Chandler Act.

In short, I urge that section 112 (g) (1) of the Internal Revenue Code, which now defines a tax-free reorganization, be amplified, so that a transfer of substantially all the property of one corporation to another corporation by any judicial sale will be included. This will also require an amendment to section 113 (a) (7) so as to conform it to the amendment to section 112 (g) (1).

Now, however, the Commissioner of Internal Revenue contends in our case and in hundreds of other cases that the above reorganization plan did not provide for a tax-free reorganization under section 112 of the Internal Revenue Code and, hence, that Fifty West Broad, Inc., does not have for the purpose of depreciation the basis of its predecessor insurance company, as defined in section 113.

The Commissioner demands that the foreclosure sale price limits our basis for depreciation. This would wholly destroy our invested capital, leaving no credit against the excess-profits tax. The Commissioner has made a similar demand upon hundreds of other corporations resulting from comparable reorganizations. This demand is so extreme as to be almost absurd, because a 46-story building which cost in 1927 approximately $8,000,000, exclusive of the land, when the land itself was valued at $1,000,000 additional, is now to be limited for depreciation purposes to a foreclosure sale price or upset price of merely $1,650,000—less than 20 percent of the original cost of the land and building.

In computing the annual depreciation, the value of the land must be deducted, according to the demands of the Commissioner, from the foreclosure sale price of $1, 650,000, which leaves a relatively insignificant amount as a basis for depreciation.

We have attached to this statement as an exhibit a computation showing the hardship upon the large class of taxpayers to which Fifty West Broad, Inc., belongs under the income-tax law, which would result from obedience to the Commissioner's demands that invested capital be limited by the foreclosure sale price.

Congress has enacted from time to time during the past many years laws to prevent unfair competition. Yet by omitting from the present excess profits tax laws any provision by which the Commissioner may grant relief from abnormalities in invested capital, it is causing all corporations resulting from reorganizations to engage in competition on an extremely unfair and prejudicial basis with their competitors which have not been required to reorganize. By reorganizing and scaling down its mortgage debt and its interest rate thereon, the insurance company in the instant case planned to place its building upon a sound financial footing, but if the Commissioner's demands are not to be modified by the revenue law to be enacted this summer, this reorganization has in reality handicapped the insurance company, its policyholders, and its bondholders because it would have been much better to have had the company remain in receivership. Under receivership it would have had an invested capital based upon the cost of the building and land and an annual depreciation deduction from taxable income based upon the cost of the building, instead of one-fifth of that cost, which is the foreclosure sale price that has no relation to sound value whatsoever. Reorganized corporations should be permitted to pay taxes on the same basis as their competitors. This cannot be achieved if an upset price at a foreclosure sale is to determine the basis for depreciation or invested capital.

If no relief is to be granted by the new revenue law, this company may have to reorganize again by having the mortgage securing its present outstanding bonds foreclosed and bidding in the property through a new corporation to be created for that purpose, not at a nominal upset price, but at its sound value, making payment therefor in bonds presently outstanding of Fifty West Broad, Inc. In that manner it can increase its invested capital and secure a fairer basis for depreciation.

The reason why the tax amendment I advocate is more practical than the remedy given by the Chandler Act amendment of last summer is emphasized by the following considerations: Fair market value is no criterion for the basis for depreciation of the transferee corporation—in our situation, Fifty West Broad, Inc. Hardly ever is there any comparable property which will be of any assistance to the Commissioner of Internal Revenue in determining the fair market value of the taxpayer's property. Forty-six-story office buildings, such as ours, are not sold once in a quarter of a century to establish a fair market value. There is only one such building in the city of Columbus, so there can be no fair market value determined by examining the sale price of another such property.

It has been suggested above that the transferee corporation should have as a basis the sound value of the building, but not less than 50 percent of its predecessor's basis. The 50-percent rule has been applied to the individual bondholder under revenue acts for the last several years. This is found in the capital gain and loss provisions of the revenue laws where it is provided that bonds or other securities held for 2 years or longer, when sold or exchanged, result in taxable gain or loss only to the extent of 50 percent of the actual gain or loss. Thus, the 50-percent rule might now be extended to the corporations themselves in taxable reorganizations.

EXHIBIT A.—*Typical reorganization through judicial sale*

	Before reorganization (predecessor) (1)	After reorganization (nontaxable) (2)	After reorganization (judicial sale price) (3)	After reorganization (taxable) (sound reproduction value) (4)
Basis of building:				
Cost price (predecessor)	$8,000,000	$8,000,000		
Judicial sales price			$1,650,000	
Sound reproduction value				$1,500,000
Bonds outstanding:				
6 percent	3,500,000			
4 percent [1]		2,600,000	2,600,000	2,600,000
Income before interest and depreciation	250,000	250,000	250,000	250,000
Interest:				
6 percent	210,000			
4 percent [1]		104,000	104,000	104,000
Depreciation: 2 percent	160,000	160,000	33,000	90,000
Total interest and depreciation	370,000	264,000	137,000	194,000
Taxable income			113,000	56,000
Loss	120,000	14,000		

[1] Bondholders receive new bonds and stock.

Comment: Columns (2) and (3) of the above table illustrate the widely varying results under the technical provisions for the basis of property after a reorganization through judicial sale. Column (4) represents the application of our proposal for the correction of these inequalities.

EXHIBIT B.—*Taxable income from a reorganization under the bankruptcy law as amended in July, 1940. This amendment was sponsored by the Treasury Department*

Basis of building; fair market value	$4,000,000
Bonds outstanding, 4 percent	2,600,000
Income, before interest and depreciation	250,000
Interest, 4 percent	104,000
Depreciation, 2 percent	80,000
Total, interest and depreciation	184,000
Taxable income	[1] 66,000

[1] This resultant taxable income from a reorganization effected under the present bankruptcy law should be contrasted with a taxable income of $113,000, resulting from the same reorganization through the procedure under any judicial sale (see col. 3, exhibit A) other than a bankruptcy sale. This grossly inequitable result should be corrected by an amendment immediately in the manner presented in the statement of Hugh M. Bennett, in behalf of the superintendent of insurance of Ohio.

The CHAIRMAN. Mr. Milton Diamond.

STATEMENT OF MILTON DIAMOND, REPRESENTING DECCA RECORDS, INC., NEW YORK, N. Y.

The CHAIRMAN. Mr. Diamond, will you give your name, please, sir, and address?

Mr. DIAMOND. My name is Milton Diamond. 598 Madison Avenue, New York. I represent Decca Records, Inc.

I have prepared, Mr. Chairman, a statement that I would respectfully ask to be included in the record, and which I would also like to pass around, if I may.

The CHAIRMAN. Yes; you may do so. You appear with reference to a particular thing in the tax bill, Mr. Diamond?

Mr. DIAMOND. I do. I appear to urge the elimination of the proposed levy of 10 percent on phonograph records.

Senator CONNALLY. All of them, or just some kind of records?

Mr. DIAMOND. All of the phonograph records.

Senator CONNALLY. Oh, yes.

Mr. DIAMOND. The company I represent is one of the three major companies engaged in the recording and manufacture of phonograph records. I assume it is pertinent to examine the extent by which the proposed tax levy may be affected by a consideration of the item to which I am addressing myself.

The Treasury's schedule of anticipated revenue refers to the item of phonograph records and phonographs together and indicates a possible yield of $4,500,000 from that source on the basis of a 10-percent levy on the manufacturer's cost. I am not addressing myself to the subject of phonographs at all, I appear only in relation to phonograph records, and it is our estimate that the maximum yield from that source as distinguished from the combined items of phonographs and phonograph records would not exceed $1,500,000.

At this point, it might be important to refer briefly to some of the history of the phonograph-record business. In 1929 that industry reached a high level of well over 100,000,000 units which were sold in the American market. By 1933—and I say this unaccusingly—as the result of a combination of circumstances the total units that were distributed in the United States had been reduced to something around 12,000,000. In the following year a supreme effort was made to restore public interest in phonograph records, and the device was resorted to of offering to the public records at a retail price of 35 cents as distinguished from the evailing price for comparable records up to that time of 75 cents. The public indicated a renewed interest in phonograph records in that year and in succeeding years. We found, however, that it was not possible to operate profitably and continue to market records at that price in the light of an excise tax of 5 percent to which we were then subject and which was absorbed by the manufacturers. The margin of profit on a 35-cent record which sells to dealers for 21 cents is not very great, as you might very well imagine, and absorbing the 5 percent excise tax we found there was no possibility for continuing gainfully in the conduct of that business.

So, we addressed ourselves to the Congress, and in 1937 we made representations urging the repeal of the excise tax. In doing so, we called attention to, first, the fact that a phonograph record had a useful purpose as a cultural medium, and, secondly, that the tax yield was nominal and perhaps did not represent as much as it cost the Government to collect it.

For example, in 1936, the tax yield from the entire phonograph-record industry was $290,000, and in 1937 it reached $325,000.

Also we made some promises and predictions when addressing ourselves to the Congress in an effort to remove that tax. We said if that tax were removed the industry would really prosper, that it would continue in its effort at revival, that the phonograph record was an important part of the cultural life of the community, that it would result in increased employment and in increased taxes to be paid by the manufacturers, by the artists who were employed by the manufacturers, by the suppliers of materials, and others.

Congress gave sympathetic consideration, and effective as of June 1938, the tax was removed, and since that time there have been rather important developments in that little industry of which we have the honor to be a part.

For example, in the year 1938 the company which I represent paid out in salaries $673,000; in 1940 it paid out in salaries over $1,235,000. In 1938 we employed 614 people, and in 1940, 2 years after the removal of the tax, the number of employees almost doubled. In 1940, this company paid in direct taxes $186,000, as compared with $78,000 which it paid in the year during which the tax was removed. We think 1941 will be an even more important year.

Senator VANDENBERG. Why would the removal of the tax be responsible for the increase if you absorb the tax?

Mr. DIAMOND. We were not able to carry on our business profitably until that tax was removed. It was not until 1938 that the tax was removed.

Senator VANDENBERG. I understand that.

Mr. DIAMOND. When the tax was removed it became possible for us to expand to the point where we could employ additional capital and additional labor and additional artists and additional suppliers of materials, bringing about this increased consumption of our material by the public.

Senator VANDENBERG. It was not the wholesale price of the record to the public?

Mr. DIAMOND. Well, the price of the record to the public is what reawakened the interest in the records on the part of the public. We could not carry on the business and maintain that price and absorb the tax at the same time. That is why we applied for the removal of the tax, and when our efforts became successful and the tax was removed, it was possible for us to expand.

Senator DANAHER. What were your gross sales for the period in which you had $1,253,000-plus of salaries?

Mr. DIAMOND. Our gross sales in 1940 were under $6,000,000.

The CHAIRMAN. Mr. Diamond, what is the average price of your record, the manufacturer's price, I mean, the wholesale price?

Mr. DIAMOND. The wholesale price of more than two-thirds of the product that we sell is 21 cents. The manufacturer's cost is less than that, of course, but the price which dealers pay is 21 cents. That is the wholesale price for the 35-cent record.

The CHAIRMAN. The tax is on the wholesale price?

Mr. DIAMOND. The tax is on the manufacturer's cost. It would be somewhere between 1½ to 2 cents.

The CHAIRMAN. On each record?

Mr. DIAMOND. On each record.

The CHAIRMAN. Or is that the average?

Mr. DIAMOND. On each of the 35-cent records.

The CHAIRMAN. That is about two-thirds of the business?

Mr. DIAMOND. That is about two-thirds of the business. On the basis of the 1940 figures, had there been an excise tax the tax collectible on the 35-cent records would not have been greater than $600,000.

Now, we say that we have passed through these vicissitudes, that we have rendered and are rendering an important service, that the phonograph record has definite value, as a cultural medium, and that it would be unprofitable to take the hazard of reimposing a tax which

Congress, upon a complete understanding of all the circumstances, removed only a few years ago, and then perhaps bring this industry back to the condition in which it was in 1938 before Congress had removed the tax.

The CHAIRMAN. Did you enter into this recommendation, do you recall, by the manufacturer of the records with the defense people? Did the defense commission or the defense people make any suggestion that this was a necessary defense material?

Mr. DIAMOND. No such suggestion has been made, Mr. Chairman.

The CHAIRMAN. That does not enter into it?

Mr. DIAMOND. That does not enter into it, because the amount of metal used is so small, and the importance of the phonograph record in connection with defense work is appreciable, because there is no camp without phonograph records. One of the first items that was acquired by those in charge of operating the camps for the entertainment and edification of our young men in the camps was the phonograph record, and there has been no suggestion that we are not entitled to continue to use the small amount of metal that we do use in the processing of the masters.

The CHAIRMAN. I was making inquiries because I was not familiar with it. I did not know whether they did include you in the recommendation that they submitted to the Ways and Means Committee of the House.

Mr. DIAMOND. If that has been done, I am not aware of it. My information is it has not been done.

The CHAIRMAN. Is there any further statement you wish to make?

Mr. DIAMOND. That is all I would like to say at this time, except I would like to ask that my statement be incorporated and made a part of the record.

The CHAIRMAN. You may leave it with the reporter.

(The statement referred to is as follows:)

MEMORANDUM IN OPPOSITION TO PROPOSED MANUFACTURERS' EXCISE TAX ON PHONOGRAPH RECORDS

FACTS

Decca Records, Inc., advocating the repeal of the 5-percent excise tax on phonograph records imposed by section 607 of the Revenue Act of 1932, stated in 1936 and 1937 that the elimination of this levy—

(1) Would increase employment in the industry;
(2) Would increase the taxable income of and create new taxpayers among its employees;
(3) Would bring into existence large taxable incomes of record manufacturers subject to excess-profits taxes and taxes on corporate accumulations; and
(4) Would generally contribute to the economic recovery of the Nation.

The tax was repealed in 1938. These promised benefits occurred and, indeed, exceeded the expectations of the advocates of repeal. Now, the threatened reimposition of an excise tax on phonograph records—at the rate of 10 percent as contrasted with the former 5 percent—spells the doom of these gains and jeopardizes, once again, the existence of the phonograph record industry.

ARGUMENT

Decca Records, Inc., respectfully submits this memorandum in which it will demonstrate that—

(1) The proposed levy will be an ineffective revenue-raising device;
(2) To reimpose this tax so recently abolished will be to reverse the general tax policy of unburdening media for the dissemination of culture and education;
(3) The recreation of this levy will be in total disregard of the proved benefits derived from its recent repeal; and
(4) In any event, the proposed levy should not apply to inexpensive records.

POINT I.—*The proposed manufacturers' excise tax on phonograph records will be an ineffective revenue-raising device*

In 1936 that part of section 607 of the 1932 Revenue Act applying to phonograph records yielded the Government the approximate sum of $290,000. In 1937, the return from the excise levy was about $325,000. This infinitesimal revenue was further diminished by administrative expenses necessitated in the collection thereof. For these reasons it was foreseen that the small amount of revenue derivable from the levy on phonograph records would more than be offset by liberating the industry from its burden. That foresight should be applied again today.

Although exact statistics are not available, it is liberally estimated that no more than $2,000,000 would be currently forthcoming in the current year from the proposed 10-percent excise levy. This sum is based on sales of all types of records. But this figure presupposes that the industry can continue on its present basis. The imposition of this tax will reduce by more than two-thirds the profit on records produced to sell at a retail price of 35 cents. It will also be shown that this decrease when added to the inroads presently being made by higher production costs will all but erase any possible profit. Record production will radically decrease and, with this curtailment, expected revenues from the proposed excise tax will vanish. At the same time the rapid trend of reemployment in the industry and the creation and augmentation of taxable income of employees will be radically reversed. Consequently, the revenue realized from the industry from all forms of levy will be greatly if not entirely curtailed.

POINT II.—*The manufacturers' excise tax on phonograph records is completely inconsistent with the general tax policy of the United States since it burdens an important means of disseminating culture and education*

Formulation of this Nation's tax program has always aimed at avoiding undue burdens upon educational and cultural media. The revenue acts have specifically allowed deductions from gross income of contributions to educational institutions (I. R. C., secs 23 (o), 23 (q), and 162 (a)) among which are included associations sponsoring classical concerts (1 C. B, 147-8). Such associations themselves are exempt from income taxation (I. R. C., sec. 101 (6)). Admissions tax provisions specifically exempt performances of symphony societies and concerts given by civic membership associations (I. R. C., sec. 1701 (a) and (c)). The Tariff Act of 1930 does not apply to certain books, paintings, and works of art (19 U. S. C. A. 1201, pars. 1628, 1630, 1631, 1807-1812). Libraries are accorded reduced postal rates (39 U. S. C. A. sec. 293 (a)). These examples taken at random clearly demonstrate the aim and desire of the Government to foster and not to burden culture and education.

Any proposed special taxation on phonograph records should be considered in the light of this long-established policy. They are a significant and ever-increasing medium for the dissemination of education and culture. The uses of phonograph records have become manifold. The blind may read, children may hear the songs and stories which are their social and cultural heritage; diction, phonetics and foreign languages may be taught in a manner not attainable from the printed page; the voices of historic characters and occurrences of world-shaping events may be preserved for posterity; the instant of dramatic creation of a Barrymore or Cornell may be relived in the future.

And the musical value of records is even more transcendent. Musical study relies on recourse to phonograph records. The monophonous beginnings of modern music may be traced; the primitive chants of the American Indian, the Chinese, and the Hindu are preserved. Caruso and Chaliapin still sing. Musical appreciation courses rely almost entirely on recordings. Full instructions for

listening to symphonic works have been recorded by such internationally known artists as Walter Damrosch and Leopold Stokowski. The music and folk songs of Latin America are brought to all sections of the American public. And after love of music has been instilled, it is obviously nurtured most economically and conveniently by recordings, since only a few of the population of this country find concerts readily available. Records are no longer luxuries. They are necessities, and their production should be encouraged.

Taxation of records therefore is taxation of American culture and education. This misapplied and unproductive levy was recently removed. To restore it is to negate the intelligent, progressive, and liberal consideration of this question so recently adopted by the Congress.

POINT III.—*Elimination in 1938 of the 5 percent excise tax on phonograph records has been attended by a sharp increase in employment and taxes paid by phonograph record manufacturers*

The Revenue Act of 1938 eliminated the 5-percent excise tax on phonograph records imposed by section 607 of the 1932 law. This tax had been placed on the books in 1932 without debate and with little consideration of its basis or effect. (See Cong. Rec., March 29, 1932, p. 7037.) It administered what almost amounted to the final blow to an industry already prostrate from the catastrophic competition of radio broadcasting. In 1921 the manufacturers' value of phonograph records sold exceeded $47,000,000. In 1933, the total volume of business barely reached $2,500,000. And, few crumbs from the replenishing table of national recovery fell to this industry. In 1935, the value of record sales rose to $3,700,000; in 1937 disk record sales were valued at $4,750,000. Following is a table of phonograph record sales from 1921 to 1937 prepared biennially by the Bureau of Foreign and Domestic Commerce of the Department of Commerce:

Year	Disk records		Cylinder records and blanks	
	Number	Value	Number	Value
1921	103,436,710	$47,322,954	1,755,219	$520,902
1923	92,855,073	35,714,194	5,249,206	658,216
1925	(1)	(1)	82,125,060	[2] 26,790,847
1927	104,766,228	31,486,279	935,074	295,164
1929	105,085,042	[3] 34,128,735	(4)	(4)
1931	30,851,282	[5] 7,697,787	(3)	(3)
1933	(4)	[6] 2,500,477	(3)	(3)
1935	(4)	[6] 3,705,016	(3)	(3)
1937	(4)	[6] 4,755,877	(4)	1,267,986
1937	(4)	[7] 1,613,530		
1937	(4)	[7] 185,799		

[1] Disk, cylinder, and blank records combined in order to avoid disclosing data for individual establishments.
[2] Disk records only.
[3] Blank cylinder records not reported but included in "Other products of the industry."
[4] Not reported.
[5] Includes both disk and electrical transcriptions.
[6] Electrical transcriptions only.
[7] Other records.

In 1938 when the excise levy was eliminated, Decca Records, Inc. foresaw the immediate benefits which would result from the abolition of this tax. In advocating the abolition of the levy, it promised that relief from the tax would result in an increase of its employees, the creation of new income taxpayers and the increase of the taxable income of record producers. This pledge has been more than fulfilled. Following is a table showing the salaries paid to employees, the number of persons employed and the taxes paid by Decca Records, Inc. ever increasing in the years 1938, 1939, and 1940:

Year	Salaries paid	Number of employees (approximate average)	Taxes paid (all levies, State and Federal except social security taxes)
1938	$673,669.92	614	$78,434.91
1939	1,073,202.25	936	138,506.88
1940	1,253,597.18	1,067	186,195.99

Thus, in the year following the abolition of the excise levy, 1939, the number of Decca's employees increased over 50 percent; in 1940 the increase was almost 100 percent over 1938. Salaries paid followed a similar pattern of increase. Taxes paid rose accordingly. Generally, in 1939 the value of disk records sold in the entire industry had risen to $15,980,130. Obviously, the benefits derived from the abolition of the excise levy more than compensated the Federal Government for the relinquishment of the inconsequential revenue it had formerly derived from this source. And, what is most important, the benefits were directly passed on to working men and women who became taxpayers, to recording artists whose augmented incomes placed them in the surtax brackets, and generally to the public. This situation found its counterpart in other major phonograph record manufacturers.

It can definitely be said that the elimination of the excise tax substantially if not entirely contributed to this rise in the Decca figures. For, Decca operates on an extremely close margin. The preponderant bulk of its records retail for 35 cents. Decca's billing price to its distributing company is less than one-half of the retail price. A minute margin of profit, obviously irreducible, is thus presently maintained.

The 1932, 5 percent excise levy discouraged production and jeopardized the realization of profit. The currently proposed 10 percent excise levy would amount to more than two-thirds of this margin of profit. And this inroad into net receipts is not the only one currently threatened. The cost of all supplies is skyrocketing. For example, shellac, the basic ingredient from which records are pressed has recently increased in cost by 80 percent. Other ingredients have also risen in price. And a substantial increase in wages has also been entirely absorbed. Obviously, the small profit would be almost entirely eliminated by the reimposition of this proposed excise levy. The industry will fall back into the doldrums.

Nor can this proposed tax be passed on to the public by Decca. Until Decca's advent into the recording field, records similar to its 35-cent type were sold at a retail price of 75 cents, although many previous but unsuccessful essays had been made into the lower priced field. The successful production and marketing of the 35-cent record has been almost entirely responsible for the revitalization of the industry. It is estimated that one-half of all phonograph records sold annually in the United States are of the 35-cent class, although the higher priced records account for two-thirds of the revenue received by record manufacturers. Obviously, the 35-cent record is purchased by those of the music-loving public who cannot afford the higher priced records.

It is therefore respectfully urged that the proposed reimposition of an excise levy on phonograph records will be unproductive of revenue, will be a reversal of long established and carefully considered policy against burdening media for the dissemination of culture, and will be in direct disregard of the benefits derived from recent abolition of a similar levy. Consequently, this tax should not be reimposed upon phonograph records.

POINT IV.—*In any event, phonograph records retailing at 35 cents or less should be exempted from any excise tax*

What has been said above represents our considered view as to the advisability of not again placing a crushing excise tax on the now revitalized phonograph record industry. However, we recognize that there will be those who will say that no industry should be entirely exempted from the burden of national defense, and that some tax should be paid by the record industry. For the reasons set forth in this memorandum, we believe such an argument to be fallacious but if despite this the Congress should feel that some part of the load must be borne by the phonograph record industry, then it is submitted the committee recognize the principle that those who are best able to pay should do so. We therefore respectfully urge that the law exempt from the burden of the tax records made to retail at 35 cents or less.

As has been demonstrated, these records are marketed by manufacturers at a price which keeps profits at the bare minimum. They are the records to which the poor man turns for his entertainment. These records are marketed at a price which is so close to cost as to render the manufacturer's excise tax the difference between a possible profit and a certain loss. In the 75-cent field, yes, even in the 50-cent field, there may be some slack and consequent ability to absorb additional tax; but not so in the 35-cent field. Material, labor, advertising, talent, packing and shipping costs, plant overhead—all these items and others enter into a 35-cent record almost to the same extent as in a 50-cent, a 75-cent, or a $1 record;

but the return to the manufacturer is substantially less. Thus, while the 35-cent record hovers just above the subsistence level, the higher priced record enjoys a margin of profit which secures its existence. We ask the committee to recognize this problem and, if there must be a new tax placed upon the industry, to place it where it can best be borne—on the more expensive record.

Nor will the application of this exemption result in any material curtailment in revenue. The 35-cent record accounts for but one-third of the total income of the industry. In 1940, the total value of 35-cent records subject to the proposed levy would have been approximately $6,000,000. The total tax derivable therefrom would have been $600,000. Yet, the injury resulting from such levy would be profound and immeasurable.

This principle of exemption at the lower end of the scale has repeatedly found recognition in other taxing statutes. Admissions taxes begin at 20 cents (I. R. C., sec. 1700 (a)); even the proposed amended statute would exempt admissions under 10 cents (press releases of April 23, 1941). Admissions to roof gardens, cabarets, and the like are exempt from tax when they fall below 51 cents (I. R. C., sec. 1700 (c)). The New York City sales tax applies only to purchases over 12 cents (regulations under Local Law No. 21 of 1938, art. 4); and on food served in restaurants it attaches only when the price of the meal is $1 or over (regulations under Local Law No. 21 of 1938, art. 57). Incomes in the lower brackets are exempt from surtax (I. R. C., sec. 12), and personal exemptions plus an earned income credit are allowed (I. R. C., sec. 25). Telephone calls costing less than 50 cents are tax free (I. R. C., sec. 3465). The statute provides exemptions for annual dues under $25, and for initiation fees less than $10 (I. R. C., sec. 1710 (a)).

The same principle may be found in various former excise-tax laws. For example, the tax on furs from 1934 to 1936 did not apply to fur articles where the sale was in an amount less than $75 (sec. 604 of the Revenue Act of 1932, as amended). The excise tax on jewelry originally provided an exemption only for watch parts costing less than 10 cents (sec. 605 of the Revenue Act of 1932). In 1934, the same tax rate was maintained, but an exemption was introduced for all articles of jewelry under $3 in price. Later in the same year, the act was again amended to provide an exemption for all sales of jewelry under $25 (sec. 609 of the Revenue Act of 1934); and this exemption was continued with the tax at the same rate until it was terminated in 1936 (sec. 809 of the Revenue Act of 1936). An analogous situation is found in the excise tax on toilet preparations. Although no exemption has been declared on the price of an article, mouth washes, dentifrices, and toilet soaps were exempted from the operation of the tax in 1938 (sec. 701 (a) of the Revenue Act of 1938).

It thus appears that the problem of necessity as against luxury has been in the minds of the legislators who have drafted our tax statutes in the past. Significant are the exemptions in the former jewelry tax, which seems to recognize the fact that the meanest of us might have an inexpensive watch or some article of personal adornment, and the similar exemption in the fur tax. So, those toilet preparations which are used by practically the entire population of the country have been exempted from the excise tax. Not only the problem of the manufacturer in bearing the proposed tax of 10 percent on a phonograph record which is made to retail at 35 cents or less and marketed at a wholesale price which produces an extremely low margin of profit, but also the problem of the consuming public which has come to depend upon this low-priced record as a part of normal living, demands consideration at this time. The problem has been recognized in the other taxes discussed above. We believe that the position of the producer and consumer of the phonograph record in the lowest price bracket falls into the same category.

Respectfully submitted.

MILTON DIAMOND,
Attorney for Decca Records, Inc.,
New York, N. Y.

Senator VANDENBERG. How many records are still sold at the higher cost, more than 35 cents?

Mr. DIAMOND. As of 1940, I think that about 15 or 18 million records were sold in this country at the higher price. I do make the suggestion in concluding my memorandum that, if a tax in the form of an excise tax be made on records, that it apply to records that retail for more than 35 cents because there is a possibility for a greater profit margin. It may very well be that the manufacturers would

be able to afford that tax on the higher-priced records; there is no possibility of the tax being absorbed on the 35-cent records.

Senator VANDENBERG. What is the comparison in dollar value of the sales at 35 cents and over 35 cents? Do you have that?

Mr. DIAMOND. Yes; I think I have it here. I think in dollar value, the records that are sold at more than 35 cents would represent over 50 percent of the gross revenue of the industry, despite the fact that the unit value of 35 cents would number about two-thirds of the records sold by the industry.

Senator VANDENBERG. And the gross revenue of the industry in 1939 was about $16,000,000?

Senator TAFT. Have you found that the imposition of a sales tax in the State of Ohio has retarded the sale of records?

Mr. DIAMOND. We found that the State of Ohio was about as well off as other States in responding to the efforts to revive the industry.

Senator TAFT. Well, we have a sales tax in Ohio, 36 cents for a 35-cent record, which tax has to be passed on. I wondered whether that deterred the sales?

Mr. DIAMOND. I am afraid I am not able to answer as to the effect of that on sales for that State in relation to States of comparable population and purchasing power.

Senator TAFT. I have heard no complaint of the Ohio sales tax, and New York also carries such a sales tax, does it not?

Mr. DIAMOND. Yes.

Senator DANAHER. Has there been any shortage of the shellac from which you make the records?

Mr. DIAMOND. Well, it comes from India. We have all tried to provide in advance for the supply of it, but we have also carried on considerable research to produce a material which will enable us to reduce the shellac content of the record without impairing, in any way, its quality. We have been successful, in the main, to the point where I don't think we shall ever feel the need of shellac in the event there is any difficulty in continuing its importation.

Senator DANAHER. It has about doubled in price this year, hasn't it?

Mr. DIAMOND. Yes; and labor has increased, and all other materials have increased in price. All of that we have been able to absorb and I believe, are prepared to continue to absorb, but obviously an excise tax of anywhere from 1½ to 2 cents per record would completely wipe out the spread between the cost and sales price of the manufacturer.

Senator DANAHER. You would just have to fold up?

The CHAIRMAN. Is rubber used in the manufacture?

Mr. DIAMOND. No; we use a carbon black.

The CHAIRMAN. You don't use rubber?

Mr. DIAMOND. No.

The CHAIRMAN. Very well.

Mr. George A. Hughes; you are appearing for the Edison General Electric Appliance Co.?

Mr. HUGHES. Yes.

The CHAIRMAN. On electrical appliances?

Mr. HUGHES. Yes. I have been asked to represent the electrical range and electric water heater manufacturers. If you will bear with me, I will be just as brief as I possibly can. It will take me about 15 minutes, I think, to go over this.

STATEMENT OF GEORGE A. HUGHES, CHICAGO, ILL., CHAIRMAN, EDISON GENERAL ELECTRIC APPLIANCE CO.

Mr. HUGHES. Gentlemen, the need for additional revenue is not questioned, and we do not oppose taxation on our product. I am sure it is your wish that whatever program is adopted for raising this revenue will be consistent with the public welfare, and as free as possible from discrimination. May I direct your attention to that section of the bill before you, where it seems to us that a discriminatory tax has been proposed?

I refer specifically to section 552, "New Manufacturers Excise Tax," subchapter A of chapter 29, section 3406, item 3, reading as follows:

Electric appliances.—Electric motor-driven fans and air circulators; electric storage water heaters; electric flatirons; electric air heaters (not including furnaces); electric immersion heaters; electric heating pads and blankets; electric appliances of the type used for cooking, warming or keeping warm food or beverages for consumption on the premises; electric mixers, whippers and juicers, and household type electric vacuum cleaners, 10 per centum.

It may be that electrical appliances are viewed as luxuries by some, because of their advantages in use-value over old-style devices, and it is perfectly natural that the draftsmen of this bill should have included, without realizing it, some items of electrical equipment which are not luxuries, but necessities. Gentlemen, an electric stove is a necessity—not a luxury. It is necessary as the food that is cooked on it. This view is held by many builders of low-cost housing projects, where large numbers of electric ranges have been installed.

My belief that electric cook stoves were unintentionally included in the bill is supported by the fact that the Ways and Means Committee included the housewife's friend, the washing machine, in their original bill, but later eliminated this device. I am further encouraged to believe that the tax on electric cook stoves was not intended, because another department of the Government, the Office of Civilian Supply, is dealing with the stove industry as a whole.

Senator VANDENBERG. Do I understand you are not complaining of the tax against any of the other electrical appliances?

Mr. HUGHES. I am not complaining against this tax except that it discriminates against our industry.

Senator VANDENBERG. How much is involved in the tax just on electric stoves?

Mr. HUGHES. About 13 percent of the total; I have the figures, I will read them.

May I ask, therefore, is it the intention, gentlemen, to put a tax on the cook stove? If so, then it is only fair to put a tax on all cook stoves, just as the bill does in taxing all mechanical refrigerators, electric, gas, or any other kind, without discrimination.

If it is not intended to tax cook stoves, then the clause to which I refer, on page 73 of the amendments to the bill introduced under Report 1040, lines 9, 10, and 11 should be changed to read as follows:

Electric table appliances of the type used for household cooking, warming or keeping warm food or beverages for consumption on the premises.

This change in the wording would obviously exclude cook stoves.

However, gentlemen, if, in your minds, the emergency requires taxation of the family cook stove, may I suggest these facts for your consideration? The 1939 census value of all cook stoves produced

was approximately $124,000,000. This does not include the value of high-pressure cylinders on customers' premises necessary where bottled gas is used. From the best figures available, we estimate that the value of all cook stoves produced in 1940 amounted to approximately $161,000,000. The value of electric cook stoves amounted to only 13 percent of this total. It is obvious that as a tax-revenue producing item, the electric cook stoves by themselves, are relatively unimportant.

Would it not be wiser to consider a smaller tax on the entire cook stove industry? For example, a 1¼-percent tax on all cook stoves would raise as much revenue as you would get from a 10-percent tax on electric cook stoves alone; a 2½-percent tax on all cook stoves would yield twice as much, and on on. The revenue thus obtained would be a very substantial sum, but the smaller tax would be much less burdensome.

May I elaborate a little on this matter of discrimination? Gentlemen, there are 8½ million homes wired for electricity which do not have city gas. There are 7 States that have more electric ranges in use than gas ranges. The population of these States live in small cities and villages, many of which enjoy low-cost hydroelectric power. They are not industrial States. In addition, there are 8 States in which electric and gas ranges are almost equal in number. For example, Senator George, your own State of Georgia is among these 15. What would the people of Georgia think if their electric ranges were singled out for taxation as luxuries? In your town of Vienna, they do not have city gas, and yet it costs only $2 a month on the average to cook electrically. Three of you gentlemen come from cities which have no city gas. The average costs to use electric cook stoves vary from about $1 to $3.25, while the average cost to cook by gas varies from 90 cents to $3.50 a month, in the 20 cities where you have residences, as shown by the table which I will leave with you. Should the people in these small cities and villages be discriminated against?

One-third of the farms of this country are already electrified, and many of these farmers are buying electric ranges. Should they be discriminated against? Should the entire Rural Electrification program be handicapped by a discriminatory tax? It is the working people of the country, on the farms and in the towns, who buy electric ranges. Should they be discriminated against?

Aside from the unfairness of this proposed discrimination, let me point out that this is no time to discourage the use of electric cooking. I realize that this committee cannot take time to listen to a eulogy of our product, but in this time of national emergency, a cooking device which enables the housewife to save time and labor, conserve the vitamins and minerals in food, which is safe, clean, and economical, is an article to be appreciated and encouraged. In addition to its contribution to the health and welfare of its users, the electric range has advantages from the standpoint of national defense. By weight, electric ranges use less iron and steel. Even though oil stoves are lighter in structure, they require heavy fuel containers. In the United States Navy, where minimum weight, maximum efficiency and safety are really vital, electric cooking equipment is used 100 percent.

In that connection, I might say that my company alone has already eliminated 1,250,000 pounds of aluminum. We use no aluminum

now; we do use 40 cents less of nickel on a $140 article; we cannot get away from that.

Senator VANDENBERG. In your statement to Senator George, "What would the people of Georgia think if their electric ranges were singled out for taxation as luxuries?" this tax would not apply to any range now owned in the State of Georgia, would it?

Mr. HUGHES. No, sir; it would have to be sold in the future, but there is a large market there that is not yet filled.

Senator VANDENBERG. I just wanted Senator George to have an answer to send down.

The CHAIRMAN. If they traded in the old one and got a new one, there would be a tax.

Mr. HUGHES. Electric ranges tend to conserve transportation facilities. It is estimated that 40 percent of the ranges in use are served by electricity produced from water power. They eliminate the transportation of fuel to service them. I have pointed out that the majority of electric ranges have not gone into industrial areas. We hear estimates of oil shortages mainly because of the transportation problem; coal and other fuels must be transported also.

May I also direct your attention to the similar discrimination proposed against electric cooking for commercial and industrial uses? If it is the intention to include all electric cooking and baking equipment under the proposed excise tax, then I think you will agree that the tax should also be placed on corresponding nonelectric cooking and baking equipment.

Following that is a statement from your home towns of what it costs for all of this and the next sheet contains a census of manufacturers so you can see what the situation was in 1939.

Following that is a list of 15 States where we have more, or almost as many, electric ranges as gas ranges, and the total number of customers. I would like to say just a word about the electric water heater.

I think you will find those figures interesting.

A brief has just been presented by us, asking that you free the family's electric cook stove from possible discriminatory taxation. For some reason, "electric storage water heaters" are specifically mentioned in the bill. Possibly this is because they so appeared in the Census of Manufactures under the heading "Electrical appliances."

As the proposed bill comes to you, section 3406, item 3, previously quoted, contains this specific reference. Possibly this is because some consider electric water heaters are luxuries and so these heaters are singled out without intentional discrimination.

Please understand me, I do not oppose taxing my company's products, nor those of the electrical industry, of which my company is a part. Gentlemen, I ask that, if it is necessary to produce revenue from taxing household hot water supply systems or appliances, then please apply the same percentage of tax to all kinds.

Electric water heaters, like stoves or furnaces, are part of the house we live in, and are no more a luxury device (except in the sense that they give superior service) than are other forms, commonplace or ingenious—such as solar systems made a part of the roof for heating water in Florida bungalows.

The Census of Manufactures for 1939 shows that the value of electric water heaters produced is only 13.7 percent of the total value

of all kinds of water heaters reported. Therefore, a discriminatory tax on electric heaters would provide the Government with only a little more than one-eighth of the total revenue available from an equal tax applied to all water heaters.

Storage electric water heaters are the most efficient form of heating water for the home, and are very economical. This is due to the fact that electric water heaters, generally apply the heat at 100 percent conversion of energy through heating units immersed in the water inside the tank. They enjoy extremely low-cost rates for the electricity they use, which use occurs largely during off-peak hours, much of it in the early morning. And by this same token, this technically perfected yet commonplace, package type of hot water supply system, least of all interferes with the other necessary demands for electricity. Their wide use has contributed in a substantial way to economically sound reduction of electric rates for all other electricity used in the home.

Many people in the low-income brackets are purchasing electric water heaters for their homes, and they boast of the low-operating cost.

With your permission, Senator George, I should like to use your home State of Georgia to illustrate again. In Georgia, the average monthly bill for approximately all of the electric water heaters in use is $2.30.

Senator GEORGE. I am afraid you have been writing my people because I have been hearing from them on this.

Mr. HUGHES. Well, Georgia happens to have one of the most progressive utility company users in the country.

Gentlemen, a supply of hot water for each family's welfare and health is necessary. There are 150 uses of hot water familiar to the homemaker—and only 3 uses for cold water, drinking, fire protection, and sewerage. Hot water is used every 20 minutes of the day in the home. Its use is even more needed on the farm, particularly the dairy farm.

The storage electric heater is probably the most economically desirable appliance which the farmer buys. Gentlemen, this will interest you—private and public power authorities can be said to agree on the economic necessity of the electric water heater and the electric cook stove to the successful completion of the electrification of our rural areas.

Over 15,000,000 wired homes in this country can have rates of 1.2 cents per kilowatt-hour for water heating. These contributions to public welfare should not be discriminated against.

In the brief on electric cook stoves, it was pointed out that there are 8½ million homes which have electricity but are without city gas. These would include, of course, the 2,000,000 electrified farms, a number rapidly increasing. Would you propose to penalize the people in these rural homes, as they mostly are, by taxing their electric water heater while the people in large cities could buy a water heater tax-free?

The cities have the choice—gas or electricity—but that doesn't apply to the farm.

Like the electric cook stove, electric water heaters conserve transportation of fuels and of materials by weight. It is estimated that a majority of the electric water heaters in use are served by electricity from water power, an energy conversion involving no solid, liquid, or

gaseous fuel. In comparing weights of materials, the necessary auxiliary equipment for storage of fuels in basements or back yards should be borne in mind.

This brief, considered in connection with electric cook stoves, provides ample information upon which your considered judgment will, I believe, free these necessary devices in the home from any discriminatory tax.

Senator TAFT. These figures are based on what?

Mr. HUGHES. That is the average rate of the homes in these communities.

Senator TAFT. Those figures are not taken from actual bills?

Mr. HUGHES. The average; yes.

Senator TAFT. Or, is it just arbitrarily calculated from what that much electricity would cost a certain number of users?

Mr. HUGHES. Let us say there are 250 homes and the bill is $1,000. We know the average would be $4. Of course the bill would vary very much but it does indicate an average.

Senator DANAHER. I have a question or two: These so-called manufacturers' excise taxes which include electrical appliances were inquired of by me the other day, when the Secretary was here, and he said some of them had been included on the ground they dealt with luxuries, and when I asked him if he considered a typewriter to be a luxury, he added a good many of the items had been included here because their manufacture would conflict with our defense.

Now what is there about an electric-stove that would conflict with our production for defense needs?

Mr. HUGHES. Well, it uses iron; about 40 cents worth of nickel, and that is about all. The water heater used iron too, but that is true of all our competitors. The only difference between the electric and gas range is that the gas range also uses a stainless steel ring which is half nickel, so they would all use some nickel.

Senator DANAHER. And iron; so that, if we are going to include that on the theory that its manufacture would conflict with production for defense needs, and you are going to try to discourage the manufacture of electric stoves entirely, then I should say we ought to increase the rate, too, shouldn't we? I mean, to be logical about this claim that this manufacture interferes with defense production, we should raise the rate?

Mr. HUGHES. You mean, it increases the use of the gas range also? We are not complaining about the fact of the tax; our complaint is the discriminatory nature of it.

Senator DANAHER. If we limit the tax to electric stoves, but really wish to discourage the manufacture of them, we should increase the rate on that item, should we not?

Mr. HUGHES. Well, I hope you won't.

The CHAIRMAN. I suppose the use of electric energy is one of the things the defense people might have had in mind, although you don't manufacture that and aren't concerned with it.

Mr. HUGHES. Yes; we are very greatly concerned with it. Our products go very largely in the rural areas, in the great waterpower section of the Northwest. For instance, in the State of Idaho, which is a waterpower State, we have 56 percent saturation on electric ranges and 35 percent saturation on electric water heaters. In other words, the farther west you go, the greater use of electricity is evident.

The CHAIRMAN. I suppose you have pretty rigid restrictions on nickel?

Mr. HUGHES. Yes; we manufacture practically all the equipment for the Army and Navy, practically every boat that is built today is so equipped. We have priorities on all that stuff, of course.

The CHAIRMAN. Any further questions?

Senator WALSH. Were these manufacturers given an opportunity to appear before the Ways and Means Committee with reference to these taxes?

The CHAIRMAN. I don't think so. You didn't appear before the Ways and Means Committee?

Mr. HUGHES. No, sir. I did not; I knew about the tax on some other things but I thought our industry was so small they would overlook us, but the first thing I know, it was in. That is the reason I am here.

(The Comparison of cooking stove and range values based on 1939 Census of Manufactures; Statement from your home towns relative to costs: Census of Manufactures, and list of 15 States giving comparison of electric ranges to gas ranges, referred to by Mr. Hughes, are as follows:)

Comparison of cooking stove and range values, based on 1939 Census of Manufactures

	Number	Value	Per unit value
Electric household ranges (2½ kilowatts and over)	237,128	$16,181,782	$68.24
Nonelectric stoves and ranges:			
Coal and wood	633,151	20,069,912	31.70
Gas (exclusive of hotplates)	[1] 1,500,319	63,724,354	42.47
Kerosene, distillate and fuel oil	1,107,568	13,603,219	12.28
Gasoline (exclusive of camp stoves) [2]	51,384	834,713	16.24
Combination coal, wood, and gas	[3] 100,167	9,714,787	96.99
Total nonelectric	3,392,589	107,946,985	31.82
Total electric and nonelectric	3,629,717	124,128,767	34.20
	Percent	*Percent*	*Percent*
Ratio electric to nonelectric	7.0	15.0	214.5
Ratio electric to total	6.5	13.0	199.5
1940 estimated at 30 percent above 1939 ($124,128,767×1.3)	.....	$161,300,000	.....

[1] Approximate—no data available on number with value of $22,902, so number not included.
[2] Gasoline camp stoves: Number, 121,066; value, $314,751.
[3] Approximate—no data available on number with value of $192,697, so number not included.

Statement from your home town relative to costs, based on 1939 Census of Manufactures

Name	Town	Monthly cost for—			
		Cooking		Water heating	
		Electricity (105 KWH)	Gas (10.75 th)	Electricity (340 KWH N.; 200 KWH S.)	Gas (22.06 th N.; 18.80 th S.)
W. F. George (D)	Vienna, Ga	$2.10	[1]	$2.90	[1]
D. I. Walsh (D)	Clinton, Mass	3.15	$3.54	5.10	$4.18
A. W. Barkley (D)	Paducah, Ky	2.60	2.82	3.20	2.78
T. Connally (D)	Marlin, Tex	2.07	1.17	.....	1.26
J. W. Bailey (D)	Raleigh, N. C	2.45	3.09	[2] 4.51	3.20
B. C. Clark (D)	St. Louis, Mo	2.49	2.03	.....	2.50
H. F. Byrd (D)	Berryville, Va	2.70	[1]	3.85	[1]
P. G. Gerry (D)	Warwick, R. I	3.15	2.60	5.10	3.89
J. F. Guffey (D)	Pittsburgh, Pa	1.85	1.37	.....	1.25
P. M. Brown (D)	St. Ignace, Mich	2.10	[1]	3.90	[1]
C. L. Herring (D)	Des Moines, Iowa	2.63	2.02	3.60	3.79
E. C. Johnson (D)	Denver, Colo	2.10	1.89	3.40	2.03
G. L. Radcliffe (D)	Baltimore, Md	3.47	1.83	[2] 4.08	3.24
R. M. La Follette (P)	Madison, Wis	1.60	2.05	3.60	3.54
A. Capper (R)	Topeka, Kans	1.05	1.31	4.10	1.68
A. M. Vandenberg (R)	Grand Rapids, Mich	2.10	1.80	3.40	1.98
J. J. Davis (R)	Pittsburgh, Pa	1.85	1.37	.....	1.25
E. C. Lodge, Jr. (R)	Beverly, Mass	3.27	3.11	5.10	3.68
J. A. Danaher (R)	Hartford, Conn	2.45	2.53	3.80	3.13
R. A. Taft (R)	Cincinnati, Ohio	1.58	.91	4.20	1.68

SUMMARY

	Maximum	Minimum	Average
Cooking:			
Electricity	$3.27	$1.05	$2.34
Gas	3.54	.91	2.08
Water heating:			
Electricity	5.10	2.90	3.99
Gas	4.18	1.25	2.65

[1] No gas. [2] No rate.

Comparison of domestic water-heater values based on 1939 Census of Manufactures

	Number	Value	Per unit value
Electric household storage water heater [1]	81,741	$3,339,535	$40.86
Nonelectric (domestic supply):			
Coal and wood:			
With storage tanks	58,091	1,597,910	.....
Without storage tanks	251,233	1,759,419	.....
Total	309,324	3,357,329	10.85
Gas:			
With storage tanks	462,184	13,850,911	29.97
Without storage tanks	[2] 356,959	2,226,515	6.24
Total	819,143	16,236,888	19.82
Kerosene and distillate (pot, wick, and wickless storage tanks) [3]	70,939	1,484,910	20.93
Total, nonelectric [4]	1,199,406	21,079,127	17.57
Total, electric and nonelectric	1,281,147	24,418,662	19.06
	Percent	*Percent*	
Ratio, electric and nonelectric	6.8	16.0	.....
Ratio, electric to total	6.4	13.7	.....

[1] Side-arm heaters not included because census lists them with auxiliary and nonpressure heaters with total value of $113,891.
[2] Approximate; no data available on number with value of $159,462, so number not included.
[3] Census does not mention fuel-oil water heaters nor storage tanks.
[4] Approximately 55 percent of the nonelectric heaters do not include storage tanks, thereby increasing amount of labor necessary to assemble or install on premises.

The State of North Carolina as of January 1, 1941, had 91,680 electric ranges and 47,350 gas ranges in use.

There are seven States where electric ranges exceed gas ranges in use, namely, North Carolina, South Carolina, Idaho, Nevada, Tennessee, Utah, Washington.

There are eight additional States where the number of electric ranges in use is close to the number of gas ranges in use (within 30 percent or less), namely, Maine, Vermont, North Dakota, South Dakota, Oregon, Georgia, Florida.

Source: Bureau of Census, Department of Commerce.

Total electric domestic customers	25, 600, 000
Total gas domestic customers	16, 900, 000
Difference (wired homes without gas)	8, 600, 000

Ratio of manufactured gas customers to total domestic gas customers is 10 to 17; 10 manufactured gas to 7 naturally mixed gas.

Thirty-two and six-tenths percent of the United States farms are electrified as of January 1, 1941. Electrified farms, 1,988,361; total farms, 6,096,789.

As of January 1, 1941, there are 15,238,000 household meters with water-heater rates of 1.2 cents per kilowatt-hour or less. There are 20,342,213 household meters with water-heater rates of 1½ cents per kilowatt-hour.

Three hundred and ninety-four private utilities included in this survey.

The CHAIRMAN. Mr. Blodgett, will you give the reporter your name, address, and information as to whom you appear for?

STATEMENT OF GEORGE R. BLODGETT, BOSTON, MASS.

Mr. BLODGETT. My name is George R. Blodgett. I am an attorney, a member of the law firm of Herrick, Smith, Donald & Farley, 1 Federal Street, Boston, and I do a considerable amount of corporate tax work. I am not appearing here specifically for any client. I ran into serious problems of the nature I am going to mention for about eight clients. They appeared to me so serious that after discussing the matter with others similarly engaged, I felt that they should be brought to the attention of the committee.

The CHAIRMAN. I see you refer to section 734. I never quite understood it; I don't know how it works out in practice.

Mr. BLODGETT. The main purpose of my talk is to point out some practical problems which have arisen in the mere preparation of clients' excess-profits returns. These problems have arisen under section 734 of the code, which was added to the excess profits tax law by the March 1941 amendments.

This section makes provision for adjustments in cases of so-called inconsistent position. The underlying purpose of this section is apparently to prevent a taxpayer from reducing its excess-profits tax through unconscionably reversing a position which had been erroneously allowed to it in some prior year tax matter and which had reduced its tax for that prior year. But it goes far beyond such a purpose and produces totally different and unfair results as I shall show by illustrations.

The section was enacted without general public discussion. The text of the section is not easy to read, nor are many of its possible results and implications apparent upon superficial analysis. In the months that have intervened, some of us have begun to realize how serious these may be. Apparently neither the taxpayers nor tax practitioners in general as yet understand the effect of the section, and the serious consequences under it involved in the mere filing of an excess-profits tax return, their ignorance being probably due to the fact that the section was not enacted until just before excess-profits

tax returns were due, and the regulations were not issued until weeks afterward, and the pitfalls in merely filing a return do not appear on a first reading.

Section 734 provides in principal part that: If a taxpayer, in connection with its current excess-profits tax return, maintains a position as regards any item, which position is finally adopted (the words "maintaining a position" are not defined), and that position is inconsistent with the way that item was actually but incorrectly treated in determining the tax liability for any year beginning 1913 of the taxpayer or any "predecessor" (the word "predecessor" is not defined in the law), then there is added to the excess-profits tax otherwise payable for the current year the amount of all taxes saved to the taxpayer and its predecessors, in all years since 1913, through the erroneous and inconsistent treatment of the item in the earlier years, together with interest at 6 percent from the time those prior-year taxes should have been paid. In other words, the penalty is not to fairly adjust its invested capital or other items entering into its 1940 excess-profits tax. The effect of the section is to go back and charge it with an item occurring in 1913 or 1920, and that is the penalty, even though there would be no excess-profits tax payable for 1940 regardless of which position it takes—whether consistent or inconsistent.

And that is so despite the fact that the statute of limitations has otherwise run, and despite the fact that the Bureau may have ruled that the taxpayer's prior-year treatment was correct under the regulations, decisions, and rulings in force when the prior-year return was made and audited.

This has much greater scope than a statute merely waiving the statute of limitations back to 1913 because (1) it imposes on a taxpayer the unpaid-tax liabilities of other independent taxpayers for which it may never have been liable under former law; and (2) it permits the Government to reopen specific tax liabilities previously brought to a final court or Board decision between the taxpayer (or a so-called "predecessor") and the Government.

It is not my purpose to discuss the philosophy underlying the section. I shall talk only about the hardships resulting from the present wording to taxpayers who are striving not to take inconsistent positions or to be otherwise unfair. I hope that a recital of a few of these hardships will lead the committee to ask the experts to carefully and fully consider this section because specific amendments can best be worked out in connection with such a full consideration, and I do not have the time to discuss the remedies here.

The section is seriously defective in leaving several of its most important terms totally undefined, as—

(1) What constitutes "maintaining a position" by the taxpayer. The regulations say that the mere filing of a return by the taxpayer does this, and there is no indication in the law or regulations that having once taken a position in this manner a taxpayer may later voluntarily withdraw or change his position. Probably most taxpayers have already irrevocably maintained inconsistent positions under this regulation without having any idea that they have done so, or that section 734 is in any way applicable to them.

(2) The statute does not define what constitutes a "predecessor" whose unpaid taxes may by the law be collected from this taxpayer. The regulations define this as any other taxpayer whose income-tax

liability for a prior year would have been different if there had been no inconsistency between the treatment of the item for the current year's excess-profits tax and the way the item was treated in finally determining the other taxpayer's taxes for the prior year. This makes the present corporation liable for taxes of persons for whom it never could possibly have been liable before section 734 was enacted, and whose action it could not have controlled. For instance, if a corporation has consistently and correctly treated its past distributions to stockholders as dividends out of earnings, it is nevertheless liable under section 734 for the unpaid taxes, however far back, of any stockholders who have treated any part of those distributions as nontaxable returns of capital. In no other case until section 734 was enacted has a corporation ever been liable for the taxes payable by its stockholders.

Using an extremely simple example to illustrate some of the difficulties with section 734 which arise before the current excess-profits return can be filed, assume that in 1920 a going corporation issued substantial amounts of its stock to many individuals for property in a transaction which everyone has always correctly treated as taxable to the individuals. The value of that stock when issued is material in computing the corporation's invested capital for excess profits tax purposes in 1940 and its depreciation in intervening years. While the value of stock is always a matter of opinion, which no one can answer definitely, even in the case of a stock listed on a national stock exchange when large blocks are involved, let us assume that $200 a share was the correct value which the corporation has consistently used and which the Bureau, after investigation, has always accepted. I have to warn the corporation that, if the 1920 taxes of any of the sellers of the property were determined by using a value of less than $200 a share, it will be liable for all the 1920 taxes those sellers thereby avoided plus 6 percent interest thereon since 1921. I must also warn the client that it must solve its problems before it files the excess profits tax return, because however serious the result under section 734, it probably will have no opportunity later to retreat from the position taken on its return

The corporation asks first how it can be liable for the seller's taxes since it could not possibly have been liable for them under the 1920 law or any other law until section 734 was enacted in 1941. I can only say that this section, as interpreted in the regulations, flatly makes it liable for taxes for which it could never otherwise have been liable, even if there were no statute of limitations. It imposes a brand new liability on my client to pay somebody else's 1920 taxes, and neither my client, nor any business to which it succeeded, was ever liable for those taxes, or ever had any opportunity to control them, or can now in practice find out their amount or anything else about them.

My client next points out that it would not have any 1940 excess-profits tax even if it valued that stock at zero and that, accordingly, it is not doing anything fair or unfair to reduce its excess-profits tax since there would not be any tax anyway. But these considerations make no difference in the application of section 734. It must pay the seller's 1920 taxes even though it has no 1940 excess-profits tax.

My client next suggests that we put on the return a rider disclaiming any intention to take any inconsistent position, and offering to let

the Commissioner reduce its invested capital to any figure necessary to avoid an inconsistency. But that will not help my client for the law does not allow such procedure to have any effect under section 734 on the addition of the 1920 tax, and does not give the Commissioner any discretion to reach a more equitable result.

The corporation then suggests that in order to avoid maintaining an inconsistent position in filing its return, it should value the stock at the lowest possible reasonable figure, say $150 a share, or even at zero. But I have to point out that it has no right to do anything like this; that it is required by law to file and swear to a correct excess-profits tax return, and that the use of any figure which it knows to be lower than the correct figure would constitute a fraudulent and false return in order to avoid the addition to the tax under section 734. The taxpayer is given no option to abide by its former incorrect tax position and pay the additional excess-profits tax thereby occasioned, as the alternative to paying the very large adjustment under section 734. It is required to file and swear to a correct excess-profits tax return, and therefore it has no option but to maintain the inconsistent position since, by assumption, the former position was wrong. A return which knowingly continued the former error and which gave the Government the additional excess-profits tax resulting from not making the so-called unconscionable change in position would be a return fraudulently made in order to avoid any larger additional tax under section 734 if a correct (though inconsistent) return was filed.

I also point out that if my client uses $150 on its excess-profits tax return and the Commissioner does not choose to attack the $150 figure, even though he knows it is wrong, the taxpayer will have to pay all the additional taxes for every intervening year from 1920 to the present which result from reducing its annual depreciation allowance on the property because of this reduction in purchase price, as well as any 1920 deficiency in taxes of the sellers resulting from their having used a value of less than $150.

Senator WALSH. Are these illustrations possibilities of construction, or have the constructions already actually been made?

Mr. BLODGETT. Returns involving these questions have been made; they have not been audited yet.

Senator WALSH. By the regulation and by the taxpayer's having been ordered to comply with them?

Mr. BLODGETT: There is no ambiguous language in the law; the Commissioner has no discretion.

Senator WALSH. And you are arguing that these regulations will result in these confusions and these hardships if the present language is permitted to stand?

Mr. BLODGETT. That is correct.

Senator WALSH. There have been no such tax returns yet?

Mr. BLODGETT. They have not yet been audited; they have been filed.

I next point out to the corporation that the law provides that when the people from whom it bought the property for stock sell the stock, if they paid too much tax then by using as a cost to them of the stock less than its real value in 1920, there is to be an adjustment under section 734 in my client's favor measured by the excess tax which these individuals paid on sales in the intervening years. Of course

it is entirely impossible for my client to determine, let alone bear the burden of proving, how much these unrelated sellers may have overpaid their taxes in the years between 1921 and the present.

In addition to the theoretical difficulties included above, consider the following practical ones:

(1) My client cannot determine the fair value of the stock in 1920, even if it knows all the basic facts, as value is a matter of opinion.

(2) Probably most records and data are destroyed and witnesses dead, so that the necessary basic facts cannot now be proved.

(3) It cannot determine how the sellers were taxed in 1920, what values they used for the stock, what surtax rates they paid, and what the property originally cost them; in all probability their taxes were settled by the Government on some informal compromise of the question of value at somewhat less than the $200 a share assumed to be correct.

(4) My client cannot prove the favorable adjustments to which it would be entitled because of unnecessary taxes paid by the sellers (through use of the low value) when they sold the stock.

(5) Under established principles, the burden of proving every one of these facts before the Bureau of Internal Revenue, a court or the Board of Tax Appeals, is on my client.

Finally, I must point out to my client one other possibility of trouble which seems so unjust that my client may question my sanity. It is reasonable to suppose that if the present taxpayer files a 1940 excess-profits tax return and under section 734 pays a large addition to that tax measured by unpaid 1920 taxes of the sellers, plus interest since 1920, it can then file its excess-profits return for the next year (1941) on the same basis without having to pay the 1920 taxes all over again as an addition to its 1941 excess-profits tax also. But the law does not so provide—section 734 makes the same 1920 adjustment an addition to the current excess-profits tax for each year. To be sure, the regulations provide the very sensible result that the additional 1920 tax is to be paid only once. However, even if we assume that the Commissioner will not amend this regulation in this respect, there is a serious question whether or not the Commissioner can by regulation entirely waive a tax required by act of Congress—that is, collection a second time as an addition to 1941 excess-profits tax of a 1920 tax adjustment already collected in connection with the 1940 excess-profits tax.

The corporation would be in no better position if the question of the value of the stock had previously been fought out to a final court or board decision in determining a prior year tax of either the taxpayer or the sellers. Section 734 allows the whole matter to be opened up (even though there is such a final decision) and the congressional committee report expressly contemplates that that shall be done.

The illustration above related to a simple case where the only trouble centered around the value of the stock. More difficult cases arise continually where there is a question of law as to whether the issuance of the stock for the property was a tax-free transaction to the seller because of some rule of law, such as that pertaining to nontaxable exchanges. A corporation's invested capital may be greatly affected by whether property which it acquired by issuing its stock was

acquired in a transaction which was tax-free to the seller of the property.

For instance, suppose the present taxpayer, corporation A, years ago when it was already a going concern, acquired property from corporation B by issuing some of its stock to B, and B then promptly distributed A's stock to its stockholders and dissolved. Assuming that the stockholders of B were entirely different persons from the stockholders of A, there is no fairness in now making A pay any taxes which B or its stockholders should have paid years ago. If the transaction was in fact treated as tax free to B and its stockholders, either as a result of applying specific provisions of the regulations then in force, or as the result of full investigation by the Bureau, or even as a result of a final court decision on the particular transaction, the whole matter may now be reopened. As a result A may now be required to pay all the taxes that B or its stockholders should have paid (since they are A's predecessors within the definition in the regulations) if it is now held under principles of cases decided perhaps 20 years after the transaction that it should have been treated as taxable.

This is a very real danger because of the great uncertainty as to what constitutes tax-free exchanges in reorganization, particularly in early years. Until 1924 no provision of the law specifically permitted a corporation to avoid a tax on the gain resulting to it from disposing of its property in a reorganization, but from 1918 on, the regulations permitted that to be done in many types of transactions which were rather loosely defined in the regulations. The question of the validity of those regulations and the question of whether a corporation could ever dispose of its property tax free in a reorganization between 1917 and 1924 has never been settled by any satisfactory court decisions; in fact, there are very few decisions on the entire subject.

The effect of section 734 is to now reopen all those questions. If the early year transaction is now held taxable, corporation A will have to pay all the taxes which corporation B and its stockholders should have paid 20 years ago, with interest at 6 percent, although it was never liable for any of those taxes, particularly those of B's stockholders, until section 734 was enacted. What is probably much worse in practice—neither the present corporation A nor the Commissioner of Internal Revenue can now possibly ascertain with any degree of accuracy any of the facts relating to those former taxes, such as the cost of the property to the selling corporation and the cost to its stockholders of their stock, the surtax rates which the stockholders then paid, or the facts necessary to determine the value of the stock issued which will measure the taxable profit. Presumably the Commissioner will "guess" at these amounts and arrive at a back tax liability adequate to surely protect the Government's interest, and the taxpayer cannot possibly bear the burden legally imposed upon it of both disproving the correctness of the Commissioner's figures and establishing the correctness of the figures which it wishes to have substituted.

In the 1924 act, a long detailed definition of what constitutes a tax-free reorganization is inserted and has been maintained since in large part, but despite the comprehensiveness of that statutory definition the exemptions have been greatly whittled down in recent years by Supreme Court decisions imposing further requirements for tax-free exchanges which are not even hinted at in the statutory definition. I refer to such cases as the decisions handed down in the middle

1930's requiring a "continuity of interest" in the transferor's stockholders in order to have a tax-free reorganization—this extra statutory limitation being still largely undefined by the decisions after 17 years of this statute. Another limitation introduced by the Supreme Court is the requirement of the *Gregory case* that a reorganization must have been for a business purpose. The effect of section 734 seems to be to now reopen the question of fact or law in all those cases closed by the Bureau in previous years as to whether there was a business purpose behind the reorganization—and the meaning of that phrase is still pretty vague.

As another example, decisions of five different circuit courts of appeals in the last few years show unutterable confusion on what is the basis to a corporation of assets acquired in a bondholders reorganization, at least three different rules being now in effect in different circuits. This is a question that enters into the computation of invested capital, and it is pretty hard to make the successor corporation guess correctly at this time which of the three rules will finally be adopted by the Supreme Court and if it guesses wrong to penalize it under section 734 by imposing taxes which ought to have been paid by bondholders individually.

There are an almost infinite number of other entirely different ways in which section 734 can operate unfairly or impractically, but I cannot go into them here.

In conclusion, I have stated that time does not permit me to discuss remedies which are needed and the particular form they should take. That is a problem falling within the competence of the technical experts.

Senator GERRY. Were any of these questions brought out in any of the House hearings?

Mr. BLODGETT. No, sir. So far as I know they were not.

Senator GERRY. Any hearing on this section before it was passed?

The CHAIRMAN. No; there were no hearings.

Senator GERRY. My recollection is there were no hearings.

The CHAIRMAN. There was an effort made to iron out a great many of the inequalities and a great many of the hard situations developed by the excess-profits tax and in certain respects, there were very constructive things worked out in that 1941 act, but there were no public hearings.

Mr. BLODGETT. I have sought to point out by concrete illustrations some of the dangers and probabilities of crushing hardship which the section in its present form contains. I believe the Congress has no desire to inflict unnecessary hardships and inequities upon taxpayers, and that this section was enacted without a clear realization of many of its possible effects. In the interests of ordinary fairness, I respectfully submit that it should either be revised on the basis of more equitable principles, or at least be limited in its operation to a reasonable period in the past. If these suggestions prove for any reason not to be feasible, then it is my conviction the section should be repealed.

The CHAIRMAN. Thank you very much.

Senator WALSH. Have you discussed this matter with the Treasury experts?

Mr. BLODGETT. This matter came up so suddenly that I have not had an opportunity; I have, however, communicated with them and

sent them copies and I hope to have an opportunity to discuss it further with them.

(Mr. Blodgett submitted the following additional memorandum:)

MEMORANDUM REGARDING SECTION 734 OF THE INTERNAL REVENUE CODE

Submitted by GEORGE R. BLODGETT, Esq., of Boston, Mass., supplementing his verbal statement

The great hardships which may result from section 734, as discussed below, should be corrected in the pending tax bill, rather than that correction be postponed until the proposed second tax bill planned to embody technical corrections. I fear that reenactment of the law by the present bill will be construed by the courts to give congressional approval to the present regulations which are responsible for many, but by no means all, of the inequities. Furthermore, any amendments affecting such vital matters with respect to 1940 excess-profits-tax liabilities should be passed as soon as possible in order that audits of 1940 excess-profits-tax returns (which presumably will commence shortly) may proceed without the unnecessary investigations and disputes which are certain to arise under the present section and which will waste the time of both the Bureau and taxpayers and involve the taxpayers in substantial expense. Taxpayers need to know where they stand on items having such large bearing on 1940 and future excess-profits-tax liabilities. The possibility of a large addition to 1940 tax under section 734, which is probably present in the case of most reorganized companies and many others, will furnish a serious obstacle to the sale by a corporation of its business or its reorganization into some other corporation, because such a sale or reorganization is often prevented if there is uncertainty involving a large amount of back taxes. If no extensions are to be granted for 1941 excess-profits-tax returns as announced, taxpayers will have to do much of the work of preparing them, if not actually filing them, before the proposed second tax bill is enacted. My office is now, because of section 734, spending weeks trying to ascertain the facts about certain clients' reorganizations before 1920, and our clients should be relieved of this burden as soon as possible.

The problems which have arisen in my practice and to which my speech before the Senate Finance Committee and this memorandum are devoted center around corporations which have no desire to take any unconscionable inconsistent position, but which on the contrary are striving to find some honorable way, by making concessions or otherwise, to avoid the tremendous penalties which may be imposed by section 734.

The remainder of this memorandum falls under the following heads:

I. THE STATUTE SHOULD BE SPECIFICALLY AMENDED, AND RELIEF SHOULD NOT BE LEFT TO ADMINISTRATIVE PRACTICE.

II. LISTING OF OBJECTIONS TO THE PRESENT STATUTE.

III. A FEW ILLUSTRATIONS OF SITUATIONS TO WHICH SECTION 734 MAY RELATE.

IV. SOME GENERAL SUGGESTIONS ABOUT REMEDIES.

I. *The statute should be specifically amended, and relief should not be left to administrative practice.*—It has been suggested that instead of amending the statute, Congress and taxpayers should hope that the Bureau of Internal Revenue will not apply the statute except in cases where the taxpayer is knowingly adopting some clearly unconscionable change of position, and then only to the extent necessary to prevent an unconscionable reduction of current excess-profits tax.

The statute gives neither the Commissioner, the Board, nor the courts the slightest discretion to waive or ameliorate its effect in any respect, nor do the Commissioner's regulations contain the slightest hint that anything of this kind is to be done. Tax practitioners seldom find employees of the Bureau waiving in the taxpayer's favor tax liabilities which are mandatory under the statute and regulations. Tax practitioners may well fear that the Commissioner's true attitude toward administration of this section is well indicated by the provisions of his recent regulations on section 734 which are much more oppressive than anything required by the statute in that they:

(1) Greatly extend the meaning of "predecessor" beyond anything required by the wording of the law, so as to subject the taxpayer to prior year tax liabilities of other taxpayers for which it was never liable until section 734 was enacted. See illustrations (*a*), (*b*) and (*c*) below.

The regulations ignore one limitation given in the congressional committee reports as to what constitutes a "predecessor." See discussion under objection (5) below.

(2) Provide that the mere filing of a tax return is maintaining a position by the taxpayer, thereby probably subjecting thousands of taxpayers to unfavorable adjustments under section 734 who had no idea from the wording of the law that the mere filing of a return subjected them to section 734 and even though the regulation was not issued until weeks after the return was filed. See discussion under objection (3) below.

I have not learned of any instructions issued by the Bureau to field agents indicating that section 734 is to be applied otherwise than in accordance with the literal terms of the law and regulations.

But even if the statute were amended so as to expressly give the Commissioner a discretion both as to whether to apply section 734 in any case or to waive part of the adjustment required, and even if we assume that the Commissioner, and all his subordinates, would show great courage and a wonderful sense of fairness in applying this section, the principal difficulties would still remain. It would be an entirely novel departure in taxation, and a most dangerous experiment, to pass laws unqualifiedly subjecting taxpayers to heavy taxes and then give the Commissioner a discretion to waive the tax in the hope that he and all his subordinates would develop the unusual qualities necessary to administer it fairly. Many questions of statutory interpretation governing prior-year tax liabilities are still entirely unsettled. It cannot be supposed that in such cases the Commissioner will fully abandon the possibility that a prior-year tax may be unpaid, or that the taxpayer will be happy to concede the Government's arguments and pay an adjustment under section 734. For instance, I point out below that, while regulations and administrative practice permitted corporations to dispose of assets tax-free in reorganizations before 1924, there was no provision of law to that effect and it is still entirely uncertain whether those transactions were in fact tax-free. Can anyone expect that the Commissioner, if vested with a discretion, would exercise it so as to waive all adjustment under section 734 until this point of law is finally settled by a Supreme Court decision? As shown under objection (8) below, many of the facts relating to a deficiency in prior years' taxes cannot now be either ascertained or proved, particularly those which relate to so-called "predecessors"; and it is impossible that any exercise of an expressly granted discretion would generally reach fair results in such cases.

The existence of any such discretion in the Commissioner would in effect negative any benefit of the taxpayer from applying to the Board or the courts. If the Commissioner is given a discretion and offers a compromise, the taxpayer must accept it however unfair, or lose the benefit of the offered compromise if it appeals; for it is well established that the Board and the courts decide tax liabilities according to the meaning of the law and without any discretion whatsoever to relieve against hardships or results not contemplated by the framers of the law.

And whatever the Bureau intends to do in administering section 734, I do not believe that the members of the field staff of the Bureau are competent by training or experience to exercise any discretion which might by express amendment of the statute be given them to enforce the statute only so far as necessary to prevent grossly inequitable changes in position to the manifestly unfair disadvantage of the Government. My experience is that most of the Bureau's field representatives are sincere, honest men who would like to be fair but who feel obliged by the Bureau's rules of procedure to give no consideration at all to questions of fairness or equity, but to follow the letter of the law and regulations (even though inconsistent with all decided cases) in order to assert the maximum tax possible, and, where a question of doubt arises, to take the position most favorable to the Government in the particular case, even though that results in the Government arguing at the same time for both sides of a single question. I doubt whether the average revenue agent or conferee will have any better view than I have been able to form as to whether reorganizations of corporations before 1924 were taxable to the original corporation, and many other unsettled questions of law which will arise to a great extent in applying section 734. I shall expect the average revenue agent to assert the maximum addition to tax under section 734 sustainable on any theory that is not clearly discredited by decided cases, and I

see years of litigation ahead because I do not think any of his superiors will take the responsibility for reducing his determination materially until the whole matter has been thrashed out in court.

Furthermore, I usually find that if I do get a concession from the Bureau on one point in a case, I am forced to pay a pretty heavy price for it in conceding to the Government other independent points.

II. *Objections to the present statute.*—(1) While the purpose of section 734 was apparently to prevent a reduction of the current excess-profits tax through an unconscionable change of position, the remedy provided by section 734 is not the reduction of invested capital or income credit so far as necessary to avoid such an unconscionable advantage, but is in effect a penalty measured by some prior year tax which bears no relation in amount to the current year's excess-profits-tax saving resulting from the so-called change of position, conscionable or unconscionable. For instance, I have clients who might be subject to a staggering prior-year adjustment under section 734, even though they have no current excess-profits tax to pay whichever of two positions they take (one consistent with the prior year determination, the other inconsistent). I am told of a case involving a war-profits tax of 60 percent. This means, on each million dollars of profit which was not taxed in 1917 under rulings then in force but subsequently upset, an adjustment under section 734 of $600,000 tax, plus $900,000 interest (25 years at 6 percent), or a total adjustment under section 734 of $1,500,000. The effect on invested capital cannot be greater than the increased credit of 8 percent, $80,000, and the current excess-profits tax saved cannot be greater than the maximum 50 percent rate of $40,000. In other words, the penalty on the taxpayer because the Government determined its 1917 taxes incorrectly although in accordance with the Bureaus' rulings then existing is, as to each $1,000,000 of error in taxable income, an adjustment of $1,500,000, in tax under section 734 even though the maximum reduction of current excess-profits-tax is $40,000.

(2) The taxpayer is given no right to continue its former position, pay the increased current excess-profits tax and thereby avoid any adjustment under section 734. As the purpose of section 734 is to prevent the taxpayer from taking inconsistent positions, he should be allowed to do just this. But, assuming, as the statute presupposes, that the former position is incorrect, the taxpayer in filing its 1941 return cannot continue that former position because it is required by law to file and swear to a correct tax return, which necessarily forces it to take an inconsistent position. Any return knowingly continuing the former error would be false and fraudulent to evade tax (i. e., the adjustment under sec. 734). Example (*d*) below gives an instance where the only 1940 excess-profits tax return which the taxpayer can correctly file is necessarily inconsistent with the prior-year determination, and the correct excess-profits-tax return has the effect of increasing the current excess-profits tax over what it would be if the taxpayer continued the former erroneous position, but the taxpayer is nevertheless subjected to an adverse prior-year adjustment under section 734.

(3) While the regulation (sec. 30.734–2) says that "the making of the excess-profits-tax return * * * is a determination by the taxpayer," from which he apparently cannot later withdraw, the taxpayer has no right to put on his return a statement either (*a*) denying any intention to take an inconsistent position, or (*b*) agreeing to reduce its invested capital, or otherwise increase its excess-profits tax, so far as necessary to avoid unconscionable benefit from any inconsistency and to prevent any adverse adjustment under section 734.

(4) By requiring adjustments for all prior years back to 1913,[1] the taxpayer is charged with back tax liabilities for years (*a*) when no one then knew, or may now know, what the correct rule of law was; (*b*) for which the case was closed after full consideration of the express transaction in accordance with the existing regulations and decisions; and (*c*) when the necessary facts to determine the tax liability cannot now be ascertained by anyone. For instance, I have in my practice encountered many cases where going corporations before 1924 issued their stock to acquire other businesses. No provision of the law expressly permitted a corporation to dispose of its assets tax-free in a reorganization before 1924. The regulations provided that this could be done tax-free in certain loosely defined cases, but only if the sole consideration received was stock. Bureau practice regularly held reorganizations of that general type tax-free. There are no authoritative court decisions on this subject, and what few decisions exist are in

[1] Except recent years not barred by the statute of limitations.

considerable confusion. My client should not now be required to litigate a question of law as to whether the reorganization was tax-free to the absorbed corporation, and such questions of fact as the value, years ago, of my client's stock issued on the reorganization and the tax cost to each of the absorbed corporations of the assets transferred. As an additional complexity in such cases, the *Hendler case*[2] indicates that the invariably necessary assumption of the absorbed corporation's liabilities prevents the absorbed corporation from having disposed of its assets solely for stock, which was one of the flat requirements of the regulations before 1924,[3] and the amendatory legislation following the *Hendler case*[4] does not apply to taxable years before 1924.

(5) The term "predecessor" is not defined in the law. It is defined by the regulations to include: "any taxpayer * * * whose income tax liability for such prior taxable year would have been different if there had been no inconsistency between the treatment accorded an item or transaction in the determination of the excess profits tax liability of the taxpayer and the treatment accorded such item or transaction in the determination of its (i. e. the predecessor's) own income tax liability for such prior taxable year" (sec. 30.734–1).

This regulation has the effect of saddling the taxpayer with tax liabilities of other persons for which it could never possibly have been liable until section 734 was enacted. In that respect section 734 goes far beyond any waiver of the statute of limitations or any purpose to prevent the taxpayer from taking a position inconsistent with one which it has previously taken. For example, under the definition in the regulations:

(i) A mining corporation which has consistently and correctly treated all, or part, of its distributions to its stockholders as taxable dividends, is liable for the unpaid taxes back to 1913 of any of its stockholders who have reported less than the proper amount as taxable dividends.

(ii) Assume that corporation A acquired the assets of corporation B before or after 1924 for A's stock, that B then distributed A's stock to B's stockholders, and that the transaction was incorrectly ruled a nontaxable reorganization. Section 734 makes A liable not only for B's unpaid taxes but for all the unpaid taxes of B's stockholders for which latter taxes it could not conceivably have been liable before section 734 was enacted.

In fact, it has been suggested, apparently correctly, that every expense item or capital disbursement ever previously made by a corporation may give rise to an adjustment under section 734. For instance, assume payment of a cash salary or a purchase of supplies for cash in 1920. If the employee or supplier fraudulently or negligently failed to report the receipt of the cash, there seems to be an inconsistency between his failure and the reflection of the item in the corporation's statement of accumulated earnings and profits on the excess-profits-tax return, which under the regulations makes the corporation liable for the unpaid 1920 tax of the employee or supplier.

Note that the regulation entirely omits the following additional requirement contained in the definition of "predecessor" given in the committee report on the 1941 bill as one "whose tax liability in a prior taxable year in respect of a particular item affects the liability of a taxpayer under chapter 2E with respect to such item * * *."

Whatever the foregoing statement means, it clearly shows a congressional intent that in none of the examples given above shall the corporation be liable for the unpaid taxes of its own stockholders or those of corporation B's stockholders or of its employees or suppliers.

(6) The statute does not define what constitutes maintaining a position by the taxpayer. The regulations, section 30.734–2, state: "the making of the excess-profits-tax return required by section 729 or section 730 is a determination by the taxpayer * * *."

Neither the statute nor the regulations indicate that having once filed its tax return, the taxpayer may later withdraw therefrom or take some other position. Of course, the taxpayer may be relieved from his original position if the Commissioner takes some other position on the item or a board or court finds otherwise. But such a result is unlikely if the taxpayer has fulfilled his duty of filing a correct return in the first place, and the taxpayer is thereby probably bound to pay any adjustment under section 734 because of some prior year error.

The statute is defective in not plainly defining what constitutes "maintaining a position" by the taxpayer. The practical difficulties are accentuated by the

[2] 303 U. S. 564 (1938).
[3] Regulation 62, art. 1566.
[4] Sec. 213 of the Revenue Act of 1939.

fact that the taxpayer puts on its 1940 excess-profits tax return only a few figures for the components of invested capital (such as the totals of accumulated earnings and profits, and of property paid in for stock) and certain figures for its income for the 4 base-period years. There is no requirement that it explain the computation of these items, and it will not normally do so nor state specifically its position with regard to any prior-year transaction. Accordingly, the regulation must mean that filling in a single figure, as the total of earnings and profits, constitutes maintaining a position by the taxpayer as to every single item in its entire past history which enters into the computation of that figure, even though neither the detail of that computation nor any statement concerning any transaction is required to be set out on the return.

Section 734 is usually thought of as relating to invested capital matters, but items of income or expense for the 4 base-period years are within its scope. The taxpayer has no alternative but to use the correct figures for such base-period years on its excess-profits-tax return, and is thereby maintaining in connection with its 1940 excess-profits-tax return a position on every item which enters into its 1936 to 1939, and even 1940, taxable net income. Among such items will be depreciation, so that it is maintaining a position as regards the cost to it of all depreciable property, which may well be inconsistent with some prior year determination with regard thereto as applied to it or a predecessor. But it has no choice but to insert as its base-period income the correct figures for its base-period years.

The theoretical concept may be that, before filing an excess-profits-tax return, the taxpayer should go back and analyze every transaction it ever had in order to determine its correct effect on accumulated earnings and profits, etc., under the most recent retroactive decisions and statutory changes. But in practice that theoretical ideal is never reached—the taxpayer usually takes its book figures, particularly where no excess-profits tax is involved anyway. I am firmly convinced that if the foregoing regulation is correct the large majority of taxpayers who filed excess-profits-tax returns have subjected themselves to adjustments under section 734, which bear no relation to the amount of any reduction of the excess-profits tax, because the returns involve a change of position, conscious or unconscious, and that most of those taxpayers have either never heard of section 734, or have no idea that it applies to their facts. After all, the regulations greatly extending the meaning of "predecessor" and "maintaining a position" were not issued until weeks after the 1940 excess-profits-tax returns were originally due.

(7) It permits reopening of cases already specifically decided by final decision of the Board and courts in a proceeding between the taxpayer (or its so-called "predecessor") and the Commissioner. In that respect it goes far beyond a waiver of the statute of limitations. The congressional report on the 1941 bill expressly contemplates (end of first paragraph under sec. 11) that neither a "closing agreement, Board decision, or rule of *res judicata*, etc. * * * " shall bar an adjustment under section 734.

(8) Of the utmost importance to the tax practitioner is the practical impossibility of anyone determining, let alone proving, the facts relating to the prior year transactions. Consider the many cases of reorganizations before 1924 which have come up in my practice. I have not, in most instances, been able even to find out whether the reorganization was finally determined, in settling prior taxes of the predecessor, to be taxable or tax free. Whether as a matter of law it should have been taxable or tax free is still entirely vague. And I cannot determine the facts necessary to prove the value of the successor corporation's stock issued for the assets on the reorganization, let alone the tax cost to the absorbed corporation of the assets involved, or, as regards the stockholders of the absorbed corporations, the tax cost to each of them of the stock which they previously held and their surtax rates, etc. In no case have I been able to make even the roughest estimate of what the adjustment under section 734 might amount to. In most cases the records of the predecessor corporations are destroyed and their officials are dead. I do not know how to even start finding out who their stockholders were.

The Commissioner will be in little if any better position to determine these back facts. Presumably he will be unable to determine them in large part, and will accordingly "guess" at the amount of the tax liability to be determined against my client under section 734, which guess will presumably be large enough to contain a margin necessary to fully protect the Government's interest. How can I hope to bear the burden of proof imposed upon the taxpayer by the Commissioner, the Board, and the courts of both affirmatively disapproving the Commissioner's determination and affirmatively proving the correct figure?

(9) The statute apparently contemplates some adjustments in my client's favor in computing the net adjustment to be paid by it under section 734. For instance, in the illustrations given above where my client is made liable for taxes not paid by: (1) its former stockholders on dividend distributions, or (2) by stockholders of the absorbed corporation upon a reorganization, the statute contemplates that my client shall have a favorable adjustment measured by the tax paid by such stockholder on later selling his stock which would not have been payable if he had treated the prior year transaction correctly. But it is utterly impossible to claim any such favorable adjustment because of lack of ability to ascertain and prove whether or not the stockholders sold their stock, the price received, the tax rate, etc. The Bureau could not let my client see any of the tax returns of the stockholders.

Any such favorable adjustment relating to a year for which correction is not prevented will be made by refund to the stockholder or other "predecessor".[5] If my client is charged with the original adverse adjustment under section 734, it should be entitled to the benefit of all subsequent reductions of tax liability consequent thereon, but the statute prevents any such favorable adjustment being made to it under section 734 in respect of a year for which correction is not prevented, and it is given no right to recover any refund made to the stockholder or other so-called "predecessor."

(10) The statute contemplates that in some cases the net adjustment under section 734 may be favorable to the taxpayer. But that benefit is largely illusory.

The adjustment is to be made only if the Commissioner "maintains" a certain position. This necessarily means a position different from that taken by the taxpayer. Assuming that the honest, reasonably intelligent taxpayer, in whom alone I am interested, has probably made out correct excess-profits tax returns (at least unless the question involved is one of law which is still unsettled), the Commissioner will then have no occasion to maintain any position different from the taxpayer and there will be no favorable adjustment under section 734, however much the taxes were improperly overpaid in a prior year, because the Commissioner has not met the statutory requirement of maintaining a position. Furthermore, it is difficult to imagine that the Commissioner will ever maintain a position which will have the effect of reducing the total taxes to be paid by the taxpayer.

Also, the favorable adjustment to the taxpayer can only operate as "a net decrease" to "be subtracted from, the tax otherwise computed under this subchapter * * *" (Section 734 (c) (1)), so that the favorable adjustment cannot exceed the excess-profits tax otherwise due. On the other hand, the adverse adjustment against the taxpayer is unlimited under section 734, and may be a very large amount even though no excess-profits tax at all would have been due had the taxpayer been legally able to file an excess-profits tax return not containing the inconsistent position.

(11) The statute should plainly adopt the statement of the regulations that, if the taxpayer fully pays the prior year tax as an addition under section 734 to its 1940 excess-profits tax, it does not have to pay the same prior-year tax over again, if succeeding excess-profits tax returns taking the same inconsistent position are filed. The statute requires an annual adjustment under section 734, measured each year by the full amount of the prior-year tax and interest. While the regulation provides that the adjustment shall be made only once, there is doubt about the Commissioner's power to waive totally a tax provided by act of Congress, (i. e., the adjustment under section 734).

III. *A few illustrations of situations to which section 734 may relate.*—Application of section 734 may result from an infinite number of types of prior year transactions. The excess-profits tax returns require that one figure be filled in for "Property paid in for stock, or as paid-in surplus, or as a contribution to capital," and one for "Accumulated earnings and profits" (schedule B, lines 2 and 4). Practically every past transaction will be reflected in these items or in other information called for by schedule B, or in the base period years' data required in schedule A, so that in filing the return the taxpayer is, under the regulation, maintaining a position on each past item which enters into any of these figures. If any of those past transactions were incorrectly taxed to either the taxpayer or its so-called predecessors, section 734 becomes applicable.

A principal source of trouble will certainly be the question of whether prior-year reorganizations of corporations were tax-free or taxable under rules which vary with statutory changes (some retroactive) and with decisions which always

[5] Note the use of the phrase "such year" in the third sentence of section 734 (d)

have retroactive effect. There is still grave doubt whether, prior to 1924, a corporation could dispose of its property tax-free in any type of reorganization, and the rules governing tax-free exchanges then by stockholders are still entirely unsettled in many of their most important respects. The statutory provisions introduced in 1924 were greatly varied or limited by subsequent Supreme Court interpretations, such as the *Gregory case*, which did not come down until 1935, and the *Pinellas case*, about the extrastatutory requirement of a continuity of interest, which did not come down until 1933. My address to the Senate Finance Committee referred to the fact that five different circuit courts of appeal by recent cases hold at the present time three different views of the basis to a corporation which results from a bondholders' reorganization.

The following other illustrations are given above:

(*a*) The case where an officer, employee, or supplier has incorrectly failed to report as income wages, salaries, or price of supplies paid him.

(*b*) The case where stockholders of taxpayer have failed to report the proper amount of distributions as taxable dividends.

(*c*) The case where corporation A acquired corporation B's business for stock of A which B promptly distributed in liquidation to B's stockholders. Corporation A may be liable for adjustment under section 734 if B's stockholders incorrectly paid too little tax on the transaction through treating it as either tax ble or nontaxable.

Additional instances which will probably frequently arise in practice are:

(*d*) Whether a transaction under which property was acquired for stock constituted a tax-free exchange under section 112 (b) (5) or corresponding provisions of a prior law (transfer to a controlled corporation). This section was first interpreted to apply only where the property was other than cash (GCM 2862; VII–1 CB 161 (1928)).

This former Bureau rule was overturned by the courts, (*Halliburton et al* v. *Commissioner* 78, F. 2d, 205–CCA9–1935). As a result, the taxpayer which followed the Bureau's prior-year determination and claimed a new, higher, basis of property so acquired will be taking an inconsistent position if it files its excess-profits tax return on the correct basis using its predecessor's cost. It would thereby become liable for a section 734 adjustment measured by excessive depreciation claimed and allowed in prior years through using the higher basis, even though the effect of using the low basis on its excess-profits tax return is to increase, rather than reduce, its current excess-profits tax. The only escape from this result would be to file knowingly false excess-profits tax returns continuing the erroneous position adopted by the Bureau in closing the prior years' taxes.

(*e*) Whether the acquisition of property by a parent corporation on a liquidation of a subsidiary during a consolidated return period before 1929, was a tax-free exchange. Many such cases were treated as tax-free by the parent company under Sol. Op. 131 (I–1 CB 18–1922); GCM 1501–VI–1 CB 260–1927 and these rulings were not authoritatively revoked by the Bureau until GCM 11676–XII–1 CB 75 in 1933.

(*f*) The illustration in my address to the Senate Finance Committee, relating to the situation where a corporation at any time issues stock for property in a transaction correctly treated as taxable by everyone involved, stressed that the corporation is taking an inconsistent position and subjecting itself to penalties under section 734 if it values the stock which it issued (for purposes of determining the cost at which to enter the property acquired, and hence invested capital under sec. 718 (a)) at a higher figure than the Bureau used in determining the seller's taxes. This holds true even though the corporation's determination of value is correct, or as correct as any determination of value can be.

(*g*) Inconsistent positions may be forced upon the taxpayer by retroactive changes in the law. I refer to the retroactive amendments under section 115 about computing earnings or profits which are applicable under all prior revenue acts as of the date of their enactment.[6] Similarly, with regard to legislation to correct the *Hendler case* situation which was retroactive to 1924.[7] Under these, the taxpayer may be able to file a correct 1940 excess-profits tax return only if it adopts a position inconsistent with one it took under the prior law but which was correct under the prior law, and may, nevertheless, be subject to a prior year tax adjustment under section 734 because the prior-year law has been amended retroactively so as to increase taxable income beyond what it would have been under the law originally applicable to such prior year. Nothing in section 734 says that

[6] Section 601 of the Second Revenue Act of 9940.
[7] Section 213 of the Revenue Act of 1939.

the correction is to be determined by the law originally applicable to the prior year, rather than by such law as amended after the prior year tax liability was finally determined.

(*h*) Prior year matters concerning the amount of depreciation allowances, and questions of "allowable" against "allowed" depreciation, may be reopened under section 734. If the taxpayer, in correctly computing its base period normal tax net income in schedule A of its 1940 return, uses figures arrived at by claiming depreciation on certain property on the basis of a 50-year life, whereas it formerly claimed and was allowed depreciation on a 33⅓-year life, it is maintaining an inconsistent position and may be charged with the tax avoided by using the higher depreciation in the earlier years. This is true even though it is willing to concede that the full amount of prior year depreciation is an adjustment to its cost basis so that there will be no duplication of depreciation deduction in the future.

IV. *Some general suggestions about remedies.*—I disapprove of the whole philosophy of section 734 and believe that it should be stricken out in toto. I feel that the general principles which make the statutes of limitation desirable in other fields of law are particularly applicable in tax matters, where returns are promptly audited, where large amounts are involved, and where questions of fact and law usually are so uncertain and difficult to prove that it imposes a serious burden on all parties to reopen questions years afterward. The burden is particularly serious on the taxpayer, who almost invariably has to bear the burden of proof.

But, if there must be something of this kind in the law, the correction should logically and sensibly be a prevention of any inequitable excess-profits tax advantage which the taxpayer might obtain through a change of position, rather than a penalty measured in some other entirely different way. In other words, the taxpayer's current year excess-profits tax credit, based either on invested capital or on base period income, may be reduced so far as necessary to prevent its receiving the benefits of an unconscionable change of position, unless and until either:

(1) It affirmatively chooses to pay the deficiency in prior-year taxes in order to avoid such a reduction of its current excess-profits tax credit (in such case it should not be penalized by having interest added to the prior-year tax); or,

(2) The aggregate amount of additional excess-profits tax paid by it over a period of years as a result of such reduction in its exemption equals the amount of the prior year deficiency.

After that there should be no reduction of its excess-profits tax credit because of the inconsistency.

Such a remedy would effectively prevent any unconscionable advantage which I believe section 734 was designed to prevent. It does not impose the hardship of a large penalty adjustment under section 734 on a taxpayer which has merely followed the statutory requirement of filing a correct excess-profits tax return and which would not have paid any excess-profits tax whichever of the several possible positions it had adopted on its return with regard to a given item.

There should be a provision that the taxpayer is not required to elect whether to pay the back tax or to suffer a reduction of its credit until the amount of the back tax has been finally determined by agreement with the Government or by board or court decision.

The party, Commissioner or taxpayer, which is seeking an adjustment favorable to it under this section should be required to bear the burden of proof, for in many cases this will prove in practice an impossible burden to bear.

No adjustment because of deficiency in taxes for any year should be considered except for years commencing after December 31, 1935. This is due to the difficulties of proving facts further back than that date, and to the many changes in the rules of law made since that date by court decisions which interpret the reorganization sections retroactively to 1924, and other sections of the law even further back. I select this date because it marks the beginning of tax years following the rendering of revolutionary decisions interpreting the reorganization and liquidation sections in ways not previously contemplated. I have in mind, particularly (1) the *Gregory case* in 1935, imposing an entirely extrastatutory limitation on reorganizations that they be for a business purpose, a largely undefined term; (2) the *Pinellas case* (1933) and the *Minnesota Tea case* (1935) imposing the extrastatutory limitation on a tax-free reorganization that there be a "continuity of interest"; and (3) the *Riggs National Bank case* in 1932 and the *Aluminum Goods Co. case* in 1933, holding that liquidations of consolidated subsidiaries before 1929 were taxable transactions.

The statute should define what constitutes "maintaining a position," and a taxpayer should be expressly allowed to withdraw without penalty from any position which it has taken until final determination of the tax.

The term "predecessor" should be expressly defined in the statute and should be limited to the present taxpayer, or to taxpayers whose actions the present taxpayer controlled in the earlier taxable year through ownership of a majority of their voting stock. A taxpayer is not normally liable for any other party's prior-year deficiencies. It should certainly not be liable for taxes on its stockholders or for taxes of stockholders of companies absorbed by it as it is made liable under section 734, as shown in examples given above. It is not equitable to make the taxpayer liable by adjustment under section 734 for deficiencies of every business to which it succeeded and for whose unpaid income taxes it was originally liable as transferee or because of the operation of some sales-in-bulk law. The reason why this would be inequitable is found in the procedure usually adopted when corporation A absorbs corporation B's business. Usually an estimate is made of B's probable tax liabilities and the consideration to be paid by A for B's business in stock or otherwise is fixed in relation to those tax liabilities, and A is secured in some manner against B's having any larger tax liabilities. This may be done by deferring final payment of the purchase price until B's tax liabilities are wound up, or by taking a guaranty (secured or unsecured) of some of B's officers or stockholders. Any such rights which A previously obtained to protect itself would be valueless to it if the burden of B's former taxes is now imposed on it through a section 731 adjustment, since, in the case of a transaction taking place even only a few years ago, the parties would have believed that the prior year taxes were all wound up when the statutes of limitations expired, and the purchase price would have been finally paid and the security released or guaranty canceled. Furthermore, any such agreements or guaranties would have related strictly to income taxes paid in respect of years before the reorganization, and an adjustment under section 734 would not come within their scope because the additional amount to be paid under section 734 is not paid as a prior-year tax, as such, but as an addition to the current excess-profits tax. (See sec. 734 (c).)

The CHAIRMAN. Charles E. Mickelwait.

STATEMENT OF CHARLES E. MICKELWAIT, NEW YORK, N. Y.

The CHAIRMAN. Mr. Mickelwait, are you addressing yourself to any particular portion of this bill?

Mr. MICKELWAIT. My views are my own. I have no interest other than the 10,000,000 other bettors, who I hope will agree with what I am about to tell your committee.

Senator WALSH. Are you going to speak generally, on the bill?

Mr. MICKELWAIT. I am going to speak generally on the 10-percent tax on mutuel—parimutuel betting. I hope that the other 10,000,000 agree with me. I know that the Government needs the money; I think it is justifiable. I think I am competent to speak on the subject. I am a retired racing official; I have had much experience and am considered an authority.

The CHAIRMAN. There is nothing in this bill on that as it now stands. Do I understand that you wish to recommend the inclusion of such a tax?

Mr. MICKELWAIT. Yes.

The CHAIRMAN. It is not in the bill. However, we are not bound by what is in there. We can consider it. Go on.

Mr. MICKELWAIT. I read over a statement by Mr. Carr, who presented the side of the racing associations, and I believe that my ideas reflect the views, or I hope they do, of the other bettors.

Senator GEORGE. You may proceed.

Mr. MICKELWAIT. The point I would like to make is that an added tax of 10 percent would not disrupt it greatly, and the suggestion I have to offer is that, in order to accomplish this, the programs should

be reduced to six races daily, which would have the effect of sending people home earlier and make it generally more satisfactory. The majority of bettors are $2 bettors; none of them win. They may be temporary winners but, in the end they are all losers. It is a very desirable means of securing money for the Government. Those are my views.

The CHAIRMAN. If you have any particular brief or memorandum you wish to file, you may give it to the reporter.

Mr. MICKELWAIT. I would be glad to give any further information that would be helpful to the committee.

Senator WALSH. How much money do you estimate this plan would bring in?

Mr. MICKELWAIT. I should say there will be about $500,000,000 bet this year and you could realize $50,000,000 on a 10-percent tax.

Senator WALSH. That is all.

The CHAIRMAN. That is all. I believe that completes the list of witnesses for the afternoon, unless there is someone here who desires to make a statement so as to avoid returning in the morning.

Is there anyone here who would care to be heard this afternoon?

(No response.)

The CHAIRMAN. We will recess until 10 o'clock in the morning.

(Thereupon, at 4:15 p. m., a recess was taken until 10 a. m., Tuesday, August 12, 1941.)

REVENUE ACT OF 1941

AUGUST 12, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order. Congressman Harter, please.

STATEMENT OF HON. DOW W. HARTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. HARTER. Mr. Chairman, and gentlemen of the committee, my name is Dow W. Harter. I represent the Fourteenth District of Ohio, which includes Akron, the largest manufacturing center for tires and tubes in this country. Because of the special interest which my district has in this question, I am making this presentation on behalf of the industry. Mr. C. W. Halligan, of the Rubber Manufacturers Association, will assist in answering any questions which you may wish to ask when I have finished my statement.

The rubber industry recognizes that that total tax load of this country must be increased heavily. The rubber industry is prepared to pay cheerfully whatever part of this increased tax burden can be fairly assigned to it.

We know that any industry which raises the question regarding the proposed tax program may expose itself to the charge that it welcomes taxes for everybody else except itself, but rate of excise taxes on tires and tubes is already so far out of line, on the high side, when compared with the tax on similar products that we are not in the least ashamed to call your attention as forcibly as possible to this inequity.

Tires and tubes.—The excise tax on tires and tubes is on a weight basis; 2½ cents a pound on tires and 5 cents a pound on tubes. This amounts to 8.9 percent ad valorem. Tires and tubes obviously are automobile parts and accessories. The tax on all other automobile parts and accessories is only 2½ cents. In the revenue acts prior to 1932, the rate of excise tax on tires and tubes had always been exactly the same as the tax on other parts and accessories, as it logically should be.

In the 1932 act, when these taxes were revived after a lapse, the House proposed the same basis for tires and tubes as for other parts and accessories. The Senate proposed to substitute an import tax

on crude rubber for the excise tax on tires and tubes. This plan was abandoned and the excise tax based on weight was hastily adopted apparently without the realization that the rates would work out to be almost four times as heavy percentage-wise as they should be. Not only is the tax on tires and tubes much heavier than on other automobile parts and accessories and similar products where the rate is only 2½ and 3 percent, it is even higher than it is on many luxuries. Tires are not a luxury, but a necessity used by all classes of people, including most laborers and farmers, and they should not be taxed at luxury rates.

Section 535 of H. R. 5417 the revenue bill of 1941 passed by the House of Representatives doubles the excise taxes on many items including tires and tubes. We recognize that it is a natural instinct at a time like this when more money must be raised by taxation to make a flat increase of a given rate in all taxes of a certain type, but if the tax on tires and tubes is doubled, it will be 18 percent, whereas the tax on other automobile parts and accessories will be only 5 percent. The 8.9 percent tax which already exists on tires and tubes is almost twice as heavy as the new tax will be on other automobile parts and accessories if it is double

We submit that no item of necessity such as tires and tubes should bear an excise tax as high as 18 percent. Apparently we shy away from even a small general manufacturers' sales tax and yet it is proposed to lay a tax of 18 percent on an item of strict necessity which many millions of people use to earn their living.

In this connection, it is worth pointing out that perhaps the most significant development that has taken place in the tire industry in many years is the recent rapid growth in the use of rubber tires on tractors and other farm implements. We do not believe that the tires which a farmer uses on machines and vehicles to plow his ground and to harvest his crop or haul it to market or which the laborer uses to go to his work should be subject to any higher tax than that which is levied on similar products. The rate on similar products is 2½ percent with a 5 percent proposed in the new bill. We submit that in logic and in fairness the rate on tires and tubes should not be 18 percent or should not be increased at all because it is already almost double the new rate on similar products.

Our case boils down to this. We started off on the wrong basis when these excise taxes were revived in 1932; our rate being almost four times as high ad valorem as on like products. Every time that excise taxes are increased by a flat rate, the inequality is broadened. As a matter of fact, the ad valorem equivalent on the weight tax on tires and tubes has been increased automatically over recent years because the weight and quality of the product have been increased much more rapidly than its price.

Put tires and tubes on the right basis, make the rate of their tax the same or approximately the same as the rate on similar products, then increase the tax by whatever flat rate is necessary, no matter how much, and the tire and tube manufacturers will pay this tax like good soldiers and without any argument.

The present method of assessing the tax on a pound basis has proved to be convenient from an administrative standpoint, both to the industry and to the Treasury Department and we recommend

that this method be kept, but that you do not raise the present pound rate and increase the tax disparity between tires and tubes and other comparable goods.

This tax has a bearing on one of our most acute agricultural problems, cotton. The tire industry of this country is the largest single user of American cotton in the world. The present price of cotton is about 17 cents a pound. The excise tax on tires 2½ cents a pound on total weight means that there is a tax of nearly 15 percent on all cotton used in tires. If the excise tax should be doubled, it would mean a tax of nearly 30 percent on all cotton consumed by the largest single user. There is no denying the fact that a tax this high places a penalty upon the cotton grower.

It has been suggested by some people that since crude rubber is a strategic material for which we are entirely dependent on imports an especially high tax on tires and tubes is advisable in order to conserve crude rubber. It has even been proposed that a tax of 20 percent be placed on all automobiles, parts, and accessories to throttle civilian use of the materials needed for defense.

It is perfectly true that crude rubber is a strategic material of which the Government is trying to build a stock pile as rapidly as possible and that steps have been taken by O. P. M. to conserve the use of rubber. We all know that defense needs come first in all products and that the use of essential material for automobiles, automobile parts, and accessories, or for anything else, must be controlled to whatever degree is required by the defense program. But we must remember that automobiles, tires and tubes, and other automobile parts are items of necessity. In effect, they are tools needed by the vast majority of our people in making their living. They are not luxury items. The automotive industry is one of the prime factors responsible for the tremendous economic strength of this country and any unnecessary brake placed on that industry would cause a profound adverse effect on our whole economy, would weaken instead of strengthen our defense effort.

Surely at a time when the cry is to preserve the democratic way of living, we are not proposing to conserve a product with which the mass of our people make their living, by jacking up the price. If we act on this principle, the people with plenty of money who want automobiles and tires for nonessential reasons could easily afford them, while the people who need them to earn their living might not be able to buy them. Now that the time has come to conserve rubber and other materials used in the automotive industry, should we not do it according to the use to which the products are to be put and not according to the ability to pay.

The argument that a heavy tax on tires and tubes and other automotive products would raise prices bears very close attention. One of the most important and most difficult problems the country has to cope with is to prevent an inflationary spiral of prices. The prices of all commodities, especially of necessities, are being watched with utmost care. Is it not obvious then that we should avoid any tax which automatically increased by 9 percent the manufacturers' cost of tires in a product that is indispensable to American business and the American public. Tires may not be in the forefront of our general price structure as prominently as some other items, such as steel

but they enter more vitally and more directly in the budget of the average person than steel and many other products and an unduly high tax on an item of necessity makes it more difficult to control inflation.

We submit the equities of the case dictate that the tax on tires and tubes be the equal and no more than the tax imposed on other automobile parts and accessories.

Other rubber products.—And this is a new imposition fixed by the bill passed by the House of Representatives——

Senator VANDENBERG (interposing). Before you reach that, Congressman, tell me how much is involved in this proposed increased tax. How much in total is involved?

Mr. HARTER. It would be double the present tax, which yields in the neighborhood of $40,000,000 annually.

Mr. HALLIGAN. About that, I would say, at present, but it would reach $60,000,000 or more, according to the volume involved.

Mr. HARTER. That is the excise tax on tires and tubes, and what I am going to speak of now is the tax that is imposed under the House bill upon rubber articles or rubber products.

Senator VANDENBERG. The House bill increased tires and tubes $30,000,000?

Mr. HARTER. Yes; it doubles the present excise tax rate on tires and tubes, and imposes an additional tax which is a new excise tax upon other rubber products.

Under section 3406 of the revenue bill of 1941 passed by the House of Representatives, a new excise tax is imposed on rubber articles described as follows:

> Articles of which rubber is the component material of chief weight, 10 per centum. The tax imposed under the paragraph shall not be applicable to footwear, articles designed especially for hospital or surgical use, or articles taxable under any other provision of this chapter.

We oppose this proposed tax on certain rubber products. It is totally unfair to single out one industry and saddle it with such a high percentage of the excise tax burden. The tax on tires and tubes increased as proposed in the House bill already represents ad valorem tax of almost 18 percent on these articles which constitute the principal volume product in the rubber-manufacturing industry. The imposition of a further tax on all other rubber products will result in a serious aggravation of the excise tax burden on the industry which is already out of proportion with comparable industries, both under the law as it is presently constituted and also under the proposed 100-percent increase. The total amount of tax which the bill seeks to impose on the rubber industry through the 10-percent tax on rubber products is estimated at $21,000,000 annually.

This sum is relatively small in relation to the total revenue to be obtained and it is doubtful whether even half of this amount would be actually realized because articles sold to the Government would be tax free and it would be found that many rubber articles would be exempt by reason of being taxed under other sections of the bill. The burden of administering this new excise tax will be both very heavy for the taxpayer as well as for the Government. It is therefore respectfully urged that this section be entirely eliminated from the bill as being

impractical of application and difficult and costly to administer. There is another serious objection to this proposed tax which will make its administration most difficult. The wording of the House bill is very ambiguous, restricting the tax to "articles of which rubber is the component of chief weight." It is not evident in the bill as to whether the House intended the word "rubber" to apply to crude rubber solely or to include synthetic rubbers and recailm from its scope.

There are over 30,000 articles covered by the rubber industry many of which should be taxable under the terms of the proposed bill and many others would not be taxable. On some articles one manufacturer would pay a tax and another manufacturer could sell the same product tax-free because of differences in manufacturing processes.

The rubber manufacturing industry as a whole is a progressive one and maintains large research staffs who are constantly experimenting to improve the quality of their product. As a result, the specifications for most of the products are constantly changing so that on one day a product may be taxable or subject to tax and the next day the same product would cease to be subject to tax.

In many cases, it will be impossible to determine whether some articles are taxable until they are ultimately consumed. An example of this is the material used for retreading tires. Under the regulations of the Revenue Bureau, if a tire is retreaded from bead to bead, completely obliterating the original markings and identity of the original tire, the retreaded tire is then subject to the full excise tax and the camelback or retreading material would not be taxable as a "rubber product." On the other hand, if the original markings on a tire are not obliterated in the retreading operation, the tire would not be subject to the excise tax on the tires, but the retreading material or camelback would be subject to the rubber-products tax.

Similarly, solid rubber tiring sold in lengths by rubber manufacturers to juvenile-vehicle manufacturers to be made into tires is subject to the excise tax on tires at the time the tiring is cut to the exact length necessary to form a tire at the vehicle manufacturer's plant. If it is not cut to length or not used on a juvenile vehicle, it would be subject to the rubber-products tax. Neither eventuality would be known to the rubber manufacturer at the time the goods are sold or shipped.

Competing articles manufactured by other industries are not similarly taxed which will result in placing rubber manufacturers at a serious disadvantage. The imposition of this tax will therefore result in causing the rubber industry customers to turn to substitutes, thus directly penalizing the industry, but in effect subsidizing its competitors.

For example, leather and fabric power-transmission belting, under the proposed revenue bill, may be sold tax free, while rubber belting, including agricultural belting, will be subject to tax when the rubber content exceeds the other ingredients by weight. Oilskin raincoats and clothing, oilcloth, and linoleum will be sold free of tax, while their competitive products made of rubber, such as rubber raincoats and clothing and rubber flooring, will be subject to tax.

It would be impossible to enumerate many of these thousands of articles manufactured largely of rubber and which would be taxable under the provision included in the House bill. For instance, there

is an extensive manufacture of rubber toys of all kinds and descriptions, including toy balloons. Due to lack of importations from Japan, Germany, and England in recent years, the rubber-toy industry has taken on greater volume and importance in the United States. It would be a gross injustice to tax the products of this rubber-toy industry, which is in competition with toys made of metal, plastic, glass, wood, and other materials. The same argument, of course, holds good with reference to a myriad of rubber products, which are in daily competition with commercial counterparts usable for like purposes, upon which this bill imposes no tax whatsoever.

According to the wording of the House bill, the tax imposed does not apply to footwear. We assume this exception was taken as rubber footwear is an article of clothing. If footwear be accepted on these grounds, rubber clothing of all types should also be excepted as articles of necessity in the family budget of the American public generally.

Again the term "footwear" is not complete unless it includes the shoe bottom. Therefore it is submitted that rubber heels and soles, soling slabs, and top lift strips should be specifically exempted from application of excise tax, both when used in the manufacturing of new shoes and the repair of worn shoes. It is a fact that rubber heel and sole products are used in the production of types of shoes which are used extensively by farmers, workmen, and people in the low-income brackets.

Undoubtedly it will be necessary to specify the "articles designed especially for hospital or surgical use" which are to be exempted from the new excise tax. As an aid to your committee in doing so, and to enable it most clearly to visualize the probable scope of this intended exemption, we should like to submit a list of such articles which, in the opinion of the industry, is quite complete.

I might say that that list has been made up and will be handed to the reporter for the purpose of the record.

(The list referred to is as follows:)

EXHIBIT A.—*List of articles exempt because especially designed for hospital or surgical use*

Accessories.
Atomizer bulbs.
Attachment sets.
Babies' water bottles.
Bath sponges.
Bath sprays.
Bottles, water.
Breast forms, sponge rubber.
Breast pumps.
Bulb syringes.
Caps, nursing-bottle.
Catheters.
Colon tubes.
Colostomy outfits.
Combinations, syringe.
Comfort cushions.
Compacto.
Cots, light-weight.
Crutch tips.
Cushions, invalid.
Cushions, operating.
Douches, vaginal.
Droppers, medicine.
Ear syringes.
Electrosheet.
Face bottles.
Finger cots.
Fittings.
Flat goods.
Gloves, obstetrical.
Gloves, surgeons'.
Hard rubber pipes.
Hard rubber syringes.
Hospital standard line.
Hot-water bottles.
Ice caps.
Infant syringes.
Invalid cushions.
Laboratory stopples.
Medicine droppers.
Nipples, nursing-bottle.
Obstetrical gloves.
Orthopedic devices.
Packette.
Penrose tubing.
Pessaries.
Pile pipes.
Pipes, hard rubber.
Rectal syringes.
Rectal tubes.
Serum stopples.
Sheeting, hospital.
Stomach tubes.
Stopples, laboratory and serum.
Surgeons' gloves.
Syringes, bulb:
  Combination.
  Ear.
  Fountain.

Syringes, bulb—Continued	Tissue cots.	Tubes, celon:
Hard rubber.	Throat bags.	Rectal.
Infant.	Tubing, surgical.	Stomach.
Vaginal.	Tubing, penrose.	Urinals:

It is undoubtedly evident to you that the "other rubber products" embraced by section 3406 of the House bill includes many articles which are definitely of a defense and semidefense nature such as conveyor and power transmission belting, air, water, steam, welding, oil, gasoline, and other types of hose in particular fire hose for general fire-protection service. These so-called mechanical or industrial rubber goods and hard rubber goods are essential to the operation of key industries that are definitely of a defense character—food and kindred products; textile mill and other fiber manufactures; apparel and other finished products made from fabrics; lumber and timber; chemicals, petroleum; coal; steel; electrical machinery; all forms of transportation; all types of mining operations; and others too numerous to mention. The question naturally arises whether it is the wish of Congress to impose an additional 10 percent burden on all of these essential defense industries.

We must emphasize the point that the rubber manufacturing industry appears to have been singled out for taxation in this proposed bill. There does not appear to be another essential industry, other than automobiles, that would be subject to the contemplated taxation and entirely aside from our statement with respect to the proposed rates on tires and tubes, we again make the point that under the proposed bill industrial rubber goods of highly essential character would be involved.

We submit that the excise tax as proposed in section 3406 of H. R. 5417 as written is unfair to the industry and too impractical to administer and works an undue hardship on the industry as compared with other industries.

I might say that I have here a few articles that I would like to hand to the chairman and members of the committee which illustrate how difficult is going to be the fair manner of the imposition of this tax and the fact that articles which have slightly less than 50 percent content of rubber will be in competition with those that contain more than 50 percent, or 50 percent or more under the House bill, so it will result in the most unfair competition.

These are camel-backs [indicating] or the rubber strips that are used for the retreading of tires. One contains more than 50 percent of rubber and one less.

Here are two types of rubber backing, one of which contains in excess of 50 percent and the other less [indicating].

These are samples of conveyor belting, one of which would be taxable and the other would not [indicating].

Senator VANDENBERG. Was this viewpoint presented to the House Ways and Means Committee?

Mr. HARTER. The viewpoint with reference to excise tax was presented to the House Ways and Means Committee. At that time, we did not know that the 10 percent tax was to be imposed upon rubber products, so the presentation of the latter part was not made to the House Ways and Means Committee.

Senator VANDENBERG. By the way, the figure we were discussing previously as to the increased revenue from the new tax on tires and

tubes is estimated in the House report at $44,600,000, rather than $30,000,000.

Mr. HARTER. It ran in my mind that the tax raised, under the present rate, some $39,000,000 or $40,000,000.

Senator GUFFEY. Mr. Harter, was this suggested by the House committee itself, or the Treasury Department?

Mr. HARTER. Senator, I am unable to answer that. I do not know. I know for a number of years when revenue bills have been up, the matter has been laid before the Ways and Means Committee as to the inequity of the excise tax upon tires and tubes as compared with other automotive accessories and parts. We felt, for many years, it was most unfair that this particular accessory, because certainly tires and tubes are accessories, should bear the unfair proportion of tax that has been their burden under the acts in recent years.

Senator VANDENBERG. Well, to meet the entire difficulty which you pyramid into a rather staggering proposition, would not you have to fall back on the general manufacturers' sales tax as far as your theory is concerned?

Mr. HARTER. Either that or see that all excise taxes, particularly with reference to the automotive products, were placed on a fair, equitable, and reasonable basis.

Senator VANDENBERG. Of course, I thoroughly sympathize with your fundamental point of view that the automotive industry and related parts is a traditional goat when it comes to the tax policy of the Government.

Mr. HARTER. And the rubber industry, even to a greater extent than other kindred automotive manufacturers.

Mr. Chairman, I want to thank you for the courtesy of appearing first, as the House is in session. Are there any further questions?

The CHAIRMAN. Are there any questions that any member of the committee wants to ask? Mr. Halligan, is there any statement that you wish to make?

Mr. HALLIGAN. No; I have nothing to add to the statement that we aided in preparing.

The CHAIRMAN. Thank you.

Mr. HARTER. Thank you very much.

The CHAIRMAN. Mr. Satterlee.

STATEMENT OF HUGH SATTERLEE, NEW YORK, N. Y., CHAIRMAN, COMMITTEE ON TAXATION, NEW YORK COUNTY LAWYERS ASSOCIATION

Mr. SATTERLEE. My name is Hugh Satterlee. I am chairman of the committee on taxation of the New York County Lawyers Association. On behalf of the committee on taxation and on behalf of the New York County Lawyers Association, I should like to submit a statement involving the subject of joint returns of husband and wife. This was prepared before the provision was eliminated from the House bill but, inasmuch as the subject may be revived, I should like to file this statement and have it considered in that event, although I see no present need for asking you gentlemen to listen to any oral statement on that subject so, if agreeable, I should like to file copies of this statement with the clerk.

The CHAIRMAN. That is agreeable, Mr. Satterlee. Do you wish it printed in the record?

Mr. SATTERLEE. I think it may be well worth while. We have spent some time on the law on the subject.

The CHAIRMAN. It will be printed in the record. You may file a copy with the reporter or the clerk.

Mr. SATTERLEE. There are two other matters on which I would like to speak briefly, although, as I have no formal authorization from the association, I am really speaking as an individual.

One involves a proposed amendment to the personal holding company provisions. The personal holding company provisions of the statute which, as you will recall, were first enacted in 1934, were plainly designed to compel the distribution of earnings of that class of companies, as indeed was the undistributed profits tax under the 1936 act. However, by the 1937 amendment to the 1936 act, an error—which I think was an error—occurred which resulted in very great injustice. I can illustrate briefly by giving you an actual example with figures.

The B corporation, with a capital deficit on January 1, 1937, had taxable net income for 1937 of $34,000, received from interest and dividends, but, because of losses in excess of $100,000 on the sale of capital assets, it naturally had a larger capital deficit on December 31, 1937, and no earnings or profits of the taxable year. During 1937 it distributed to its stockholders $36,000, which the corporation treated as dividends paid and which the stockholders treated as taxable income and reported as such in their returns. Nevertheless this corporation, which realized losses for the year greater than its gains, but even so distributed $36,000 to stockholders, is taxable not only as to the normal tax, but also as to the undistributed-profits surtax and as to the personal holding-company surtax, resulting in Federal taxes of over $30,000, or 88 percent of its technical taxable net income. If the corporation had suffered no losses for 1937 its tax would have been less than $1,000 instead of $30,000.

That was the purpose of the statute. However, in a case where a corporation, as did this corporation, had losses, capital losses substantially in excess of its net income it, under the then interpretation of the word "earnings," had no earnings for the year; and therefore, although $36,000 was actually distributed and the tax paid on such distribution by the stockholders, it was not regarded as a dividend out of earnings. The corporation having had no accumulated profits prior to that year it was not entitled to a dividends-paid credit, and the corporation was taxed not only with the normal tax but also with the personal holding-company tax and undistributed-profits tax amounting to over $30,000. So that on a new income, technical net income which involved net earnings because of the losses, and although it distributed more than its net income the corporation was really taxed on its losses almost to the entire extent of its net income.

Now, that matter has been brought to the attention of the Treasury Department and it has assured a number of lawyers who are interested in that question that it realized that an injustice was done and that if called upon it would recommend an amendment to take care of that situation.

Without imposing upon your time further as to that, I should like to file a letter in which I set forth a proposed amendment to the income-tax provisions of the present bill which I think would

cover the situation, but I am informed, as I said, that the Treasury Department has an amendment of its own which it would recommend if called upon for the submission of such an amendment.

The CHAIRMAN. You may file your letter so we may bring it to the attention of the Treasury.

(The letter referred to is as follows:)

SATTERLEE & GREEN,
New York, N. Y., August 11, 1941.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, Senate Office Building,
Washington, D. C.

DEAR SIR: To correct an admitted injustice which has existed since the amendment of the Revenue Act of 1936 by the Revenue Act of 1937, I respectfully propose the insertion at the end of title I of the revenue bill of 1941 of the following provision:

"Section 356 of title IA of the Revenue Act of 1936, as added by title I of the Revenue Act of 1937, amending section 351 of title IA of the Revenue Act of 1936; section 406 of the Revenue Act of 1938; and section 505 of the Internal Revenue Code as amended by the Revenue Act of 1939, are amended by inserting at the end thereof the following subdivision:

"*Payment of surtax on pro rata shares.*—The tax imposed by this title or subchapter shall not apply if (1) all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the adjusted or title IA or subchapter A net income of the corporation for such year, and (2) 90 percent or more of such net income is so included in the gross income of shareholders other than corporations. Any amount so included in the gross income of a shareholder shall be treated as a dividend received. Any subsequent distribution made by the corporation out of earnings or profits for such taxable year shall, if distributed to any shareholder who has so included in his gross income his pro rata share, be exempt from tax in the amount of the share so included.

"This amendment shall apply with respect to taxable years beginning after December 31, 1936."

I am assured that the Treasury Department favors such a provision, which was included with respect to corporate surtaxes in all revenue acts (except 1924) from 1921 to 1936, but was omitted in the 1937 revision of the 1936 act on the mistaken assumption that the same result was achieved by the provision for a dividends paid credit.

To prevent the imposition of the surtax on undistributed profits where the shareholders reported and paid taxes on distributions from the corporation which, although representing "net income" to it, were not out of "earnings," a similar provision should be added to section 14 or section 27 (h) of the Revenue Act of 1936; and section 28 (c) of the Revenue Act of 1938 and of the Internal Revenue Code might be amended so as to eliminate the words enclosed in brackets, as follows:

"There shall be allowed to the corporation, as a part of its basic surtax credit for the taxable year, a consent dividends credit equal to [such portion of] the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d) [as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and each shareholder making such a consent had received, on the consent dividends day, the amount] specified in the consent."

I understand that the Treasury Department has prepared a recommendation for amendments designed to achieve the same result as the foregoing, and I respectfully suggest that it be requested to submit such recommendation.

Yours very truly,

(Signed) HUGH SATTERLEE.

Mr. SATTERLEE. The other point I have is this: Under the excess-profits tax amendments of 1941 there was added section 734 to the excess-profits tax law by section 11 of the 1941 act, and I notice by this morning's paper that Mr. Blodgett, of Boston, discussed that subject before you yesterday (see p. 140), but I should like to add a word on that.

The effect of that section 734 is, in the first instance, to remove the bar of the statute of limitations so far as the Government is concerned, but without helping the taxpayer. It goes even further than that. The second effect that it has is the one which I think is unfair, and which should be eliminated by an amendment.

In the case of a transaction, we will say, that took place in 1930, where property was transferred to a taxpayer by another corporation, under the law as it stood, then in certain circumstances it made no difference to the transferee corporation whether or not that was a nontaxable transfer so far as the transferor corporation was concerned. So that, so far as the transferee was concerned, it derived no benefit from the transferor attempting to shape the transaction in such form that it would be nontaxable as to it. Since then, however, the law has been changed as to basis, so that the basis of the transferee would be better, would be higher, if that were a taxable transaction than if it had been a nontaxable transaction, and the courts have decided in situations such as those I have in mind that it was a taxable transaction so far as the transferor was concerned.

Now, this section 734 provides in effect that if——

Senator CONNALLY. Let me ask you right there: You mentioned the transfer of property. They transferred all the assets of the corporation?

Mr. SATTERLEE. Yes.

Senator CONNALLY. All right. Thank you.

Mr. SATTERLEE. Now, however, section 734 provides this drastic thing: It says that if the transferee now wants to claim that its basis is higher, that that was a taxable transaction even though at the time it was made it made not the slightest difference to it whether it was taxable or nontaxable. If it now takes that position, and that is a correct position under the law as held by the courts, it would make itself subject not to any tax which it avoided by the original form of the transaction but to the entire tax which the transferor would have had to pay if at the time that the transaction occurred it had been held to be a taxable transaction. In other words, the transferee is called upon not to assume now a burden which it justly should have assumed at the time of the transaction on the basis of the claim it is now making, but it is compelled to pay a tax which, under no view of the law, would it ever have been compelled to pay. That is the part of the section which it seems to me is extremely unfair, and, in fact, vicious. It compels a transferee at the present time, who has derived no benefit from a form in which a transferor has shaped a particular transaction, to pay the transferor's tax, although that, of course, has long since been barred by the statute of limitations.

The CHAIRMAN. That is the result of changing position?

Mr. SATTERLEE. That is the result of changing position. But, as a matter of fact, as I said to start with, inasmuch as the form of the transaction at the time it was consummated had no effect one way or another on the transferee, the transferee is not really changing its position, because it was a matter of indifference to it. It needed to take no position at that time at all, it was only the transferor's position claimed at that time that the transferee is now saying was erroneous.

The CHAIRMAN. In other words, in your case, in the case that you are presenting, it is rather the taking of the position in the first instance, actually taking a position in the first instance.

Mr. SATTERLEE. That is correct. It never took any position previously, because it did not need to take any position.

The CHAIRMAN. But technically it does take that position now, and in that particular instance, the property transferred from one corporation to another back in 1930, it assumes the liability of the predecessor?

Mr. SATTERLEE. The predecessor, not in the sense that it was the successor corporation but it was simply a transfer in part of a then still existing corporation's property to it. So that the predecessor, so-called, is still in existence, but its liability has been barred by the statute of limitations, and that liability is now, by the statute, saddled upon the transferee as a condition for it taking a position which the law entitles it to take.

Senator WALSH. Mr. Chairman, I think the Treasury should be asked to make a report on the objections made by Mr. Satterlee and Mr. Blodgett on this section.

The CHAIRMAN. I think we will call on the Treasury to do that. We will let them know. That is section 734. We would like to have the Treasury examine the testimony of Mr. Satterlee and the testimony of Mr. Blodgett on yesterday and then give us the advantage of a report on it.

Mr. SATTERLEE. In anticipation of the criticism which may be made against what I said, that it does not help to increase the taxes, as a matter of fact, it would, to an insignificant degree possibly, reduce the revenue, I should like to add that the last speaker's discussion made me think that it might be well to add that ever since 1920, when I was converted to the principle of a general sales tax, I have been very much in favor of a general sales tax as complementary to the income tax.

In my opinion, and for what little it may be worth, I have for over 20 years devoted most of my practice to tax matters. I believe that a great many of the inequities of the income tax which cannot be avoided, and a great many objections to the general sales tax which I believe exist to a lesser extent than is commonly supposed, would offset each other if the two taxes were combined. I think, for example, that the proposed possibility, which I believe is now under discussion, of lessening exemptions so as to subject to income-tax people, individuals with much smaller incomes than are now taxed, that that could be avoided and yet the same result of spreading, of widening the base of taxation could be achieved by a general sales tax, which would also obviate some of the inequities that the last speaker has mentioned, as existing in the case of the rubber industry.

It seems to me that if there were imposed a general turn-over sales tax at a low rate, it would solve a great many of the difficulties that you gentlemen are now facing.

Back early in the 1920's or earlier, when general sales taxes were first proposed, the economists and others said, among other things, that a sales tax was very inequitable and it could not be thought of in connection with a single State or single city for example. Since then, as we know, a number of States have adopted sales taxes which

have not proved unduly burdensome. Even cities have done so. In the city of New York we have a sales tax which is more or less annoying, but I have not heard of anyone who considers it really burdensome.

Senator CONNALLY. Is not the argument against a sales tax that the States and cities have already levied them? Do you want to levy another one on top of it?

Mr. SATTERLEE. I said a number of States have levied them and some cities. I doubt if many cities have levied them but if a general sales tax were imposed by the Federal Government it might be that the States and cities could be provided for in some other way, or encouraged to abandon them.

Senator BARKLEY. In other words, your theory is that the Federal Government ought to invade all the sources of revenue possible and let the cities and States scramble around the best they can to raise revenue for their own purposes?

Mr. SATTERLEE. I remember some years ago, Senator, that the proposition was very largely advocated that estate taxes should be left to the States, and that the Federal Government should eliminate any estate taxation from its taxing system. Of course, that idea has had to be abandoned. Of course, the States and localities now have the general property taxes, and a good many States too, have adopted income taxes, as has the State of New York, for example.

Senator BARKLEY. We may have to come to a general sales tax. I am not closing the door to it, but it seems to me we ought not to do it until we have to.

Mr. SATTERLEE. Well, it seems to me that with the increasing number of these special excise taxes, which, of course, are sales taxes, and the differences in rates, that before very long, even without meaning to, there will be so many articles taxed that you will have, in effect, a general sales tax with the disadvantages of differing rates which it would be, I should say it is impossible to work out to absolute fairness in every case, and yet without the ease of administration which would come from imposing a low rate of tax on practically all articles. A tax of 10 percent on a specific article is, of course, a burden not only on the manufacturer, the retailer, or whomever the tax is imposed upon, but also on the purchaser, but a tax of 2 percent or 1 percent on every article, whatever inequity there is, is pretty much smoothed out by the fact that the size of the tax, the rate of the tax is so small.

Senator BYRD. May I ask you a question right there?

Mr. SATTERLEE. Surely.

Senator BYRD. You just spoke of a tax on every article. Do your studies convince you that the sales tax should be all-inclusive, or should you exempt food, clothing, medicine, and fuel, which are so-called necessities?

Mr. SATTERLEE. Well, Senator, I have not made, in the last year or two, any renewal of studies on the sales tax. As a matter of fact, most of the work I did on the sales tax was 10 years or so ago. I would not have any positive opinion as to that. It seems to me that the rate of the tax has a good deal to do with it. I cannot conceive that a tax of 1 percent, for example, on food would be a very serious

matter. Quite possibly, however, that could be done, and possibly some other articles which, for instance, are not consumable, or do not go into the final possession of the purchaser, but which are sold and resold could have some special provision.

For example, stocks and bonds. It would be rather difficult to impose a sales tax on every sale of those, because it would practically deter people from making reinvestments.

Senator BYRD. What would you say as to articles, for example, that are being sold at one point and then later go into the manufactured article? Would your plan be for a manufacturer's sales tax as to those articles?

Mr. SATTERLEE. Personally, I am very much in favor of a straight turn-over tax at a low rate. Of course, there is argument against that, which I think is offset by making it a very low rate. However, that could be handled too, as has been suggested in the past, in the case of every subsequent sale by taxing only the proceeds from that subsequent sale in excess of the cost of the article or material on which a tax has already been imposed.

Senator BYRD. What machinery have you had in mind? Would you collect it at the source? You would not attempt to collect a retail sales tax, would you? Because that is the system most of the States have.

Mr. SATTERLEE. You mean, whether it should be imposed on the consumer, on the purchaser?

Senator BYRD. I mean the method of collection. For instance, in a manufactured article, would you collect it from the manufacturer or the retailer?

Mr. SATTERLEE. I would collect it from the seller.

Senator BYRD. In other words, you would collect it on the wholesale price?

Mr. SATTERLEE. Yes.

Senator BYRD. Not on the retail price?

Mr. SATTERLEE. Well, on the wholesale price and then again on the retail price, subject to this possible provision which I just mentioned of giving the retailer the credit for what the article cost him.

Senator GERRY. Don't you terminate with the tax on the retailer if you do that?

Mr. SATTERLEE. You would if you had a high rate of tax. I think the researches which were made some time ago—as I said, I am rather rusty on it—show that the average amounts to 4 percent.

Senator BYRD. Your plan is somewhat similar then to the gross sales tax, is it not?

Mr. SATTERLEE. Quite similar; yes.

The CHAIRMAN. Thank you very much.

(The statement submitted by Mr. Satterlee is as follows:)

NEW YORK COUNTY LAWYERS' ASSOCIATION,
COMMITTEE ON TAXATION,
August 1, 1941.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, Senate Office Building,
Washington, D. C.

DEAR SIR: The provision in H. R. 5417, as reported by the Committee on Ways and Means of the House of Representatives, for requiring a joint return of the separate incomes of husband and wife, in our opinion seriously violates

established principles of constitutional law and sound theory of income taxation, as well as precipitating grave social questions. As lawyers we address ourselves to the legal issues.

I. *The provision for the taxation of the combined income of husband and wife, as though it were the income of one person, violates the fifth amendment to the Constitution of the United States in that it would deprive the taxpayer of his property without due process of law.*

The sixteenth amendment provides that "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." The tax contemplated by this amendment is a tax levied upon the recipient of income, based and computed upon the amount of income received by him, and not a tax levied upon the recipient of income based and computed upon income received by some other person. The latter proposition is what the bill attempts. It levies a tax upon the husband based and computed upon the income and property of the wife.

This practice has been heretofore condemned by the Supreme Court. In *Knowlton* v. *Moore* (178 U. S. 41), the Supreme Court held that a tax levied upon separate legacies or distributive shares could not be measured by the amount of the whole estate. The Court there said on page 77:

"It may be doubted by some, aside from express constitutional restrictions, whether the taxation by Congress of the property of one person, accompanied with an arbitrary provision that the rate of tax shall be fixed with reference to the sum of the property of another, thus bringing about the profound inequality which we have noticed, would not transcend the limitations arising from those fundamental conceptions of free government which underlie all constitutional systems."

A State law similar to the proposed statute has been held by the Supreme Court to be unconstitutional (*Hoeper* v. *Tax Commission of Wisconsin*, 284 U. S. 206). In that case a statute of the State of Wisconsin provided:

"SEC. 71.05 (2) (d): '* * * In computing taxes and the amount of taxes payable by persons residing together as members of a family, the income of the wife and the income of each child under eighteen years of age shall be added to that of the husband or father, or if he be not living, to that of the head of the family and assessed to him except as hereinafter provided. The taxes levied shall be payable by such husband or head of the family, but if not paid by him may be enforced against any person whose income is included within the tax computation.'

* * * * * * *

"SEC. 71.09 (4) (c): 'Married persons living together as husband and wife may make separate returns or join in a single joint return. In either case the tax shall be computed on the combined average taxable income. The exemptions provided for in subsection (2) of § 71.05 shall be allowed but once and divided equally and the amount of tax due shall be paid by each in the proportion that the average income of each bears to the combined average income.'"

The Supreme Court in the *Hoeper case* set forth all the various rights and privileges accorded to married women under the laws of Wisconsin, including the right to hold and convey property, and then went on to say:

"Since, then, in law and in fact, the wife's income is in the fullest degree her separate property and in no sense that of her husband, the question presented is whether the State has power by an income-tax law to measure his tax, not by his own income but, in part, by that of another. * * *

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the fourteenth amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income. * * *"

The Tax Commission attempted to justify the tax upon the ground that it was necessary in order to prevent frauds and evasions of the tax by married persons. The argument, the Court held, was answered in the case of *Schlesinger* v. *Wisconsin* (270 U. S. 230), where it was said:

"That is to say, 'A' may be required to submit to an exactment forbidden by the Constitution if this seems necessary in order to enable the State readily

to collect lawful charges against 'B.' Rights guaranteed by the Federal Constitution are not to be so lightly treated; they are superior to this supposed necessity. The State is forbidden to deny due process of law or the equal protection of the laws for any purpose whatsoever."

The second argument urged by the Tax Commission as a justification for the tax was that it was a regulation of marriage, something directly within the power of the State to do. This argument was answered by the Court when it said,

"Again, it is clear that the law is a revenue measure, and not one imposing regulatory taxes * * *. It is obvious that the act does not purport to regulate the status or relationships of any person, natural or artificial. Arbitrary and discriminatory provisions contained in it cannot be justified by calling them special regulations of the persons or relationships which are the object of the discrimination * * *."

Perhaps the gist of the entire opinion is found in the following quotation from the opinion at page 217:

"* * * the State has, except in its purely social aspects, taken from the marriage status all the elements which differentiate it from that of the single person. In property, business, and economic relations they are the same. *It can hardly be claimed that a mere difference in social relations so alters the taxable status of one receiving income as to justify a different measure for the tax.*" [Italics ours.]

The Court then concluded:

"Neither of the reasons advanced in support of the validity of the statute as applied to the appellant justifies the resulting discrimination. The exaction is arbitrary and is a denial of due process."

It would seem, therefore, that the *Hoeper case* answers the question of the constitutionality of the proposed statute. Although that case involved a State statute, it is settled that there is no distinction between the "due process" of the fourteenth amendment and the "due process" of the fifth amendment (*Heiner* v. *Donnan*, 285 U. S. 315). That which is a violation under the one is a violation under the other. The mere fact that the proposed statute is a Federal law, and that the statute involved in the *Hoeper case* was a State law cannot change the finding that the statute is a "discrimination," "is arbitrary," and "is a denial of due process."

The *Hoeper case* does not stand alone in its condemnation of a tax upon "A" based upon the property of "B." In the case of *Schlesinger* v. *Wisconsin*, *supra*, the Supreme Court held that a statute of the State of Wisconsin, which included within the estate of a decedent all gifts made within 6 years of the time of the decedent's death, was arbitrary and in plain conflict with the fourteenth amendment.

In *Frew* v. *Bowers* (12 F. (2d) 625, C. C. A. 2d) the Government contended that a Federal statute was to be interpreted as including within the estate of a decedent property which had been irrevocably transferred to a trust 12 years prior to decedent's death. Justice Hand, in a concurring opinion, after pointing out that this property at the time of decedent's death belonged to the trust and not to the decedent, stated at page 630:

"Such a law is far more capricious than merely retroactive taxes. Those do indeed impose unexpected burdens, but at least they distribute them in accordance with the taxpayer's wealth. But this section distributes them in accordance with another's wealth; that is a far more grievous injustice."

The practice was again condemned in the case of *Heiner* v. *Donnan* (285 U. S. 315), where the statute involved in effect created an irrebuttable presumption that gifts made within 2 years of the death of the donor were made in contemplation of death. The Court there said:

"The result is that upon those who succeed to the decedent's estate there is imposed the burden of a tax, measured in part by property which comprises no portion of the estate, to which the estate is in no way related, and from which the estate derives no benefit of any description. Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the *Schlesinger* and *Hoeper cases* condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoliation. 'It is not taxation that Government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the Government from his own gains and of his own property.'

(*United States* v. *Baltimore & O. R. Co.*, 17 Wall. 322, 326, 21 L. Ed. 597, 599)."

If it be argued that the statute does not tax A upon the income of B, as appears to be unconstitutional, then it must be argued that the income of B belongs to A. The statute in effect, therefore, raises an irrebuttable presumption that the income of the wife belongs to the husband and the income of the husband belongs to the wife. This procedure has likewise been condemned by the Supreme Court. In *Reinecke* v. *Smith* (61 F. (2d) 324, 325) the Court said:

"Under the broadest conception of legislative power, that which is not the income of the taxpayer and which it is impossible for him to make a part of his income may not be required arbitrarily to be included in his income. Such an attempt amounts to confiscation and offends the fifth amendment."

In *Darcy* v. *Commissioner* (66 F. (2d) 581, 585) the Court said:

"We agree that what is not income in fact cannot be made income by legislative fiat and so brought within the income-tax laws."

In *Helvering* v. *City Bank Farmers Trust Co.* (296 U. S. 85) the Court stated:

"A legislative declaration that a status of the taxpayer's creation shall, in the application of the tax, be deemed the equivalent of another status falling normally within the scope of the taxing power, if reasonably requisite to prevent evasion, does not take property without due process. But if the means are unnecessary or inappropriate to the proposed end, are unreasonably harsh or oppressive, when viewed in the light of the expected benefit, *or arbitrarily ignore recognized rights to enjoy or to convey individual property, the guaranty of due process is infringed.*" [Italics supplied.]

The cases of *Hoeper* v. *Tax Commission of Wisconsin*, and *Heiner* v. *Donnan*, *supra*, are again in point. The Court in the *Hoeper case* stated, at page 215:

"That which is not in fact the taxpayer's income cannot be made such by calling it income.

"* * * Under the law of Wisconsin the income of the wife does not at any moment or to any extent become the property of the husband. He never has any title to it, or controls any part of it. That income remains hers until the tax is paid, and what is left continues to be hers after that payment. The State merely levies a tax upon it. What Wisconsin has done is to tax as a joint income that which under its law is owned separately and thus to secure a higher tax than would be the sum of the taxes on the separate incomes."

What the Wisconsin Legislature did there, and what the proposed legislation herein under consideration would effect, are the same thing, viz, raising an irrebuttable presumption as to the recipient of the income. This is clearly in violation of the fifth amendment, as it deprives the taxpayer of his property without due process of law.

In the *Heiner case*, *supra*, the Court in speaking of the statute imposing an irrebuttable presumption of contemplation of death upon gifts made within 2 years of death, said:

"The presumption here excludes consideration of every fact and circumstance tending to show the real motive of the donor. The young man in abounding health, bereft of life by a stroke of lightning within 2 years after making a gift, is conclusively presumed to have acted under the inducement of the thought of death, equally with the old and ailing who already stand in the shadow of the inevitable end. And although the tax explicitly is based upon the circumstance that the thought of death must be the impelling cause of the transfer * * * the presumption, nevertheless, precludes the ascertainment of the truth in respect of that requisite upon which the liability is made to rest, with the result, in the present case and in many others, of putting upon an estate the burden of a tax measured in part by the value of property never owned by the estate or in the remotest degree connected with the death which brought it into existence. Such a statute is more arbitrary and less defensible against attack than one imposing arbitrarily retroactive taxes, which this court has decided to be in clear violation of the fifth amendment."

As in the *Heiner case*, the presumption here excludes consideration of every fact and circumstance tending to show the real destiny of the income. The husband, whose wife's income is used for purposes entirely removed and dissociated from the marital relationship, is conclusively presumed to have beneficially received the income, equally with the husband whose wife turns

over her weekly pay envelope to him to be expended for the upkeep of the family home. And although the tax is based upon the taxpayer receiving income, either actually or beneficially, the presumption precludes the ascertainment of the truth in respect of that requisite upon which the liability is made to rest, with the result of taxing income to one who has never, either actually or beneficially, received it.

II. *The provision for taxing separate incomes as joint income would effect an unconstitutional usurpation of the States' power to regulate property*

The proposed statute in effect would state that one of the incidents of the ownership of property by a married person is that the spouse of such person shall be taxed thereon. This is an assumption of the power of the State to regulate the ownership of property and, under the tenth amendment, is unconstitutional.

The tenth amendment to the Constitution reads:

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

The power to regulate property has long been a recognized right of the States. It was not delegated to the Federal Government by the Constitution and thus has remained, since the birth of our country, within the orbit of State control. The proposed satute would result, therefore, in usurping this power by the Federal Government.

In *Hoeper* v. *Tax Commission of Wisconsin* (284 U. S. 206), which held that a Wisconsin statute imposing compulsory joint income-tax return for husband, wife, and children under 18 years of age, was unconstitutional, Justice Holmes wrote a dissenting opinion which was concurred in by Justice Brandeis and (now Chief Justice) Stone. His opinion was based upon the premise that the States had inherent power to regulate property and that since the State of Wisconsin had been the one to grant to married women the right to hold and convey property, in contravention to the common law upon the subject, the State likewise had the power to curtail this right in any manner in which it saw fit. It held that, by the enactment of the statute there in question, the Sate was exercising is right to regulate property.

It can be seen, therefore, that even if one grants the reasoning of the dissent in the *Hoeper case* to be correct, the proposed statute would still be unconstitutional under the tenth amendment because of its usurpation of the State's power to regulate property.

Justice Holmes in the *Hoeper case* dissent said, at page 220:

"So far as the Constitution of the United States is concerned the legislature [State] has power to determine what the consequences of marriage shall be, and as it may provide that the husband shall or shall not have certain rights in his wife's property and shall or shall not be liable for his wife's debts, it may enact that he shall be liable for taxes on an income that in every probability will make his life easier and help to pay his bills * * *."

Again granting this to be true, what has been stated above in regard to the power to regulate property is equally applicable to the power to regulate marriage. This is also a power which was not delegated to the Federal Government and hence was reserved to the States. If the proposed statute be interpreted then as a regulation and consequence of marriage, it is likewise a usurpation of the States' power.

III. *"Incomes," as used in the sixteenth amendment, never contemplated the inclusion of a wife's income in her husband's taxable income*

The sixteenth amendment 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."

A definition of income, as contemplated by the sixteenth amendment, was set forth in *Eisner* v. *Macomber* (252 U. S. 189), which has often been quoted and reaffirmed. It states:

"Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets, * * *."

It is clear, therefore, that in order for property to be taxable as "income," it must fall within this definition.

Assuming, now, that one spouse receives a beneficial advantage from the income of the other spouse, how is this interest acquired? There is no valuable consideration which is paid for it. A husband and wife who have a single income are just as much bound and morally obligated to each other as the husband and wife who have two incomes. And a wife who has been working is entitled to no less from her husband when she ceases to work. In other words, then, when a man and woman enter into marriage, they assume certain duties and obligations toward each other. If subsequently, one or the other acquires an income which theretofore had not existed, the obligations and duties of the other spouse are in no way increased, even though a beneficial interest in the new income is acquired. Nothing is given in return for this income and there are not any new promises made. The new interest is acquired without the payment of a valuable consideration and, therefore, cannot be considered anything but a gift.

It is clear that a gift does not fall within the *Eisner* v. *Macomber* definition. It is neither a gain derived from capital nor a gain derived from labor, and it is not profit gained through a sale or conversion of capital assets. It has been defined as "a voluntary transfer of property by one to another without any consideration or compensation therefor." *Blair* v. *Rosseter* (33 Fed. (2d) 286), *Noel* v. *Parrott* (15 Fed. (2d) 669, 671).

Since the enactment of the first Federal income-tax law subsequently to the adoption of the sixteenth amendment, gifts have not been included in the computation of income for income-tax purposes. But what does the proposed statute purport to do? It purports to tax this gift to a spouse as income. This is completely inconsistent with section 22 (b) (3) of the Internal Revenue Code which specifically exempts gifts from inclusion in gross income, and it is inconsistent with the definition of income as stated in the *Eisner* v. *Macomber case*.

In the case of *Towne* v. *Eisner* (242 Fed. 702, affirmed 245 U. S. 418), the question involved was whether a stock dividend made in 1914 against surplus earned prior to January 1, 1913, was taxable as "income." The Court there said at page 704:

"Now it is manifest that the stock dividend in question cannot be reached by the Income Tax Act, and could not, even though Congress expressly declared it to be taxable as income, unless it is in fact income."

The Court then went on to find that a true stock dividend is not income and therefore not taxable as such.

The question was again raised in *Eisner* v. *Macomber*, *supra*, this time following the enactment of a statute specifically declaring stock dividends to be taxable as income. The Court rejected the statute as being unconstitutional and quoted the language of the *Towne* v. *Eisner case*, *supra*. It then went on to say at page 203:

"And if, for the reasons thus expressed, such a dividend is not to be regarded as 'income' or 'dividends' within the meaning of the act of 1913, we are unable to see how it can be brought within the meaning of 'incomes' in the sixteenth amendment; it being very clear that Congress intended in that act to exert its power to the extent permitted by the amendment. * * *

The reasoning expressed in the *Towne* v. *Eisner* and the *Eisner* v. *Macomber cases* is analogous to the present situation. If a spouse receives any beneficial advantage at all from the income of his spouse, it is received as a gift and not as income. If the sixteenth amendment did not contemplate the inclusion of gifts within the term "incomes," an act of Congress may not do so.

IV. *The fundamental fallacy in the proposal to tax the separate incomes of husband and wife as joint income is the treatment of the family, and not the individual, as the recipient of income*

The Committee on Ways and Means in its report starts out with the proposition that under the present law, if the entire income is earned by the husband, the family is required to pay a greater tax than if the wife had contributed to the family income. Except by assuming the point which the committee desires to prove, there is no such thing as family income for income-tax purposes. There is the income of the husband and there is the income of the wife.

The theory underlying the proposed provision is that the legal rights of the separate spouses to their separate incomes are to be ignored and that the joint income is to be treated as available to meet the family obligations imposed

upon the husband. This assumes a status which is contrary to the laws that exist in most of the States as well as to the experience of the average couple where both have means. In practice some families, usually where the income of the separate members is small, may pool their resources, but in the case of families whose members are in the medium brackets, their treatment of all the income of each of the members as common income is unusual. If a man with income sufficient to support a wife, after deduction of taxes computed on such income, should marry a woman with a little income of her own, which is not used toward the support of the family, why should the husband's tax burden be increased and the wife be subjected to tax at high rates on her small income?

The length to which the committee's unsupported theory of so-called "family income" has driven it, is illustrated by the conclusion set forth on page 11 of its report (which may or may not be implicit in the proposed act) that "In the case of death, the surviving spouse and the decedent's personal representative are required to file a joint return for the full taxable year in which the death occurred." This would not merely result in a startling joinder of legal bedfellows, but would set up the fiction of the continued existence of a "family" after the death of one spouse, even though (as indicated in a prior sentence in the committee's report) it appears to concede that the "family" is extinguished "upon divorce or legal separation." Death, apparently, is a less vital transition for income tax purposes.

Among grotesque results of the committee's proposal is its impingement on contractual obligations undertaken by husbands in divorce decrees or alimony agreements. The rate of tax on the income paid to the divorced spouse may be considerably higher than that originally contemplated merely because the husband might have subsequently remarried a woman of substantial means. For example, assuming that an ex-husband earns $30,000 a year, $15,000 of which he pays by way of alimony, and subsequently marries a woman having an income of $20,000 a year, his tax on the $15,000 paid to the divorced wife would amount to about 40 percent rather than approximately 30 percent as before. The result would be substantially to increase the burden of the alimony contract or decree.

Again, the proposed bill would result in inequality where the wife's income is received by way of an annuity from a trust established by her husband or another, since in such case the income is taxed to the fiduciary and not to the beneficiary. Obviously, one way of avoiding the compulsory joint return would be to create a trust which provided for fixed payments to the beneficiary rather than for distribution of the annual income.

The committee report refers to the discrimination between husbands and wives living in community-property States and those living in other States. Whatever inequity there is in such situation might be largely cured by taxing to the husband the income actually earned by him, even though upon its receipt the State law treated half of it as the property of the wife. But in any event there is no equity in subjecting husbands and wives in a State like New York to an additional burden in order to solve a problem existing in the community-property States. It is no comfort to a New York husband to know that community-property-State husbands are hit even harder.

The committee report refers to gifts and family partnerships. If a husband with a natural desire to provide for his wife has made bona fide gifts to her and paid gift taxes thereon, it scarcely appears equitable to tax the income from such gifts as if they had never been made. If the husband and wife are to be treated as a unit, then there should be accompanying changes in the statutes eliminating gift taxes on transfers from one spouse to the other and providing for the nonrecognition of gain in the case of sales of property as between the two spouses. As to family partnerships, if a wife bona fide contributes to the success of a business, there would appear to be no reason why she should not receive her share of the profits as her separate or joint returns. Obviously this potential disadvantage to the Government income as though she were a third person.

The Ways and Means Committee report suggests that one reason indicating need for the change is the present provision giving an option to spouses to file separate or joint returns. Obviously this potential disadvantage to the Government may be cured by eliminating the right to file joint returns.

It should be noted that in allowing an exemption to a husband and wife slightly greater than twice the exemption of a single individual, Congress has

heretofore favored husbands and wives. The present proposal is a reversal of such policy and would severely penalize marriage, particularly in the case of individuals having income in the medium brackets. An examination of the table at page 15 of the committee's report shows that the effect of requiring a joint return is slight in the low brackets and slight in the high brackets, but is substantial in the middle brackets, in which the greatest increases in rates have been made in the last 2 or 3 years.

Under the present act the combined income taxes of a husband and wife who each had a net income of $10,000 would be $1,328.80. Under the proposed rates, in the case of a husband and wife with the same combined net income of $20,000, divided equally between them, the aggregate separate taxes on their income would amount to $2,838, and the tax under a joint return would be $4,338.40. The proposed increase over the present taxes, on the basis of requiring a joint return, is over 225 percent, and, if separate returns be continued, is still over 110 percent. If the husband had an income of $18,000 and the wife an income of $2,000, on which the separate taxes would be $3,757.60, the wife's income of $2,000 would under a joint return be required to pay an additional $680.80.

Whether it be right or wrong the result of the policy reflected in the report of the Committee on Ways and Means is tremendously to increase the tax burdens of husbands and wives in the medium brackets in favor of individuals who pay no taxes or are in the lowest brackets and in favor of individuals in the high brackets. If it is of very doubtful legality and equity to subject the middle class of taxpayers to such a burden, the fact that this unprecedented exaction would yield $300,000,000 in taxes seems insufficient justification.

It is not the function of our committee to advocate or oppose the formulation of any policy which is fairly consistent with the framework of our Constitution and with the fundamental rights of our people, but we have perhaps been warranted, in addition to expressing our opinion as to legal matters, in pointing out some of the effects of the adoption of the proposal for joint returns embodied in the House bill.

Respectfully submitted.

COMMITTEE OF TAXATION, NEW YORK COUNTY LAWYERS' ASSOCIATION,
By HUGH SATTERLEE, *Chairman.*
ROBERT G. BURKE.
MARY H. DONLON.
JACOB MERTENS, Jr.
EUGENE L. MULLANEY.
DAVID OPPENHEIM.
WESTON VERNON, Jr.

(Messrs. WILBUR H. FRIEDMAN and MORTON PEPPER, the remaining members of the committee, in part dissent from and in part concur with the foregoing statement.)

The CHAIRMAN. Mr. Boyles.

Mr. Boyles, by way of explanation why you were called out of order, Senator Connally will have to leave the committee at an early hour. He suggested that you be now called.

STATEMENT OF EDWARD S. BOYLES, HOUSTON, TEX., REPRESENTING THE FIRST NATIONAL BANK OF HOUSTON

Mr. BOYLES. Thank you, sir. I am very much pleased. I would not want to keep you waiting.

Gentlemen, I am Edward S. Boyles, of Houston, Tex. I am representing here before you the First National Bank in Houston, and a very large group of banks similarly situated in their troubles, so many, in fact, that the chairman of the legislative committee of the American Banker's Association is present with me, and I trust will feel able to approve the remarks I make when I am through.

My purpose, gentlemen, in coming here is to ask for an amendment to section 22 (b) of the existing Internal Revenue Code, as amended in 1939, to take care of the subject of bad debts. I should like, in substance, an amendment at the hands of this committee providing that recoveries on a bad debt charged off should not be taxed, except to the extent of any tax benefit to the taxpayer in the year of the deduction.

Gentlemen, that is both a necessary and a common-sense request to make.

There is today an existing hurt and a very continuing hurt not only to all taxpayers dealing in loans, but particularly to banks. The thing I am asking is utterly independent of any schedule of rates or revenue raising. I am asking at the hands of the committee that they take time out in raising revenue, to be fair, and to right a very deep hurt.

I might say here, if I am permitted, that you gentlemen have all been citizens before you were Senators. You all have been businessmen, maybe some of you bankers, before you were Senators. This public of ours does not resent an increase in revenue where it is fairly spread out over all the different groups, and particularly banks. You will not find any banks up here hollering at reasonable increases in tax rates, but, gentlemen, whenever you have any part of your tax-public feeling that this committee representing them will leave a condition existing that is hurting, it breeds resentment; it breeds bitterness, it breed frustration.

Senator BARKLEY. Let me ask you, suppose a bank, or someone else who is doing it, is allowed to charge off a bad debt, say, of $2,000, in 1940, they deduct that from their total net income, and then in 3 or 4 years, or at any time afterward, they collect that $2,000, and it turns out not to have been as bad as they thought, or they collect $1,000, what is it you want done in that case?

Mr. BOYLES. I want you to do this Senator—I wanted to come to it historically—but I will stop and answer you right now. Under G. C. M. 18525, the last thing Morris Shafroth wrote before he resigned, provides that if a taxpayer took a tax-benefit or a charge-off, then when he gets recovery, he ought to pay a tax on the recovery, but if he took no tax benefit, or got no tax benefit from it, when he recovers, it is no different from a current bank loan; any more than if you borrow $10,000 from your bank today and pay it back 18 months from now. Do I make myself clear?

Senator BARKLEY. No. Take my illustration—or maybe it is too simple.

Mr. BOYLES. No.

Senator BARKLEY. Now you have got a deduction, say, for $2,000, and the amount of tax on that $2,000 which has been assessed——

Mr. BOYLES (interposing). Senator, may I interrupt you to say this, that you have to take two conditions into consideration there, one is when the taxpayer deducts it does he need it for the tax? In other words, when he charged off the $2,000, if he had other losses sufficient to overcome it, where he received no tax benefit, that is one case. The other is where it is a normal deduction he pays the tax.

Senator BARKLEY. Nobody is compelled ever to ask for a deduction.

Mr. BOYLES. Well, I beg to differ. He is compelled under a supervision of banking officials. It has been held repeatedly.

Senator BARKLEY. He is not required ordinarily by the revenue laws to claim a reduction, he can just let it go. Of course, under good banking and the regulations of State banks and even the national banks, it is their duty to charge it off, but you are not dealing simply with banks now, you are dealing with everybody, I understand. Your amendment covers everybody that makes a loan. If I make a loan to you—this is, of course, a very violent assumption that I would make one in the first place because I could not—but even if I did and it turned out to be bad, I would deduct the $2,000 from the next year's income, and I would be benefited.

Mr. BOYLES. No; not necessarily. That is the point.

Mr. BARKLEY. I would be benefited by the reduction in the tax, assuming that I would, at least.

Mr. BOYLES. If you assume it, I will answer your question.

Senator BARKLEY. Now, 3 years from now I collect that $2,000 from you, or $1,000 of it, and it goes into my income-tax return for that year.

Mr. BOYLES. Yes.

Senator BARKLEY. Now, what would your amendment do to that $1,000?

Mr. BOYLES. Nothing, because there you took the tax benefit, you said, and I think you should pay tax on the recovery. That is not the case, Senator, that I am arguing for. I am arguing for the reverse of that.

Senator CONNALLY. Let me ask you a question, Mr. Boyles.

Mr. BOYLES. Yes, Senator Connally.

Senator CONNALLY. As I understand your situation, say, 4 or 5 years from now the examiner comes around and says you have got to charge off that note, you charge it off and take a loss; your contention is that if the taking of that loss did not benefit you any by reducing your tax, that when it is repaid you ought not to pay any tax on the repayment?

Mr. BOYLES. That is precisely correct, Senator Connally.

Senator CONNALLY. Now, if that debt had been paid back there in that taxable year instead of being charged off, your theory is that there would have been no tax because you had other losses, and so on, that taking that off did not alter your tax situation at all, and if it had been paid back there when it was due there would have been naturally no change in the situation.

Mr. BOYLES. That is correct.

Senator CONNALLY. Now, your contention is that if it is paid 3 or 4 years later, that they ought not to tax you on that as an item of income, because the taking it off back in prior years did not benefit you any.

Mr. BOYLES. And plus the fact that it never was income, Senator, it was always capital. That is correct.

Senator CONNALLY. On the other hand, you are not seeking, where the bank deducted that charge-off and thereby reduced its tax for that year, you are not contending in such case that when it is repaid, it should be tax free?

Mr. BOYLES. That is correct.

Senator CONNALLY. It ought to be taxable?

Mr. BOYLES. That is correct.

Senator BARKLEY. Suppose it is not a bank and no bank examiner comes along and says you have got to charge that off as a bad debt but you do it just because you think it is a bad debt, then what?

Mr. BOYLES. That is covered by G. C. 20854.

Senator BARKLEY. Your amendment does not cover that situation?

Mr. BOYLES. Yes; it would affect it, whether it is voluntary, under banking supervision, if no tax benefit resulted.

Senator CONNALLY. Let me ask you this: Up to 19—what year was that?

Mr. BOYLES. 1940, July 8.

Senator CONNALLY. Up to 1940 the Treasury officially took your present position?

Mr. BOYLES. Yes.

Senator CONNALLY. The Solicitor, whoever he is——

Mr. BOYLES. The General Counsel.

Senator CONNALLY. The General Counsel ruled just exactly as you are contending now?

Mr. BOYLES. Yes.

Senator CONNALLY. But in 1940 the General Counsel made a new ruling which brought that money into the Treasury.

Mr. BOYLES. That is correct. Now, gentlemen, I do not mind the questions. I like it because we get our minds together. I want to preface my remarks by saying that you are busy; you have got a job and a responsibility that I do not envy, but I do want to lay this burden on your conscience; and that is while you are raising millions, it would be awfully well to take just a little time out and correct something. I can tell you first-hand that there are hundreds, not a few, of excellent, fine banks and bankers in these United States today that are fretted, upset, worried because of a very unwise, very foolish decision by the General Counsel. The committee can right it in 15 minutes, and I think you owe that duty to a bunch of men who are trying to run good banks.

Senator BARKLEY. Could you put in the testimony the original decision and the modified decision?

Mr. BOYLES. Yes; I intend to do that, Senator, if you please.

Senator VANDENBERG. The situation would be entirely corrected if the Treasury reverted to its 1940 decision?

Mr. BOYLES. If it reverted to its decision prior to July 8, 1940; that is correct.

Gentlemen, I think most of you remember the period in 1932 and 1933. I lived it in a vivid way. I am going to use that as an illustration because it illustrates what I am going to try to get over to the committee. I lived through 1932 and 1933 as a bank lawyer. I hope I will not have to do it again.

Bankers were not worried about maybe their banks going out of existence; they were not worried particularly about losing their jobs, but they were worried about the faith of 20,000 to 30,000 little accounts in those banks that might go up in smoke. Back in 1932 and 1933, when these things were happening, I. T. 4633 was in force, which provides that if a bank examiner orders a charge-off or charge-down, as to the Government, that is conclusive. It should be, because the bank had no option about it. In those days banks that had stocks, bonds, commodity loans that looked awfully good before

the collapse of the State institutions all around until the final moratorium point; these banks, under the direction of bank examiners, charged those items down to almost nothing. They got no tax benefit from that. They were doing well to be able to navigate the ship; they had so many losses that they did not need any tax benefit from those charge-offs; and they received no tax benefits from those charge-offs.

In 1937, the last thing, as I said a moment ago, that Morris Shafroth did before he resigned as General Counsel for the Income Tax Section, was to write G. C. M. 18528, which holds crystal-clear that where there has been a charge-off or charge-down in a year with no tax benefit resulting to the taxpayer, there should be no tax on the recovery. That is sound, gentlemen. That remained the law, and in 1939—please bear this in mind—the new General Counsel, Mr. Wenchel, wrote 20854, and all that 20854 did was to extend the rule to apply to those cases where the banks or individuals of their own motion charged-off.

G. C. M. 18525 was confined to charge-offs by bank examiners. Now, Mr. Wenchel wrote the General Counsel's memorandum in 1939 which said, as I find this law to be under the rules and regulations existing today, it is my solemn judgment that the rule ought to be extended to charge-offs made voluntarily by banks. That was good law and sound sense, gentlemen. Listen to this language. I will quote it verbatim, the language that Mr. Wenchel used in that opinion:

> Until a taxpayer has had the income equivalent of a full return of the capital represented by the debt there is no valid ground for treating as income any amount received in recovery of the debt.

He could not have written it in simpler English and have said anything more accurately.

All right, that was still good law.

Remember this, too, that in 1939 this Internal Revenue Code, as amended, was passed by the Congress; and to all legislative intent, it embodied in it all the rules and regulations and General Counsel's memoranda promulgated before that date, or else it would have amended it or changed it if they did not like it. That was the state of the law until the latter part of 1939.

I am going to stop and recite, because it will help get this picture before you, the experience of the First National Bank of Houston, which will bring this thing before you very vividly.

In 1932 and 1933, due to the depression losses, we charged off a whole lot of debts. In 1936 some of those sick horses came to life, and, thank God, we received a whole lot of money from them. We reported it. We received no tax benefits in the year we charged them off, in 1932 and 1933. When we got it back in 1936 we reported it. Did we report it as income? No; as a return to us of capital previously loaned out.

Senator BARKLEY. Under the present ruling, getting back to my simple $2,000 illustration, if later, $1,000 of that is recovered, is that now regarded as income?

Senator CONNALLY. That is right.

Mr. BOYLES. Yes, sir. That is what this rather foolish G. C. M. 22163 now does. That is exactly what I want to make clear, Senator. I

am giving you the experience of the First National Bank of Houston.

You remember I said we took the charge-off in 1932 and 1933; we made the recoveries in 1936. On May 2, 1940, we received a certificate of overassessment from the Commissioner of Internal Revenue, ordering the Department to pay us some $48,000. Then what happened? Between May 2, the date we got that certificate of overassessment, and the time it takes these O. K.'d bills to get around to the other side of the office to be paid by the Treasury Department, the same Mr. Wenchel—I do not mean to say that in a harsh way, it is an impersonal matter to me, but I am a little ugly about the kind of memorandum he wrote—the same gentleman now that wrote 20854, the same gentleman who said that until a taxpayer had received back the income equivalent of the full return of his capital, there is no valid ground for treating as income any amount received in recovery of the debt, that same gentleman slammed the door in the face of some of these gentlemen and wrote G. C. M. 22163, that says, regardless of whether or not there were any tax benefits to the taxpayer, the recovery must be reported in gross income and a tax must be paid on it.

Now, gentlemen, there are two reasons he alleges in the G. C. M. and neither one is sound. He says in G. C. M. 22163 the first reason for his reversal is—well, we better go back to the old rules and regulations at the time. They were that way and we would like it better. Of course, the revenue-raising plan, unadulterated revenue raising was one reason. The other reason, he says, is that it is expedient to deal in a calendar year.

Gentlemen, that is silly. There is not a man on this bench who sometime in his life has not either borrowed from the bank and paid back in the same calendar year or borrowed in one calendar year and paid back in the succeeding calendar year. It does not make sense. It is a money-raising reversal, and it does not make common sense.

Senator BARKLEY. Do you know how much money was raised?

Mr. BOYLES. No; I do not, Mr. Senator.

Senator BARKLEY. I wondered if the amount raised justified the reversal.

Mr. BOYLES. I would say no amount raised would justify the reversal. That is the point.

Senator BARKLEY. In the view of the Treasury, I mean, if that is all it was for.

Mr. BOYLES. Yes.

Senator BARKLEY. I want to know how much it raised.

Mr. BOYLES. I do not know. I have no way of knowing.

Senator CONNALLY. As I understand it, your particular bank, as the result of its transactions in 1932 and 1936, claimed an overpayment.

Mr. BOYLES. Yes.

Senator CONNALLY. The Treasury allowed you an overpayment certificate of $48,000?

Mr. BOYLES. Yes.

Senator CONNALLY. It officially declared that you were entitled to an overpayment certificate of $48,000?

Mr. BOYLES. Yes.

Senator CONNALLY. While that was in process of certification, giving you the check, they came out with this other ruling, and you did not get your $18,000; is that correct?

Mr. BOYLES. That is exactly correct.

Senator VANDENBERG. Were there any court decisions which intervened on which Mr. Wenchel sought to rely?

Mr. BOYLES. No; Senator. On the contrary, there were two board decisions, the *Central Land Investment* v. *Commissioner* (39 B. T. A. 981), and *National Bank of Commerce* v. *Commissioner* (40 B. T. A. 72); these two board cases I cite affirmed and approved G. C. M. 18525, as sound, and the Commissioner's office acquiesced in both of these decisions.

Senator CONNALLY. Will you put in the record a brief memorandum or something, giving both opinions?

Mr. BOYLES. With the permission of the committee, I will be glad to furnish—I do not like to speak from any prepared memorandum—I will furnish to the committee a brief on any of these points that I make. Is that all right, Senator George?

Senator GEORGE. Yes.

Senator CONNALLY. Put in both opinions of the solicitors or counsel, the former one and the latter one, so we can compare them.

Mr. BOYLES. Yes.

Gentlemen, here is the situation: When this revenue-raising general counsel memorandum was issued, the same rules and regulations of the Treasury Department that had been in force, G. C. M. 18525, that had been promulgated theretofore, were still there, and had not been changed.

When counsel undertook to reverse himself, these two board decisions had been acquiesced in by his department, and they had not withdrawn their acquiescence. At that same time, Congress had, and as I say, I think it is logical, had passed this new, revised revenue amendment, had an amended code approving the soundness of G. C. M. 18525.

Senator WALSH. Is it a fact that, briefly stated, you reported as a return of impaired capital and it was ruled finally to be income?

Mr. BOYLES. Yes.

Senator WALSH. That is the whole story.

Mr. BOYLES. Plus this—each one of these questions allows me to make another, I hope, definite point, Senator—a loan has been and always will be a capital transaction. The loan, the charge-off, the recovery is all part and parcel of one capital transaction.

Senator WALSH. If a loan is made for 5 years, is it always a part of the capital transaction?

Mr. BOYLES. Yes, sir.

Senator WALSH. So that the rule of reporting all transactions each year does not apply to the loans?

Mr. BOYLES. I will answer that. That is a fundamental question, Senator. The sixteenth amendment authorized you gentlemen of the Congress to tax income. You cannot tax capital, you are forbidden to tax capital. I say again that all the writing of the General Counsel in the world cannot change capital into income. You can write reams on reams and you can never change capital to income.

Sentor BARKLEY. Your contention is, if the loan had been repaid and not charged off, the only part of it that would represent income would be the interest on it?

Mr. BOYLES. Precisely, Senator.

Senator BARKLEY. If it is paid back later in full plus interest, your contention is that only the interest that would be paid back is taxable.

Mr. BOYLES. Precisely, unless there is the one exception that the taxpayer foolishly tries to use it to get a tax benefit.

Let me ask you another question. Most of you men have had banking experience, some of you may have been in banks. If what I am talking about is not sound, we better close up banks.

If Senator Connally borrows $10,000 this year and unfortunately is not able to pay it back next year, if that make it income instead of capital——

Senator CONNALLY (interposing). I wish you would arrange such a loan.

Mr. BOYLES. I might do that, Senator. I will be glad to.

All right. If Senator Vandenberg borrowed another $10,000 from another bank and pays it in the calendar year, the fact that one pays it on January 1 in the first calendar year and the other pays it on January 1 in the following calendar year, if that can change capital to income, then I am talking wrong. That is the whole sum and substance of it. I am trying to see this thing started out as a capital transaction and it is always going to remain a capital transaction.

Senator BYRD. Do you favor an amendment to the law that a loss of a capital asset should not be deducted from the income?

Mr. BOYLES. Certainly, unless you take the tax benefit from it. Let us get back, because I want to get that point clear.

Senator BYRD. You contend that a loan is entirely a capital investment?

Mr. BOYLES. I certainly do.

Senator BYRD. Therefore, if it becomes of interest to the income tax, of course you deduct it at a loss?

Mr. BOYLES. Let us get that straight.

Senator BYRD. Would you favor treating it entirely as a capital investment?

Mr. BOYLES. Certainly it is a capital investment.

Senator BYRD. Would you favor an amendment to the law that if there was a loss to the loan that was made, it could not be deducted in any instance, from the income?

Mr. BOYLES. I do not want to say that; I do not want to be understood as saying that. They are two separate things.

If you go to a bank, Senator, and borrow $10,000, and I trust you do——

Senator BARKLEY (interposing). Why not trust him for it?

Mr. BOYLES. That might be better, Senator. At any rate, if you borrow $10,000—I want to follow that a minute and answer your question—the thing I am talking about is what happens when the bank goes to make up its income tax. If, unfortunately, you cannot pay it, and the bank has enough losses generally, so that deducting that $10,000 does not give it one cent of tax benefit, then when the recovery comes in, it ought not to be taxed any more than if I borrowed $10,000 today and paid it back tomorrow. It is a capital transaction.

Senator BARKLEY. Would not that only happen where the other losses sustained by the bank wiped out this income entirely, so there would be no object in putting in an additional loss, that would not cause you to pay any tax anyhow?

Mr. BOYLES. That is exactly it, Senator.

Senator CONNALLY. Senator Byrd was talking about whether you would favor treating it as capital and not taking a loss on it. The only advantage of taking some loss is to get your tax cut. No matter how much your capital might be impaired, your bank might be worse off than before, yet as far as the Government is concerned, unless the only purpose in the world of your bank claiming that on account of lost capital would be to save some tax, if you do not have that result, your contention is it ought to remain as capital and not be taxed as income?

Mr. BOYLES. Exactly. Let me add another thing. I do not want to take too much time, but there are some of these points that I would like to make. Gentlemen, I know that this committee is interested in sound banking. If you gentlemen let this law stay the way it is, there is an incentive to bad banking. Let me tell you why I am talking common sense and talking soundly about that.

If Senator George and you gentlemen are on an executive board of a bank, and you see the XYZ Co. beginning to get in a little trouble, the smart thing for a first-class bank to do is to say to it, "You boys start writing down XYZ. Write it down 20 percent."

That is sound banking. But if you let this present G. C. M. stand, no banker in the world is going to tell its controller to go and write down XYZ 20 or 30 percent, and then have Mr. Wenchel tell them if they get recovery, they have got to pay a tax on that 20 or 30 percent; and it has been a capital investment all the time.

Have I made myself clear?

Senator BARKLEY. Is there any definite point in such a loan as that? You say, "write down." I suppose you mean write down the value of the loan. If you did not write down the loan gradually, it would mean a shut-down of the institution.

Mr. BOYLES. I do not mean that. Let me see if I can make myself clearer.

Suppose KXVY Manufacturing Co. has a line of credit with your bank for $100,000, you have loaned them $100,000 and you have got a lot of their collateral in your portfolio, when their monthly statement comes in, you say, "It looks like these fellows are losing money there. They may not be able to pay 100 cents on the dollar on the loan." You run a bank, you want to be sound all the time. The smart thing for you to do is to say, "Now in order to have a good bank, let us write the loan down 20 percent."

Senator BARKLEY. That is an arbitrary procedure on the part of the bank. It makes up its mind that the loan worth $100,000 is now worth only $80,000.

Mr. BOYLES. What difference does it make? It is a bookkeeping entry. Let us not get fogged up in the woods because of the trees. All I am saying is that a capital transaction that starts out as capital ends up as capital. The sixteenth amendment does not let anybody tax capital, and the general counsel's memorandum cannot do that.

If this $100,000 loan is made and charged off, if the bank does not get a tax benefit, then when the recovery comes in, it ought not to carry a tax charge any more than an every day current loan made daily by banks.

The CHAIRMAN. If you do get a tax benefit, you ought to be estopped?

Mr. BOYLES. That is correctly the word that I would use. That is an equitable thing. You ought to be estopped because you take a benefit.

The CHAIRMAN. Your point is, there can be no estoppel unless you did receive a tax benefit?

Mr. BOYLES. Yes; and it is always a capital transaction, there is no question about that, gentlemen.

The CHAIRMAN. Thank you very much, Mr. Boyles. I thank you for your courtesy. You may file with the reporter or the clerk the memorandum called for by Senator Connally.

(Mr. Boyles submitted the following brief, together with the Treasury Decisions referred to, appended.)

BRIEF SUBMITTED BY EDWARD S. BOYLES AND APPROVED BY AMERICAN BANKERS ASSOCIATION WITH AMENDMENT TO SECTION 22 (B) OF THE INTERNAL REVENUE CODE (AS AMENDED BY THE REVENUE ACT OF 1939)

AN AMENDMENT TO THE INTERNAL REVENUE CODE

It is recommended that section 22 (b) of the Internal Revenue Code (as amended by the Revenue Act of 1939), should be further amended by adding thereto a new subdivision (10):

"(10) RECOVERIES ON BAD DEBTS.—Amounts received on account of a debt for which a bad debt deduction or deductions have been allowed in a prior year or prior years under section 23 (k) or under a corresponding section of any revenue act to the extent that such deduction or deductions so allowed did not result in an income tax benefit in such prior year or years. This paragraph shall be effective beginning after December 31, 1935."

Section 23 (k) of the Internal Revenue Act allows a deduction from gross income for bad debts.

On April 3, 1936, the Commissioner of Internal Revenue issued T. D. 4633. In substance this ruling ordered that where banks (or other corporations subject to supervision), charged off debts in whole or in part in obedience to specific orders of an examiner or other supervisory officer, that such debts shall be conclusively presumed, for income-tax purposes, to be worthless, or recoverable only in part, as the case may be.

On June 28, 1937, Hon. Morrison Shaforth, chief counsel of the Bureau of Internal Revenue, issued G.C.M. 18525 which held, in substance, that amounts recovered upon debts previously charged off at the direction of an examiner or supervisory officer constitute no taxable income for the year of recovery if the prior allowance of deduction resulted in no tax benefit.

On May 24, 1939, the Board of Tax Appeals in *Central Loan and Investment Company* v. *Commissioner* (39 B. T. A. 981), approved G. C. M. 18525 above and enforced it.

On June 9, 1939, the Board of Tax Appeals in the case of *National Bank of Commerce of Seattle* v. *Commissioner* (40 B. T. A. 72), again approved and enforced the ruling announced in G. C. M. 18525 above.

Both of these decisions were acquiesced in by the Commissioner.

Thereafter, in 1939, a new General Counsel for the Bureau of Internal Revenue, J. P. Wenchel, issued G. C. M. 20854. This ruling not only approved G. C. M. 18525 above, but extended the ruling to cover cases where the taxpayer makes the charge-off on his own motion (and not at the direction of a supervisory officer). In this ruling counsel uses the following language:

"It is well settled that in the ordinary case amounts received in repayment of loans do not constitute income but are reimbursements of capital."

Again:

"Until a taxpayer has had the income tax equivalent of a full return of the capital represented by his debt, there is no valid ground for treating as income any amount received in recovery of the debt."

In 1939 the Bureau of Internal Revenue issued I. T. 3172, in substance reaffirming previous regulations and General Counsel memoranda. It held that recoveries by banks on bad debts deducted in prior years do not constitute income where the amount of the recovery is less than that portion of the debt deduction which did not effect a reduction in tax liability for the prior year.

To this point the revenue act itself, the rulings of the Treasury Department thereon, and the General Counsel's memoranda are all in accord; and consistently set forth the sound rule with respect to recoveries on bad debts.

Thereafter, on July 8, 1940, the same J. P. Wenchel, as General Counsel of the Bureau of Internal Revenue (who wrote the sound G. C. M. 20851 above) issued G. C. M. 22163. In substance, this ruling modifies G. C. M. 18525 and revokes G. C. M. 20851. It holds that recoveries upon debts charged off in prior years are taxable, regardless of whether or not the taxpayer received any tax benefit.

This ruling is utterly unsound and unfair. The only excuses the counsel gives for his reversal are:

(*a*) That the Bureau itself and previous Government counsels simply did not understand the intent of the act, and,

(*b*) That all operations must be confined to a single calendar year.

Both grounds are untenable. There is no member of the committee who does not know that financial transactions with respect to debts can rarely be confined to a current year. It is a reasonable deduction that this was a pressure ruling to avoid the allowance of legitimate claims then pending, and to secure additional revenue.

All of the rulings above mentioned will be found in full in an appendix to this brief.

The purpose of this brief is to secure an amendment which will have the effect of correctly stating the law, and continuing the unbroken, consistent, fair, sound, and legal construction of the act itself to July 8, 1940, when the erroneous General Counsel's Memorandum 22163 was issued.

It is no answer that the courts will eventually correct the injustice. This committee can in 15 minutes and with two sentences correct the injustice. Awaiting court construction means that the taxpayer starts with an unfair decision against him by the Bureau. He must employ counsel and pay court costs. He must wait years for final determination. In the meantime, he is bitter and resentful toward his Government that makes such wasted effort necessary; and he suffers from a deep sense of frustration.

Every member of this committee has deep and vivid recollections of the financial tragedies of 1932–36. As bank counsel, I lived those days and have no wish to ever live them again. The banks of the country, as semipublic institutions, suffered an anguish that no other class of citizens knew. They were not concerned primarily about possible closing of their banks, nor with the loss of their particular positions; but they were seared to their souls with the thought of the possible losses to hundreds of thousands of little depositors who had trusted them to keep their money safely, and give it back to them.

During those dark days securities which had been accepted in full faith became worthless. The bank examiners required that they be written off the books of the bank. The losses were so staggering that these charge-offs resulted in absolutely no benefit to the bank. In a few years some of these "dead ducks" began to revive, and eventually very substantial recoveries were had.

Until July 8, 1940, the banks were fairly treated by the Bureau of Internal Revenue. The Bureau recognized the commonplace, common-sense fact that a loan is always a capital transaction. The loan, the charge-off, the recovery are all one capital transaction.

The sixteenth amendment to the Constitution authorizes the Congress to tax income; it does not authorize any tax whatever on capital. All of the words of any general counsel can never change capital to income, or income to capi-

tal. The matter is so simple that I hesitate even to argue it. There is no distinction whatever between a loan that has become bad, charged off, and later recovered, and an every-day current loan made by a customer, with his bank. In both cases they are capital transactions. There is no distinction between a loan made in 1 year and repaid in that year and a loan made in 1 year and repaid in a succeeding year. The matter can be reduced to an absurdity by saying that if G. C. M. 22163 be the law, then every time you borrow $10,000 from your bank in 1940 but fail to pay it back until 1941 the whole loan is income, and is taxable as such.

The history of one particular bank makes clear by inference that the General Counsel's reversal in 22163 was a pressure opinion. The particular bank in 1932–33 made large charge-offs at the direction of the examiner. In 1936 recoveries were had and the bank paid an income tax thereon of approximately $50,000. When in June 1937 the Department itself had issued T. D. 4633 and G. C. M. 18525 had been promulgated, a claim for refund was made. This claim was allowed and on May 2, 1940, a certificate of overassessment was issued and delivered to the bank, directing that the Bureau refund said sum to the bank. It takes from 60 to 90 days for these orders to go through the Department and be honored. During that interval G. C. M. 22163 was issued, and thereafter payment was refused.

Please bear in mind that the same counsel who wrote that opinion is the one who said, less than a year before in G. C. M. 20854:

"Until a taxpayer has had the income tax equivalent of a full return of the capital represented by his debt, there is no valid ground for treating as income any amount received in recovery of the debt."

I doubt if the committee has any idea of the number of banks who are being hurt by this unfair ruling. There are banks in practically every State. The officers of these banks do not resent additional taxes where, for governmental purposes, such additions are needed and are reasonable; but they do bitterly resent the unfairness of the Bureau of Internal Revenue in leading them on to a reasonable and legal course of conduct and then turning about and slamming the door in their faces. Every Senator on this committee is familiar with this psychology. There is no resentment deeper than the resentment of a citizen who chafes under an unfair act of the Government which, after all, is his government. It is a kind of resentment that becomes more bitter and bitter and ends in a lack of respect for the Government that can take his taxes promptly when due; but is unwilling to carry out its contract made with him in good faith at the time his loss was taken.

G. C. M. 18525, and the previous rulings, are conducive to good banking; G. C. M. 22163 is detrimental to good banking. If a bank has a loan of $100,000 to the Smith-Jones Co. and if it develops that the company is getting into trouble, sound banking would require that the bank anticipate any possible loss and charge off a reasonable amount of that debt. However, if the bank operates under the threat that any charge-off it makes will be subjected to a full tax as income when it be received, it is not going to take any such step.

This request has nothing to do with more taxes or less taxes, or rates, or schedules, but is simply a plea to redress an injustice.

Respectfully submitted with the request that the committee do amend the act as requested.

EDWARD S. BOYLES.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

T. D. 4633

To Collectors of Internal Revenue and Others Concerned:

The last paragraph of article 23 (k)–1 of Regulations 86 and the last paragraph of article 101 of Regulations 77 are amended to read:

"Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year."

This document is issued under the authority prescribed by section 62 of the Revenue Act of 1934 and section 62 of the Revenue Act of 1932.

GUY T. HELVERING, *Commissioner.*

Approved April 3, 1936.

WAYNE C. TAYLOR,
Acting Secretary of the Treasury.

[¶6392] *Bad debts: Charged off by banks.—Application of T. D. 4633, XV–1 CB 118, re deductions for debts ascertained to be worthless in whole or in part and ordered charged off by bank examiners.*

G. C. M. 18525

REVENUE ACTS OF 1932, 1934, AND 1936

Application of Treasury Decision 4633 (C. B. XV–1, 118 (1936)), amending article 191 of Regulations 77 and article 23 (k)–1 of Regulations 86, and the last paragraph of article 23 (k)–1 of Regulation 94, relating to bad debts in the case of banks or other corporations subject to supervision of Federal or State authorities.

An opinion is requested with respect to the application of Treasury Decision 4633 (C. B. XV–1, 118 (1936)), amending the last paragraph of article 191, Regulations 77, applicable to the Revenue Act of 1932, and the last paragraph of article 23 (k)–1, Regulations 86, applicable to the Revenue Act of 1934, to read as follows:

"Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year."

The same provision is incorporated in article 23 (k)–1, Regulations 94, relating to the Revenue Act of 1936. The pertinent statutory provisions are section 23 (j) of the Revenue Act of 1932, section 23 (k) of the Revenue Act of 1934, and section 23 (k) of the Revenue Act of 1936, which provide for the allowance of—

"* * * *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

It is to be noted that the language of the statute relating to *partially* worthless debts does not *require* the taxpayer to claim such partial worthlessness as a deduction in any particular year. It is simply provided that the Commissioner *may* allow as a deduction such partial worthlessness in an amount not in excess of the part *charged off within the taxable year.* Treasury Decision 4633 must, of course, be applied in the light of such controlling statutory provision. Moreover, that decision must be construed in connection with the general regulations governing bad debts. (Article 191 *et seq.* of Regulations 77 and article 23 (k)–1 *et seq.* of Regulations 86 and 94.)

Treasury Decision 4633 and related regulations under the Revenue Acts of 1932, 1934, and 1936 establish the following principles applicable in bank cases for the years governed by those Acts:

(*a*) The order of the bank examiner relating to the charge-off in whole or in part of a debt owed to the bank is material only as *establishing conclusively* either total or partial worthlessness of such debt.

(*b*) Where *total worthlessness* of a debt has been so ascertained in any taxable year and the debt charged off the books of the bank in the same year, deduction on account of such ascertainment and charge-off is allowable only for the taxable year in which such ascertainment and charge-off are made. In other words, deduction for total worthlessness so ascertained may be taken only in the taxable

year in which occur both ascertainment of total worthlessness and the necessary charge-off.

(*c*) Where *partial worthlessness* of a debt has been so ascertained, such partial worthlessness may be allowed as a deduction in the year of such ascertainment, provided such partial worthlessness is charged off during such year.

(*d*) Where *partial worthlessness* of a debt has been so ascertained but no charge-off made in the year of such ascertainment, no deduction is allowable in the income tax return of the bank for the year of such ascertainment.

(*e*) Where *partial worthlessness* of a debt has been so ascertained in a certain amount in one taxable year *but no charge-off made or deduction allowed therefor in that taxable year*, and during a subsequent taxable year the amount of such partial worthlessness is ascertained in accordance with Treasury Decision 4633 in a greater amount than the amount of such partial worthlessness ascertained during the preceding taxable year, such partial worthlessness may be allowed by the Commissioner in such subsequent taxable year in the greater amount *ascertained and charged off in such later taxable year*.

(*f*) Where such *partial worthlessness* has been so ascertained in a particular taxable year but not charged off or allowed as a deduction for income tax purposes for that year, and *total worthlessness* is ascertained in accordance with Treasury Decision 4633 in a later taxable year and the necessary charge-off of such total worthlessness is made in the later taxable year, deduction for such total worthlessness is allowable for that year.

(*g*) If a debt has been so ascertained to be worthless either in whole or in part in any particular taxable year but has not been allowed as a deduction for income tax purposes in whole or in part as the case may be, amounts subsequently collected on account of such debt are not required to be included in gross income for the taxable year of such receipt (article 191, Regulations 77; article 23 (k)–1, Regulations 86 and 94).

(*h*) If a debt has been so ascertained to be partially worthless in a particular taxable year but such partial worthlessness has not been allowed as a deduction for income tax purposes in such taxable year, and the debt is subsequently sold, no adjustment of the basis of the debt should be made in determining gain or loss from such sale. This rule is equally applicable to cases where there has been ascertainment of partial worthlessness but no charge-off thereof, and to cases where there have been both ascertainment of partial worthlessness and a charge-off, provided no amount has been allowed as a deduction for income tax purposes in either situation.

(*i*) If a debt was so ascertained to be *totally worthless* in 1932 or subsequent years, which are governed by Treasury Decision 4633 or article 23 (k)–1, Regulations 94, but no amount has been allowed as a deduction for income tax purposes for the year of such ascertainment, and subsequently the debt is sold, the bank may not deduct any loss based upon the difference between the original basis of such debt and the sale price. It is the opinion of this office that to allow a loss based upon sale under such circumstances in a year subsequent to the year of ascertainment of total worthlessness would permit by indirection the evasion of the statutory provisions requiring deductions based upon claims of total worthlessness of a debt to be taken only in the year of ascertainment of such total worthlessness and charge-off. This rule is equally applicable to cases where the statute of limitations on refunds for the year of ascertainment of worthlessness has run and to cases where such statutory period has not expired. If, however, in any such case the debt is subsequently sold for an amount in excess of the original basis of such debt, it is held that the bank is not taxable on an amount greater than the excess of the proceeds of the sale over such original basis. A tax based upon the entire proceeds of the sale in such case would be of doubtful validity inasmuch as it would be based in substantial part upon an item which is not in reality gain or income. (See *Goodrich* v. *Edwards*, 255 U. S., 527; *Koshland* v. *Helvering*, 298 U. S., 441.)

(*j*) Where, in cases governed by the Revenue Acts of 1932 and 1934, a bad debt deduction based upon alleged total worthlessness was disallowed to a bank prior to the promulgation of Treasury Decision 4633 under circumstances which would have entitled the bank to such a deduction under the provisions of Treasury Decision 4633, and the statute has now barred a refund for the earlier taxable period, it is the opinion of this office that upon subsequent sale of such debt by the bank no adjustment should be made in the original basis of the debt for the purpose of determining gain or loss from the sale.

It is believed that some of the difficulty in bank cases has arisen from failure to recognize that Treasury Decision 4633 can only operate as a construction or application of a controlling statute, and that it must be read in the light of the

statutory provisions which it seeks to interpret in the application of the statute to these specific cases (bank cases). It cannot, of course, be taken as setting out substantive rules of law contrary to the plain provisions of the statute. Read in this light, Treasury Decision 4633 can only be taken as setting up a practical rule for *ascertainment* of total or partial worthlessness of debts in bank cases, and not as undertaking to give any effect to such ascertainment which will contravene provisions of the statute or related regulations.

The deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" (as used in (*f*), (*g*), (*h*), and (*i*) above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deduction for bad debts. [Signed by Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue.]

[¶ *6162*] *Bad debt recoveries by banks: Treatment where charge-off is (1) on direction of bank examiner; (2) on taxpayer bank's own initiative; (3) by other taxpayers.—In the treatment of recoveries on bad debts where the deduction was not used to reduce taxable income in the year of ascertainment and charge-off, the rule is the same whether the debts were charged off at the specific direction of the bank examiner or by the bank on its own initiative. The rule also applies to taxpayers other than banks. It is immaterial in what year the bad debt deduction was taken (that is whether before 1931, or thereafter) but due regard must be given to the net loss provisions of the 1932 Act and prior Acts to ascertain whether taxpayer received the benefit of the bad debt deduction through a net loss carry-over.*

Bad debt recoveries by banks: Treatment where more than one debt charged off in same taxable year.—The Bureau reconsiders its ruling in I. T. 3172, 1938-1 CB 150, and holds that if in any year two or more bad debt deductions are taken and the aggregate is more than sufficient to offset taxable net income after applying all other allowable deductions, the bad debt deductions are trained as a unit and later recoveries will be treated as nontaxable until total collections on any and all such debts equal that portion of the total deduction for the particular year which did not operate to offset taxable income for such year. Excess amounts recovered will be income in the year recovery is made.

See Art. 23(k)–2 at 391 CCH ¶ 207.0502 and 207.654.

G. C. M. 20854, 1939–9–9731 (p. 2).

G. C. M. 20854

Recoveries of debts previously deducted for Federal income tax purposes do not constitute taxable income unless the deduction of the debts in prior years resulted in a reduction of tax liability.

S. R. 2940 (C. B. IV–1, 129 (1925)) modified. Recommended that I. T. 3172 (C. B. 1938–1, 150) be modified.

Advice is requested whether the ruling in *G. C. M. 18525* (C. B. 1937–1, 80), to the effect that recoveries of debts previously charged off at the direction of Federal or State supervisory officers by banks and other corporations under Federal or State supervision do not constitute taxable income unless the prior charge-off accomplished a reduction in tax liability, is equally applicable to recoveries of debts otherwise ascertained to be worthless and charged off by banks and corporations under Federal and State supervision and to recoveries of debts previously charged off by other taxpayers generally.

The inquiry is directed particularly to the following paragraphs of *G. C. M. 18525, supra:*

(*a*) The order of the bank examiner relating to the charge-off in whole or in part of a debt owed to the bank is material only as *establishing conclusively* either total or partial worthlessness of such debt.

* * * * * * *

"(*g*) If a debt has been so ascertained to be worthless either in whole or in part in any particular taxable year but has not been allowed as a deduction for income tax purposes in whole or in part as the case may be, amounts subsequently collected on account of such debt are not required to be included in gross income for the taxable year of such receipt (article 191, Regulations 77; article 23(k)–1, Regulations 86 and 94).

* * * * * * *

"The deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" (as used in * * * (*g*) * * * above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deduction for bad debts."

The issue presented requires a general discussion of the proper treatment, for Federal income tax purposes, of recoveries of debts charged off and claimed as deductions in prior years and involves an interpretation of the following provisions of Regulations 94:

"Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. (Article 23 (k)–1.)

"Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (See article 23 (k)–1.) (Article 42–1.)"

It is well settled that in the ordinary case amounts received in repayment of loans do not constitute income but are reimbursements of capital. (*Charles M. Howell, Admr.*, 21 B. T. A., 757 [CCH Dec. 6559], petition to review dismissed on motion of the Commissioner, *Burnet* v. *Howell, Admr.*, 59 Fed. (2d), 1053.) This is also true with respect to amounts received in payment of debts arising from unpaid wages, salaries, rents, and similar items of taxable income which have been included in gross income. Unless a taxpayer has already recovered his capital for income tax purposes, recoveries with respect to a debt, in the opinion of this office, can not be considered as income.

In any case in which a bad debt has been allowed as a deduction and has had the effect of offsetting taxable income (meaning, for present purposes, income which would be the basis for the computation of a tax liability), the taxpayer has, to that extent, in effect had the benefit of a recovery of capital for income tax purposes. In determining the extent, if any, to which a taxpayer has thus benefited, the credits against net income provided in the Revenue Acts must be taken into account. To the extent that a deduction does not result in such a benefit to the taxpayer, the deduction can not be said to have accomplished a return of capital. Until a taxpayer has had the income tax equivalent of a full return of the capital represented by his debt, there is no valid ground for treating as income any amount received in recovery of the debt. Accordingly, the above-quoted provisions of the regulations are not to be interpreted as requiring the inclusion in income of amounts received in recovery of a debt until the taxpayer has finally recovered the capital represented by the debt either by the means referred to above or partly by such means and partly by repayment by the debtor.

G. C. M. 18525, supra, involved only bad debt deductions by banks or other corporations subject to supervision of Federal or State authorities as a result of the conclusive presumption of partial or total worthlessness established by orders of Federal or State supervisory officers. (*I. T. 3172*, C. B. 1938–1, 150.) However, the principle stated therein, that recoveries of debts previously deducted do not constitute taxable income unless the deduction of the debts in prior years resulted in a reduction of tax liability, is equally applicable in cases of recoveries of debts voluntarily deducted by banks or other corporations subject to Federal or State supervision and to recoveries of debts deducted by other taxpayers.

In any case where the total of the allowable deductions, including bad debt deductions, taken by a taxpayer in his return exceeds the gross income less the credits against net income, the question will arise as to the extent to which the deduction of the bad debt results in a benefit. In such case it will be assumed that all deductions other than bad debt deductions first apply in reduction of the taxable income. For example, if in his return for 1933 a taxpayer showed gross income (less the credits against net income) of $6,000 and claimed a bad debt deduction of $10,000, and other deductions aggregating $2,000, it would be considered that only $4,000 of the deduction for the bad debt operated to offset taxable income. There would thus remain $6,000 of the debt as to which the taxpayer did not have a return of capital.

If, in any one year, two or more bad debt deductions are taken and the aggregate amount deducted on account thereof is more than sufficient to offset the

taxable net income remaining after applying the other allowable deductions, the bad debt deductions will be treated as a unit (as if they constitute a single bad debt deduction); and if amounts are subsequently recovered on any of such debts, they will be treated as returns of capital until the aggregate collected on any and all such debts equals that portion of the unit which did not operate to offset taxable income. After the capital has been thus recovered, any amounts received in recovery of any of the debts will be treated as gross income. *I. T. 3172, supra*, sets forth a different rule, and it is recommended that that ruling be modified to accord with the foregoing conclusion.

What has been said herein with respect to the extent to which bad debt deductions operate to offset taxable income applies to debts deducted both before and after the effective date of the Revenue Act of 1934. However, as to debts deducted before the effective date of the Revenue Act of 1934, another factor must be taken into consideration. Under the prior Revenue Acts, a net loss sustained by a taxpayer in one taxable year is allowable as a deduction in computing net income of other taxable years in the manner and to the extent provided in the various Revenue Acts. See section 117 of the Revenue Acts of 1932 and 1928; section 206 of the Revenue Acts of 1926 and 1924; and section 204 of the Revenue Acts of 1921 and 1918. In determining whether deduction of a bad debt in any year prior to the effective date of the Revenue Act of 1934 resulted in offsetting taxable income (or, in other words, resulted in a return of capital), it must be determined whether such a result was accomplished by means of the application of a net loss.

In view of the fact that it will be impracticable for the Bureau to undertake the great amount of research necessary to determine whether any particular debt which has been previously deducted had the effect of offsetting taxable income, every taxpayer who receives any amount in complete or partial recovery of a debt previously deducted and who claims that such amount constitutes in whole or in part capital rather than income will be required to submit with his return a statement including complete details with respect to the prior deduction and other facts necessary for the Bureau to determine the extent, if any, to which the deduction served to offset taxable income. In the event that the taxpayer does not reasonably substantiate his claim that the amount received in recovery, or a portion thereof, constitutes a return of capital, the full amount received in recovery will be included in gross income for the year in which received.

S. R. 2940 (C. B. IV–1, 129 (1925)), in so far as it holds that amount which might be received in recovery of debts under the circumstances there presented would constitute taxable income, is hereby modified. [Signed by J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.]

[¶6165] *Banks: Recovery of bad debt after deduction.—Amount recovered by bank on bad debt deducted in a prior year pursuant to charge-off at the specific direction of bank examiner does not constitute income where the amount of the recovery is less than that portion of the debt deduction which did not effect a reduction in tax liability for the prior year.*

See Art. 23(k)–1 at 381 CCH ¶207.0705.

I. T. 3172, 1938–11–9236 (p. 2.)

I. T. 3172

Taxability of amounts recovered on debts deducted by a bank in a prior year pursuant to charge-offs at the specific direction of Federal or State bank examiners.

Advice is required relative to paragraph (*g*) of *G. C. M. 18525* (C. B. 1937–1, 80), relating to deductions for bad debts in the case of banks or other corporations subject to Federal or State supervision.

Article 23 (k)–1 of Regulations 94, relating to the Revenue Act of 1936, provides in part as follows:

"Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed

as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year."

Paragraph (*g*) of *G. C. M. 18525, supra*, reads as follows:

"(*g*) If a debt has been so ascertained to be worthless either in whole or in part in any particular taxable year but has not been allowed as a deduction for income tax purposes in whole or in part as the case may be, amounts subsequently collected on account of such debt are not required to be included in gross income for the taxable year of such receipt (article 191, Regulations 77; article 23 (k)–1, Regulations 86 and 84)."

In the last paragraph of *G. C. M. 18525* it is stated:

"The deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" (as used in * * * (*g*) * * *, above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deduction for bad debts."

The question presented is what portion, if any, of recoveries in 1937 on the bad debts set forth in the following case, which were charged off in 1936 in accordance with orders of a bank examiner, should be reported as taxable income for 1937:

Net income for 1936 before deduction of bad debts		$10,000
Bad debt No. 1	$10,000	
Bad debt No. 2	10,000	
		20,000
Loss on 1936 return		10,000
Recovery in 1937 on bad debt No. 1		3,000
Recovery in 1937 on bad debt No. 2		1,000
Total		4,000

G. C. M. 18525, supra, relates only to bad debt deductions by banks or other corporations subject to supervision of Federal or State authorities as a result of the conclusive presumption of partial or total worthlessness established by orders of Federal or State supervisory officers. Accordingly, paragraph (*g*) of that memorandum relates only to recoveries on account of such debts and does not relate to recoveries of debts of banks or other corporations otherwise ascertained to be worthless and deducted in prior years.

As indicated in the last paragraph of *G. C. M. 18525*, deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" refer to deductions which accomplish a reduction in tax liability. In the instant case both charge-offs were made in 1936, and it must be assumed, for practical reasons, that the taxable net income was offset by the debt deductions in proportion to the amount deducted on account of each debt. Thus, in this case each debt, to the extent of $5,000, served to offset the taxable net income, and $5,000 of each debt resulted in no reduction of taxable net income. Since the amount recovered in 1937 on each debt was less than that portion of each debt deduction which did not effect a reduction in tax liability, it is held that no taxable income was derived from the recoveries in 1937.

G. C. M. 22163

[Bad debt recovery: Taxability.] An amount recovered upon a debt previously charged off and allowed as a deduction for Federal income tax purposes constitutes taxable income for the year of recovery regardless of whether the prior allowance of the deduction resulted in a tax benefit to the taxpayer. G. C. M. 18525 (C. B. 1937–1, 80) modified; G. C. M. 20854 (C. B. 1939–1 (Part 1), 102) revoked; and S. R. 2940 (C. B. IV–1, 129 (1925) 102) modified. Recommended that I. T. 3172 (C. B. 1938–1, 150) and I. T. 3256 (C. B. 1939–1 (Part 1), 172) be revoked; that I. T. 3278 (C. B. 1939–1 (Part 1), 76) be modified; and that the acquiescence in Central Loan & Investment Co. v. Commissioner (39 B. T. A. 981 [CCH Dec. 10,706], acquiescence, C. B. 1939 2,

6) and the acquiescence in The National Bank of Commerce of Seattle v. *Commissioner* (*40 B. T. A., 72* [*CCH Dec. 10,748*], *acquiescence, C. B. 1939–2, 26*) *be withdrawn.*

See Sec. 19.23 (k)–1 at 401 CCH ¶ 207.0705, 207.645, 207.654, 207.655.

Reconsideration has been given to *G. C. M. 18525* (C. B. 1937–1, 80) and *G. C. M. 20854* (C. B. 1939–1 (Part 1), 102), both relating to bad debts, with particular attention to the question of the proper treatment for Federal income tax purposes of recoveries of debts charged off and claimed as deductions in prior years.

The last paragraph of *G. C. M. 18525, supra*, reads as follows:

"The deductions for bad debts contemplated by the clause 'allowed as a deduction for income tax purposes' (as used in (*f*), (*g*), (*h*), and (*i*) above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deductions for bad debts."

G. C. M. 18525, supra, was published to illustrate the application of the provisions of article 191 of Regulations 77 and article 23 (k)–1 of Regulations 86, both as amended by *Treasury Decision 4633* (C. B. XV–1, 118 (1936)), and the provisions of the last paragraph of article 23 (k)–1 of Regulations 94, which reads as follows:

"Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year."

The last paragraph of *G. C. M. 18525, supra*, in effect provides that there shall be no adjustment of the basis of a debt as the result of the prior deduction of such debt in whole or in part unless such prior deduction accomplished a reduction in tax liability. The primary purpose of the incorporation of that paragraph in *G. C. M. 18525* was to set forth the rule that amounts recovered upon debts deducted in prior years do not constitute taxable income unless such deduction resulted in a reduction in tax liability. Thereafter, in *I. T. 3172* (C. B. 1938–1, 150) there was set forth the method for determining the extent of the benefit derived by the deduction of bad debts. That ruling was later modified by *I. T. 3256* (C. B. 1939–1 (Part 1), 172), in accordance with the recommendation contained in *G. C. M. 20854, supra*, which is discussed in the next paragraph of this memorandum.

G. C. M. 18525, supra, involved only bad debt deductions by banks or other corporations subject to supervision of Federal or State authorities as a result of the conclusive presumption of partial or total worthlessness established by orders of Federal or State supervisory officers. However, in *G. C. M. 20854, supra*, it was held that the principle stated in *G. C. M. 18525*, that recoveries of debts previously deducted do not constitute taxable income unless the deduction of the debts in prior years resulted in a reduction in tax liability, is equally applicable in cases of recoveries of debts voluntarily deducted by banks or other corporations subject to Federal or State supervision and to recoveries of debts deducted by other taxpayers. It was held that in any case in which a bad debt has been allowed as a deduction and has had the effect of offsetting taxable income, the taxpayer has, to that extent, in effect had the benefit of a recovery of capital for income tax purposes, but that amounts received in recovery of the debt should not be treated as taxable income until the taxpayer has fully recovered the capital represented by the debt either by such means or partly by such means and partly by repayment by the debtor.

In *I. T. 3278* (C. B. 1939–1 (Part 1), 76) the principle of *G. C. M. 20854, supra*, was extended to amounts of State taxes refunded or credited, and it was held that the amount refunded or credited should be treated as taxable income only if and to the extent that it is in excess of the portion of the prior deduction which did not have the effect of offsetting taxable income. That ruling (*I. T. 3278*) modified *Mimeograph 3958* (C. B. XI–2, 33 (1932)) and *Mimeograph 4564* (C. B. 1937–1, 93), relating to the taxable status of refunds of customs duties and taxes.

In *Central Loan & Investment Co. v. Commissioner* (39 B. T. A., 981 [CCH Dec. 10,706], acquiescence, C. B. 1939–2, 6), the Board of Tax Appeals applied the rule

stated in *I. T. 3278, supra*, in reference to taxes, citing in its opinion *G. C. M. 18525, supra*, and *G. C. M. 20854, supra*. In *The National Bank of Commerce of Seattle v. Commissioner* (40 B. T. A., 72 [CCH Dec. 10,748], acquiescence, C. B. 1939–2, 26, on recovery of bad debt issue), the Board applied the said rule to bad debts, again citing the above-mentioned *General Counsel's memoranda*. In neither of these Board of Tax Appeals decisions did the Board refer to its prior decisions in *Lake View Trust & Savings Bank v. Commissioner* (27 B. T. A., 290) [CCH Dec. 7854], in which it was held that amounts received in recovery of debts allowed as deductions in prior years constitute taxable income irrespective of whether such prior deductions had the effect of reducing the taxpayer's taxable income.

Section 19.42–1 of Regulations 103, relating to the Internal Revenue Code, provides in part as follows:

"* * * Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. * * *"

This regulation has been in effect in all of the income tax regulations of the Treasury Department to the present time.

Section 19.23(k)–1 of Regulations 103 provides in part as follows:

"* * * Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. * * *"

This regulation has been in effect in all of the income tax regulations of the Treasury Department from article 151 of Regulations 62 to the present time.

Prior to the issuance of *G. C. M. 18525, supra*, the Bureau had consistently held that any amount subsequently recovered on account of a debt previously charged off and allowed as a deduction for income tax purposes must be included in gross income for the taxable year in which received, regardless of whether the prior allowance of the deduction resulted in a benefit to the taxpayer. As pointed out heretofore, in the case of *Lake View Trust & Savings Bank, supra*, decided prior to *G. C. M. 18525*, the Board of Tax Appeals sustained the Bureau practice.

Upon reconsideration, it is now the opinion of this office that the rule sustained in the case of *Lake View Trust & Savings Bank, supra*, is the correct rule to be followed. This conclusion is in accord with the decision of the Supreme Court of the United States in *Burnet v. Sanford & Brooks Co.* (282 U. S., 359, *C. D.* 277, C. B. X–1, 363 (1931) [2 USTC ¶ 636]). The taxpayer in *Burnet v. Sanford & Brooks Co.* had entered into a dredging contract with the United States and, after having performed for three years at a large loss, abandoned operations and sued the Government for breach of warranty as to the character of the material to be dredged. Judgment was recovered for $192,577.59, of which $176,271.88 was the amount by which its expenses of operation under the contract exceeded receipts from it, and the balance, $16,305.71, represented accrued interest. During the years of operation the taxpayer had returned as gross income the receipts under the contract and had deducted its expenses paid in performing the contract. For all but one of such years the returns showed net losses. The taxpayer failed to return the amount of the judgment as income in the year of receipt, and the Commissioner, therefore, assessed a deficiency. In upholding the action of the Commissioner, the Supreme Court said in part:

"All the Revenue Acts which have been enacted since the adoption of the sixteenth amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. * * *

"That the recovery made by respondent in 1920 was gross income for that year within the meaning of these sections can not, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equaled, and in a loose sense was a return of expenditures made in performing the contract, *still*, as the Board of Tax Appeals found, *the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments*, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. * * *" [Italics supplied.]

Under the principle of the Supreme Court's decision in the *Sanford & Brooks Co. case, supra*, items of expense incurred in carrying on a trade or business do not represent capital investment, the cost of which, if converted, must first be restored before there is a capital gain taxable as income. Bad debts charged off in any business are deductible under a specific provision of the Revenue Acts rather than as ordinary and necessary business expenses. They are, nevertheless, under well-established accounting practices, recognized as operating expenses of the business deductible as such in arriving at the net operating gain or loss for the periods involved. See Finney, Principles of Accounting, 1934 Edition, Volume I, page 37, and Kester, Principles of Accounting, Fourth Edition, pages 46, 116, and 554. Consequently, the amount represented by debts which become worthless and are charged off in the carrying on of a trade or business is not to be considered as an investment of capital which must first be returned in full before taxable income is derived. Under this principle, amounts recovered in any taxable year upon debts previously charged off and allowed as a deduction should be treated as taxable income regardless of whether the prior allowance of the deduction resulted in a tax benefit to the taxpayer.

It is the opinion of this office, furthermore, that in the case of a bad debt owing to a taxpayer which has not arisen in connection with the carrying on of a trade or business, the recovery of such a debt where it has been charged off and deducted in a prior year constitute taxable income irrespective of whether the prior allowance of the deduction resulted in a tax benefit. In *United States* v. *Ludey* (274 U. S., 295, *T. D. 3076*, C. B. VI-2, 157 (1927) [1 USTC ¶ 234]) it was held that in ascertaining the basis for computing gain or loss in the case of the sale of depreciable or depletable assets, the original basis thereof must be reduced by the amount of depreciation and depletion allowable as deductions in the years during which the property was held regardless of whether deductions had been claimed. It is to be observed that the Revenue Act involved in that case did not contain a specific provision requiring such a reduction of basis. It is believed that this case stands for the proposition that, under the broad purposes of the Revenue Acts, a taxpayer is to be charged with having recovered his capital to the extent that the statute permits deductions from gross income on account thereof, regardless of whether the taxpayer took advantage of the deduction privilege provided in the Revenue Acts. See also *Hardwick Realty Co., Inc.*, v. *Commissioner* (29 F. (2d), 498 [1929 CCH ¶ 9026], certiorari dismissed on motion, 279 U. S., 876), in which it was held that depreciation must be deducted in ascertaining the adjusted basis of depreciable property even though deductions for depreciation in the years sustained conferred no tax benefit.

The case of *United States* v. *Ludey, supra*, would seem to indicate that amounts recovered upon a debt, whether or not incurred in business, constitute taxable income if in any prior year such debt constituted an allowable deduction under the applicable Revenue Act, even though such deduction was not claimed and allowed. See *S. R. 2950* (C. B. IV-1, 129 (1925)), modified in *G. C. M. 2085*, *supra*, in which it was held that under article 52 of Regulations 45, article 51 of Regulations 62, and article 50 of Regulations 65, the amount of a debt written off and *allowable* as a deduction should be treated as income for the year in which actually recovered. However, in view of the fact that all of the regulations beginning with article 151 of Regulations 62, promulgated under the Revenue Act of 1921, have contained the provision that any amount subsequently received on account of a bad debt or on account of a part of such debt "previously charged off, *and allowed as a deduction for income tax purposes*" [italics supplied] must be included in gross income for the taxable year in which received, taxpayers will not be required to return as income any amounts received in recovery of debts except to the extent that such debts have been previously claimed and allowed as deductions. As indicated above, however, if a debt was allowed as a deduction in whole or in part in a prior year, amounts recovered upon such debt constitute taxable income in the year of the recovery to the extent previously allowed as a deduction, *irrespective of whether the allowance of the deduction resulted in a tax benefit to the taxpayer*.

The foregoing is consistent with the manner in which the Bureau computes the gain or deductible expense to a corporation upon the retirement of its bonds. Section 1922(a)-18 of Regulations 103 provides that if bonds are issued by a corporation at a discount, the net amount of such discount is deductible

and should be prorated or amortized over the life of the bonds. It further provides that if the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted is a deductible expense for the taxable year. It is provided, however, that if the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted, over the purchase price is gain or income for the taxable year. In computing the income or deductible expense under the regulations, the Bureau has adopted the view that it is immaterial whether the deductions on account of bond discount resulted in a tax benefit to the taxpayer.

In view of the foregoing, *G. C. M. 18525, supra*, is modified by eliminating the last paragraph thereof; *G. C. M. 20854, supra*, is revoked; and *S. R. 2940, supra*, is modified to accord with the views expressed herein. It is recommended that *I. T. 3172, supra*, and *I. T. 3256, supra*, be revoked; that *I. T. 3278, supra*, be modified; and that the acquiescence in *Central Loan & Investment Co. v. Commissioner, supra*, and the acquiescence in *The National Bank of Commerce of Seattle v. Commissioner, supra*, be withdrawn. [Signed by J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.]

Mr. BOYLES. Senator George, before I leave, I want to present Mr. Mylander.

The CHAIRMAN. Mr. Mylander, will you come over, please?

Mr. BOYLES. It will not take but a moment of time. Gentlemen of the committee, I would like to present Mr. Charles Mylander, who is chairman of the taxation committee of the American Bankers Association.

The CHAIRMAN. Yes, sir.

STATEMENT OF CHARLES MYLANDER, COLUMBUS, OHIO, CHAIRMAN, TAXATION COMMITTEE, AMERICAN BANKERS ASSOCIATION

The CHAIRMAN. Did you wish to add your endorsement to what Mr. Boyles has said?

Mr. MYLANDER. I simply want to say, Senator, that we heartily endorse everything that Mr. Boyles has said. The condition of which he speaks has been a very fine explanation of it.

The CHAIRMAN. It is a matter that I presume has been discussed by the bankers?

Mr. MYLANDER. We have discussed it with the Treasury at great length, starting way back in 1933 and 1934 and on down through the present time.

The CHAIRMAN. You have been unable to get what you conceive to be the correction of the erroneous ruling? The Treasury still adheres to that?

Mr. MYLANDER. No; because the ruling just came out in 1940, G. C. M. 22163.

The CHAIRMAN. There has been no modification of it?

Mr. MYLANDER. A slight modification to take care of things which banks had done while G. C. M. 18525 was in force.

The CHAIRMAN. I see.

Mr. MYLANDER. There was about a 2-year period in there.

The CHAIRMAN. I see. Anything else?

Mr. MYLANDER. That is all. Thank you.

The CHAIRMAN. Mr. Iglauer?

STATEMENT OF JAY IGLAUER, CLEVELAND, OHIO, CHAIRMAN, TAXATION COMMITTEE, NATIONAL RETAIL DRY GOODS ASSOCIATION

The CHAIRMAN. Mr. Iglauer, will you give to the reporter there your full name, for whom you are appearing, and so forth?

Mr. IGLAUER. Mr. Chairman and members of the Senate Finance Committee, I was very much interested in the statement made by Mr. Satterlee a few minutes ago in which he discussed a general sales tax, or a general excise tax. It was not quite clear which he meant, but you know, in our brief before the House Ways and Means Committee, we recommended a general excise tax on a large list of commodities, on the whole list except food and medicines, and if there are any members here who are interested in that question later, I will be glad to answer questions.

The CHAIRMAN. I see you have a brief.

Mr. IGLAUER. Yes.

The CHAIRMAN. Would you like to put that in the record and speak extemporaneously here?

Mr. IGLAUER. No; I would rather follow the brief, if you do not object. I shall be very glad to, however, answer any questions, I shall be willing to be interrupted at any point in the presentation.

The National Retail Dry Goods Association, for which I appear, as chairman of its taxation committee, is more than 30 years old and has in its direct membership approximately 5,900 retail dry goods and department stores located in every State in the Union.

These are days fraught with vexing problems and momentous decisions. The answers you must give to the fateful questions of the hour may well be the deciding factors in the preservation of the American way of life. At the hearings of your committee in the past we have been impressed with your earnest concentration and conscientious approach to the difficult task of raising unprecedented amounts of revenue. In our discussion of the tax bill before you we shall try to measure up to the standard set by you.

The President, the Treasury, and the Congress have declared the principle that these new taxes should be predicated upon ability to pay and upon equity to those with lower incomes. With this we are in agreement.

The Treasury has indicated it believes with the economists that in the interest of adequate defense, it is necessary to put a curb upon further expansion in consumer purchasing power by the imposition of heavy taxes. For several years the administration has engaged in a number of activities designed to stimulate purchasing power and to reduce unemployment. To continue these activities, even on the present scale, would appear to be wholly inconsistent with our present fiscal policy and with the urgent demand for funds for defense.

While it may seem not germane to this discussion, we earnestly recommend that you, as individual members of the Senate, give consideration to the suggestion made by us in our brief to the Ways and Means Committee, and made by both parties in both Houses—that a permanent committee be created composed of three members each

of the Ways and Means Committee, of the House Appropriations Committee of the Senate Finance Committee and of the Senate Appropriations Committee. This committee would have the duty of making studies and recommendations for economies and for eliminations of those activities and attendant expenses which were designed to stimulate employment and purchasing power.

The National Retail Dry Goods Association feels that these recommendations for greater efficiency and economy in nondefense Government activities are in no way inconsistent with its previously expressed support of social security, of aid to the aged or the unemployable.

Individual income taxes.—Our committee has no comment to make with respect to this part of the proposed bill as passed by the House. We are opposed to any increase in rate.

Corporation taxes.—We fully appreciate the inherently complicated character of the entire tax structure. We urge you to consider—some time, some year—if not now—simplification of Federal corporate taxes and elimination of the guesswork that is involved in the declared value tax.

We have been doing that for some time, for some years. Without considering social security and other Federal taxes, a corporation pays under this bill a normal tax, surtax, an excess profits tax, a defense tax, a capital stock and declared value tax, and a penalty tax for those who use the invested capital basis, all out of the same income. To you further comment on this suggestion would be superfluous.

Excess-profits tax.—Our taxation committee and the membership of the National Retail Dry Goods Association commend the retention in the bill of the alternative methods of computing the excess-profits credit, because it meets more equitably the needs of corporations with widely varying capital structures and earnings.

Capital stock tax and declared value excess-profits tax.—The present law provides for a declaration of value every 3 years. It is wellnigh impossible to make an adequate estimate of the earnings of a corporation for a period of 3 years in advance at any time, but particularly so at the present time under existing economic conditions. For most companies it is a guessing contest between the corporation and the Government. We therefore urge you to consider inserting in the proposed bill before you a provision for an annual declaration of value.

Senator VANDENBERG. It makes three guessing contests instead of one.

Mr. IGLAUER. That is right, but you are much nearer the facts each time.

Estate and gift taxes.—Our taxation committee feels justified in making a suggestion under this section because of its application to retail establishments where often practically the entire fortune of the taxpayer is invested in a single enterprise, the dispersion of which might be disastrous to the business as well as to the revenues to the Government.

We recommend that you include in title IV—estate and gift taxes—a provision to amend section 812 of the Internal Revenue Code to

provide that insurance taken out by a taxpayer, payable irrevocably to the Treasurer of the United States, to the extent that such insurance is used for the payment of taxes levied by the United States by reason of the death of the insured, be exempt from inclusion in the assured's gross estate, for purposes of estate and inheritance taxes, now or hereafter levied. The excess, if any, of such insurance proceeds over the amount so used for the payment of such taxes shall be repaid without interest to the estate of the decedent, and shall be taxable thereunder as to such excess. This permits provision by a taxpayer to meet the estate and inheritance-tax liability and avoids the pyramiding of estate and inheritance taxes present under the existing law.

Senator DANAHER. Suppose that the individual is not insurable?

Mr. IGLAUER. Then you do not have any problem, because you do not have any insurance. This merely avoids the payment of a tax on insurance purchased just for that purpose.

Excise Taxes.—This is the important part of our presentation. The retailers' excise taxes on jewelry, furs, and toilet preparations provided for in part V, chapter 19, should be changed to excise taxes imposed at the point of manufacture.

The bill, for the most part, provides that excise taxes shall be imposed at the point of manufacture. There seems to be no adequate reason for singling out jewelry, furs, and toilet preparations to be treated differently, by imposing a retail sales tax.

They have very little to do with the defense situation.

Senator WALSH. Is the tax made upon the retailer because a good many of those commodities are imported?

Mr. IGLAUER. No. I think it is probably because of some statements made by the Treasury, concerning the difficulties of interpretation and definition, which will be increased one-hundred-fold or one-thousand-fold if they are made upon the retailer.

Senator WALSH. It is a fact that jewelry and furs that are expensive are imported?

Mr. IGLAUER. They were imported, and to a limited extent, are imported now, but I question whether there will be a large amount imported in the immediate future. No; I think it is wholly a domestic situation.

Uniformity and ease of collection dictate that the tax be imposed at the point of manufacture.

Prior revenue acts imposed taxes on such articles at the point of manufacture and not on the sale at retail. Furthermore, the recent Revenue Act of 1940 imposed a manufacturer's excise tax on toilet preparations. Precedent, therefore, would support a continuance of the established method of collecting excise taxes, and would avoid the creation of new administrative problems.

In our opinion, the proposed taxes on retail sales will be almost impossible of administration. Everyone knows of the sales counters at the entrances of office buildings, the numerous beauty parlors and barber shops, retail stores in homes, crossroad general stores, and the numberless novelty stands in parks and resorts and the so-called 5- and 10-cent stores; all of which sell toilet preparations and

jewelry. In addition, these items are sold in department stores, specialty stores, drug stores, and countless other outlets. According to the last census[1] there were 1,770,355 individual stores reporting to the Census of Business—approximately 1 retail store for every 74 men, women, and children in the United States. It would be a tremendous task to police all these places, collect the taxes, and make any kind of a thorough audit of the returns filed. The administrative job would be made infinitely easier if the tax were made an excise tax at the point of the manufacture.

SEC. 2400. *Tax on jewelry, etc.*—Section 2400 imposes a 10-percent tax on the retail sale of all articles commonly or commercially known as jewelry, whether real or imitation, and articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof; and so forth. Unless some exemptions are made on articles of small value, evasion will be widespread and the cost of collection will be disproportionate to the revenue derived therefrom.

Practically every roadside stand, drug store, and every other form of retail outlet sells some form of inexpensive novelty or souvenir or article that might be described as jewelry or as an article "made of or ornamented, mounted, or fitted with precious metals or imitations thereof."

Many women's pocketbooks have a clasp or button which would bring them within the definition. Men's suspenders with a clasp, men's belts with buckles, evening slippers with buckles, compacts, lipstick holders, umbrellas, and many articles of widespread sale would be subject to a tax of 10 percent on the full price, because of ornamentations of insignificant value. The problem of distinguishing taxable items would be all but impossible in most stores and the auditing and administrative problems of the Bureau of Internal Revenue would be well-nigh insurmountable.

For these reasons we urge that the jewelry tax be imposed at the point of manufacture.

If the tax on jewelry is to be a retail tax, we recommend that articles sold at prices of $3 or less be exempted. This could be done by inserting the words "at a price in excess of $3" after the word "retail" in line 6, page 76, of H. R. 5417.

The proposed law is worded almost identical to a similar section in the 1932 law which imposed a 10-percent tax on the sale of jewelry by manufacturers. Although it rested on the smaller revenue-producing base of manufacturers' prices, nevertheless it provided that the 10-percent tax did not apply to any article sold for less than $3 at wholesale, except parts for watches or clocks. In the 1934 law, section 609, this exemption was raised to $25.

A $3 exemption on the sales price, we believe, would lessen some of the troublesome administrative problems with a minimum loss of revenue. This is particularly true of the innumerable items coming under the definition "mounted, ornamented, or fitted with, precious

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[1] Data from Bureau of the Census:

Population, Apr. 1, 1940, census	131,669,275
Stores: Independents, chains, and others	1,770,355
Total employees in above stores	*4,600,217
Employees, including proprietors	*6,213,890

*Do not include unpaid family members.

metals or imitations thereof; etc.," which caused great difficulty in the Bureau and among retailers under the 1918 law.

Senator VANDENBERG. As between the two suggestions, you prefer to revert to the manufacturers' tax?

Mr. IGLAUER. By all means. We prefer a general manufacturers' tax against a specific tax which is discriminatory against the industries so taxed.

Senator JOHNSON. What would you do with the retail stock on hand?

Mr. IGLAUER. I would not do anything with it.

Senator JOHNSON. You just would not tax it?

Mr. IGLAUER. That is right. We would get rid of it as fast as we could.

Senator JOHNSON. It might take several years.

Mr. IGLAUER. It does not take long. As soon as they know there is a tax going to be put on certain merchandise, they start buying it up. We already feel the impact of people trying to buy a lot of merchandise before the tax goes on.

SEC. 2401. *Tax on furs.*—Section 2401 imposes a retail tax on furs which we believe should be imposed at the point of manufacture. It is copied literally from the 1918 law and regulations 47, article 31, which was the kind of tax we recommend, namely, a manufacturers' excise tax. The manufacturer has available to him all the information necessary to determine taxability.

In the case of articles only partly made of fur, such as a fur-trimmed coat, he knows from his records the value of each component part. The retailer has no such knowledge, and in order to compute the tax he must rely on hearsay or opinion, or must obtain the information from the manufacturer or wholesaler who is under no legal obligation to disclose such information. The field examiner of the Bureau will be in no better position to determine taxability from information obtainable through the retailer whose records he may be examining. He has to go back again to the manufacturer. The variety of articles made partly of fur is far greater today than it was 22 years ago. For example: Fur-trimmed coats, hats, gloves, slippers, scarves, rugs, throws, and even toy animals; the retailer cannot be expected to know the relative value of the fur in all these articles. He does not now have the information on large stocks of fur-trimmed garments and other articles. How will he get it?

Many manufacturers of fur also sell at retail; under the law it will be difficult to determine the extent of their taxable retail sales. Retail fur outlets are too numerous to police properly and the cost of audit and collection will be disproportionate to the yield. A manufacturers' tax is collected at the source and is therefore less difficult to collect and more easily susceptible of proof by the Bureau.

Senator VANDENBERG. It seems to me that your position is absolutely incontrovertible with the single exception that your floor-stock problem still remains, and I do not think your answer to Senator Johnson covered it. I think you have got to close the gap on floor stocks.

Mr. IGLAUER. You have had floor-stock taxes in the case of manufacturers' taxes for several years.

Senator VANDENBERG. There could not be a floor-stock tax to meet that situation?

Mr. IGLAUER. If you did not have the retail tax; yes. If you have a retail tax, you could not have a floor-stock tax.

The Congress has hitherto recognized these facts as evidenced by the act of 1918 and the act of 1932 which was later amended in 1934 and 1936; all of which were manufacturers' excise taxes.

Because the proposed section taxes articles of which fur is the component material of chief value, and because it is impracticable for the retailer to determine such value, the tax liability will be difficult of determination, and tax evasion and loss of revenue will result.

In fact, it is our well-considered belief that the retailer cannot comply with the present provisions of this section of the proposed bill.

Nevertheless, if the tax is to remain as a retail tax, the law must distinctly provide that it shall be the duty of the manufacturer or wholesaler to specify on all invoices to the retailer for merchandise in which fur is only one of the materials, the value of the fur content in relation to other component parts.

We are not interested in whether he gives you each fraction of fur value, but he must indicate when fur is the component material of chief value.

Senator DANAHER. A question.

Mr. IGLAUER. Certainly.

Senator DANAHER. Is this the real purpose; is it not actually to levy a tax merely to curtail an individual buying, that that form of tax incidence will have a greater tendency to reduce public buying?

Mr. IGLAUER. I do not think it would make any difference one way or the other. In fact, take the hosiery, for instance. You are probably familiar with that through reading about it in the newspapers. As soon as there was a scarcity apparent, the women flocked to the stores to get all the hosiery they could. I think what would disturb the economy the least is what we recommended to the House Ways and Means Committee, a general excise tax on a large list of commodities at a low rate, say, 3 percent, even 4 percent. I have made some figures, which I shall be glad to give you, based on the census. The Census of Manufactures for 1939 shows that the fair value of products was $56,828,000,000. Now, from that we have to take food and drugs, the two things that we said should not be taxed, and that would take off about $11,200,000,000 leaving $45,628,000,000. Then there is the intercompany transfers. That item has to be taken out because that represents items that would be double-taxed, unless there was a drawback arrangement such as was provided in the 1932 proposal for a manufacturers' tax.

We take out $12,319,000,000 for that and we are left with $33,309,000,000; at 3 percent that would give you practically a billion dollars. If you add the liquor taxes of $127,000,000, that gives you $1,127,000,000 as compared with $514,900,000, which is the estimate of the Treasury on the yield from the same taxes, specifically charged at 10 percent on a certain group of commodities.

Senator TAFT. What would be the practicability of omitting clothing also under a certain value? Is that a difficult thing to do? I suppose food and clothing are the necessities rather than food and drugs.

Mr. IGLAUER. To eliminate clothing under a certain price would, I think, assist the situation. It would eliminate some of the tax. I

cannot tell you how much it would eliminate. But this would more than make up, you see, in amount for what was lost in taking out the joint individual returns, which was, I think, $300,000,000.

Senator VANDENBERG. Now, the figures you have used eliminate all duplications in sales and all pyramiding?

Mr. IGLAUER. I have used the Census of Manufactures. I have gotten some figures which relate to the things on which there would be duplication. I cannot put this in the record as an official record because it was very informally done, but I have taken out the intercompany transfers which amount to about 27 percent of the total of $55,000,000,000, so I have taken out the full 27 percent giving you a net of $33,309,000,000. Now, you may say why is the total production at wholesale as much as the amount which is reported by the Census of Manufactures as retail trade, which is $33,000,000,000. It is because, included in the wholesale figures are the supplies to retailers and other service industries which would not be shown at retail, you see. That is what raises that amount at wholesale. It surprised me because it means a large amount of taxes have been lost sight of, I suppose because of the ratio between wholesale and retail.

Another advantage it has is that if in another year or two the situation financially should be worse because of the war and what not, an increase of 1 or 2 percent in the rate is much easier to accomplish than to make specific changes and have a troup of men coming here, each one telling you why the tax on his industry is bad. The task on the part of your Bureau of Internal Revenue and the task on the part of the individuals in the industry would be, I think, greatly simplified.

Senator VANDENBERG. Of course, that is completely sound, also. Establish a principle and fit it to your necessities.

Mr. IGLAUER. That is right.

Senator TAFT. Mr. Iglauer, would you tell us what you think as to the passing-on incidence of these excise taxes? To what extent the retailer is likely to pass them on or be able to pass them on to the consumer?

Mr. IGLAUER. There is no shifting of burden when the retailer says, "Make this a manufacturers' excise tax instead of a retail tax," because, if it is a manufacturers' excise tax, it appears on the invoice which he receives and he has to recover on the price that he pays enough to make his margin, as he usually does.

Senator TAFT. He is likely to pass on the manufacturers' excise tax by a readjustment of prices generally?

Mr. IGLAUER. Yes; in part, at least. So will he pass on the retailer's tax. The tax on the retailer in all these cases will be passed on to the consumer. The three taxes you have selected here, i. e., the House has selected, provision is now being made in a number of States, and it is my intention to make a suggestion along that line, that the tax shall be shown as a separate item on the bill, because that is the only way you can get a fair administration of the tax and a fair audit of the tax, which I shall deal with separately in my brief.

Senator JOHNSON. Senator Brown on this committee suggested that low-priced clothing, such as the $5 shoe, should not be taxed, whereas the $12 shoe should carry a tax. Following out the question asked by Senator Taft, Is it possible to have a manufacturers' tax that

would make a difference between low-cost clothing and high-cost clothing? Could you do that?

Mr. IGLAUER. Yes. As a matter of fact, in 1936 the fur tax was a manufacturers' tax, but it set the price at $75, below which there was no tax; and that very well disposed of the component material of chief value, because a fur-trimmed cloth coat that was in excess of $75 in value left no question but that the fur was the component material of chief value. So, applying that generally, if you wanted to make the burden less heavy, you should probably reduce it to something like $300,000,000 or $400,000,000 or $500,000,000 instead of the amount indicated here, nearly a billion dollars, by putting in certain minima in the manufacturers' excise tax which would exempt certain items of clothing.

Senator TAFT. Mr. Iglauer, I notice in dealing with jewelry, you said nothing anywhere about clocks and watches. Have you any remark to make about clocks and watches?

Mr. IGLAUER. No; I make no distinction. Clocks and watches are included in the jewelry tax now. I would see no reason for making any distinction, if the tax on jewelry is to be a separate tax.

SEC. 2402. *Tax on toilet preparations.*—Under the present law this tax is a manufacturers' tax. It is repealed by this proposed measure and made a retail tax by the use of the same language. As in the case of jewelry, a retail tax on toilet preparations will be difficult to administer because of the vast number of retail outlets. The proposed law attempts to reach beauty shops, barber shops, and many types of small stores that keep no records and have no facilities for doing so. Whatever may have been the difficulties encountered in collecting the present manufacturers' tax evasion and collection difficulties will be greatly multiplied if the tax on toilet preparations is made a retail tax.

I mention this because in the Treasury report, I think, there was some mention of the administrative difficulties. It would be increased one-hundred-fold.

The tax should remain a manufacturers' tax, with little disturbance to the existing tax structure and to the established precedents of administrative procedure.

There was no occasion for us to make any recommendations before the Ways and Means Committee because no indication was given that the existing manufacturers' excise tax was to be changed to a retailers' excise tax.

In the event that the taxes on jewelry, furs, and toilet preparations are retained as retailers' excise taxes, we recommend that it be made mandatory in the law that these taxes be shown as separate items on the bill, statement or other evidence of sale.

Your attention is directed to regulations 54, covering the Revenue Act of 1918 which states in part as follows:

* * * The tax is measured by the price for which the article is sold * * * The tax cannot be included in the selling price, but must be billed as a separate item.

We suggest that this or similar language be inserted in the proposed statute. Our reasons are as follows:

(*a*) All vendors would thus be required to administer the collection of the tax in a uniform manner, and no leeway would be given

the vendor to collect and pay the tax to suit his own selling and advertising policies.

(*b*) Protection to the consumer is implemented by preventing misrepresentation or manipulation by some vendors who might reduce the quality of an article to cover the cost of the taxes.

(*c*) Protection to the Government would be insured by requiring proper and adequate itemized records by which the maximum amount of tax could be collected and audited at minimum expense by the Bureau of Internal Revenue, and would assist the Bureau in preventing evasion of the tax.

(*d*) Present retail sales tax laws of many States provide for the listing of the tax as a separate item. The consumer would thus be in a position to check the amount of tax collected.

(*e*) The inclusion of a Federal tax in the sales price, if it is hidden, would result in the imposition of a State or local sales tax upon the Federal tax. Undoubtedly this will lead to confusion and litigation.

Let me illustrate that. If you sold an article for $100 the Federal tax made it $110 and the State tax would be on the $110 instead of the $100, so the amount of the State tax would be $3.30 instead of $3, because of the inclusion of the 10-percent tax.

Senator VANDENBERG. Would this prohibit a manufacturer from absorbing the manufacturers' tax?

Mr. IGLAUER. I am not talking of this as a manufacturers' tax. I am talking of this as if it is a retail tax.

Senator VANDENBERG. Yes.

Mr. IGLAUER. As far as the manufacturer is concerned, I can tell you in 99 percent of the cases, the retailer will have the tax shown on the bill that he gets from the manufacturer.

Senator TAFT. The retailer could absorb the tax by increasing the price of his goods, I suppose.

Mr. IGLAUER. The small dealer gets away with it by representing that he is taking care of the tax.

Senator BARKLEY. Where the manufacturer or a wholesaler sends a bill for consignment of goods with the price without the tax in one column, and with the tax in another column, so the retailer knows what the tax is that has already been paid?

Mr. IGLAUER. Yes. It very frequently comes in on a separate invoice.

Senator BARKLEY. When he sells to the public, the individual consumer, he does not separate it, he adds it all together and prices it in one item, and the tax is added in, is it not?

Mr. IGLAUER. That is correct. As a matter of fact, let us be realists about this. As long as we are going to have these taxes for a good many years and we have to raise a great deal of money the more painless that tax is—the more painless we make this tax, as far as the consuming public is concerned, the better.

Senator BARKLEY. That harmonizes with the Hamiltonian theory that you can tax a coat off a man's back and if he does not know it, he will not kick. All he will do is know that he misses his coat.

If a State levies a retail sales tax, I do not see how you can avoid, in some cases, having a tax upon a tax, because, otherwise, you have got to keep a separate set of books all the way through, from manufacturer down to the consumer.

Mr. IGLAUER. No, no; there may be some States, for instance, that may not show their tax as a separate item. It is supposed to be a privilege tax. In that case there will be litigation, and there has been litigation in Michigan on that very point, because one or the other is a tax on the tax.

There are at least 18 States that I know of, and a great many others I am sure, that have sales taxes in one form or another. If this is made a retail sales tax and, in all cases where it is a retail sales tax, and it is included in the price, the State sales tax will be a tax upon a tax, which I do not think is fair, but if it is shown as a separate item, then you will not have any trouble.

Senator BARKLEY. In order to avoid that, you have got to keep it separate all the way from the manufacturer to the retailer and to the consumer.

Mr. IGLAUER. I am not talking about a manufacturer's tax. I am talking about if this is a retail sales tax. Then it should be shown as a separate item in the customer's invoice or statement. Then there can be no doubt about it.

Senator BARKLEY. If a man is just buying a hat, in some States, the tax is separate. You pay $5 for the hat and 15 cents tax, we will say.

Mr. IGLAUER. That is right.

Senator BARKLEY. And that is put into the little bill that the man gets when he pays for his hat and takes it home with him, but that is not true in all States.

Mr. IGLAUER. Unfortunately it is not. We wish it were.

Senator BARKLEY. If they charge you $5.15, sometimes $5.20 when the tax is only 15 cents, there is no way to protect the public against that, is there?

Mr. IGLAUER. Not in that case.

Senator BARKLEY. All right.

Mr. IGLAUER. We have studied this backward and forward. We have had 22 years of it, and the recommendations we made were made after a great deal of thought and after considerable examination of the question ourselves.

Senator TAFT. Mr. Iglauer, the Ohio method in which the stamp is always added to the price has worked very satisfactorily in Ohio, has it not?

Mr. IGLAUER. For a State tax, it is excellent.

Senator TAFT. That is the same principle you are advocating here?

Mr. IGLAUER. Yes; I want to make that feasible so the auditor does not have to ascertain whether it is hidden or whether it is not. It is always there. It is shown to him and he makes the audit quickly. Every sales check shows it.

If you want to collect the tax, collect it from everybody. Do not let the little dealer, or the midway dealer, the man who thinks he can get away with something, get away without collecting the tax, or give the impression to his customer that he is giving it to him without the tax.

Senator BARKLEY. How would that work where they have tokens?

Mr. IGLAUER. State tokens?

Senator BARKLEY. Yes.

Mr. IGLAUER. The same way as they do in Ohio. It is easy to calculate the tax, because then the Federal tax is the same item as the State tax.

Senator TAFT. In case the manufacturers' sales tax is passed on, there will be a State tax on that tax, will there not?

Mr. IGLAUER. Yes; that is true. Drug preparations are taxed. You cannot avoid that. May I go on, Mr. Chairman?

The CHAIRMAN. Yes, sir.

Mr. IGLAUER. For all of the above reasons, if these taxes are to be imposed upon sales at retail, the National Retail Dry Goods Association urges that it be made mandatory in the law that the retail excise tax be shown as a separate item on the bill, statement, or other evidence of sale.

SEC. 2405. *Leases, conditional sales, etc.*—Section 2405 provides that payments made on leases, contracts for sale, or conditional sales shall be subject to the tax, provided however, that such transaction in respect to which delivery has been made and part of the consideration paid, before July 1, 1941, shall not be subject to the tax.

That was introduced in the committee hearings without an opportunity for us to be heard.

This provision discriminates against purchasers in the lower income groups, inasmuch as their purchases are in effect subject to a retroactive tax.

I have had more letters from the membership on that point than anything else in the law.

For example, purchasers most able to pay avoid the tax by making their purchases for cash or on an open charge account after July 1, and prior to the effective date of the act. Those who have such conditional sales can pay them up right away and avoid paying the tax.

In contrast, a working girl, not having sufficient resources, who makes a purchase of a $35 fur-trimmed coat on a payment plan after July 1, would find that the balance due on the effective date of the act would be subject to the tax. Thus, all such persons of low salary, who buy necessities out of income, such as fur-trimmed coats, would be penalized under the July 1 limitation.

We urge that this discrimination be eliminated by making the following changes:

Delete from line 25, page 78 of H. R. 5417, the words "delivery thereunder was made," and substitute on line 26, page 78, the phrase "prior to the effective date of the act" in place of the words "before July 1, 1941."

Please remember that, while it was known there would be excise taxes, neither stores nor their customers could have foreseen that a retroactive clause on leases, contracts, and conditional sales would be inserted. It is our opinion that customers will question the good faith of retailers in the imposition of the tax and arguments will arise over the completion and delivery of garments, and that repossessions and heavy cancelations of customer purchases may result, if the July 1 date, rather than the effective date of the act is retained.

Summary of recommendations on excise taxes

SEC. 2400. *Tax on jewelry, etc.*—Because of the multiplicity of retail outlets, the difficulty of definition and because of the auditing and administrative problems, this tax should be imposed at the point of manufacture.

If a retail tax on jewelry is to be retained in that form, articles sold at the price of $3 or less should be exempt from the provision of this section to eliminate part of the troublesome administrative problems.

SEC. 2401. *Tax on furs.*—The tax on furs should be imposed at the point of manufacture, because it is only at this point that information as to the taxability of articles made partly of fur is available.

If such tax is to remain a retail tax, the law should provide that the manufacturer specify on the invoice the value of the fur content in relation to other component materials to determine taxability.

SEC. 2402. *Tax on toilet preparations.*—The tax under the present law is a manufacturers' tax and should be continued as such because of the multiplicity of retail outlets.

If these taxes are to be retained as retail taxes we urge that it be made mandatory in the law to show the tax as a separate item on the bill, statement, or evidence of sale.

SEC. 2405. *Leases, conditional sales, etc.*—We recommend that the discrimination against purchasers in the low-income groups be eliminated by amending the section to change the effective date with respect to such leases and conditional sales from July 1, 1941, to the effective date of the act.

In conclusion may I say this—several of the members of our tax committee have been continuously members during all the years in which Federal excise taxes have been levied. We have confined discussion of the bill to matters which seemed to us to be of extreme importance. Like yourselves, we recognize the inescapable necessity of obtaining huge sums to meet the emergency. We are glad to say that our large membership has indicated its willingness to assume its share of the unprecedented burden. Therefore, we are not asking for reductions in that burden—we are asking only for changes which will clarify the act so that we may conscientiously comply with it. We are asking:

1. For simplification of corporation taxes.
2. For an annual declaration of value under the capital stock and declared value excess profits tax.
3. For a provision to amend section 812 of the Revenue Code to exempt from inclusion in the decedent's estate such insurance as is taken out by the taxpayer for the irrevocable purpose of paying death taxes, and
4. That all excise taxes be made taxes at the point of manufacture and not at retail. And we have included important suggestions in connection with excise taxes which are, in our experience, essential to compliance with the law.

We hope you will give consideration to the recommendations herein presented.

Senator VANDENBERG. You have also added orally a fifth recommendation that we substitute for the entire tax structure—a manufacturers' sales tax.

Mr. IGLAUER. We think that would solve a great many of your difficulties, a great many complaints that have been pouring in here, and would solve certainly a great many difficulties for the Bureau of Internal Revenue.

Senator VANDENBERG. I think so too.

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

Mr. IGLAUER. I will be glad to answer any questions, if you have any more.

The CHAIRMAN. There seem to be no other questions now.

Mr. Davidson.

STATEMENT OF CLINTON DAVIDSON, JERSEY CITY, N. J., REPRESENTING THE FIDUCIARY COUNSEL, INC.

The CHAIRMAN. Mr. Davidson, you are appearing here for any particular group of taxpayers, are you?

Mr. DAVIDSON. Yes, sir; I represent the Fiduciary Counsel, Inc. of Jersey City, N. J., an investment advisory organization whose clients reside in every section of the United States, and I believe the suggestion I will make is pertinent to every one of them.

I wish to suggest an amendment to section 23 (a) for the purpose of reestablishing a Treasury practice which has existed up to February of this year and which, if not reestablished, will require many people to pay tax on gross income instead of net income.

For many years it has been the policy of the Revenue Bureau to permit individuals to deduct ordinary and necessary expenses which they incurred in producing their taxable income—see I. T. 2751, I. T. 2579 and O. D. 877. Such expenses usually included bookkeeping, stenographic work, office and safety-vault rent, auditing and advisory fees, legal fees, etc. On February 3 of this year, the United States Supreme Court in the case of *Higgins* v. *Commissioner*, disallowed such expenses of Mr. Higgins because of certain technical wording in the act and now individuals who incur expenses in producing their taxable income are, in the majority of cases, forced to pay tax on gross income instead of net income.

The unintentional discrimination under the law as now construed would be most amusing if it were not so serious. For example, a Wall Street investment trust may deduct all of the necessary expenses it incurs in managing and protecting its investments and income, but if an individual owns the same securities—identical in every respect—he may deduct none of these expenses, merely because the individual is not deemed to be carrying on a trade or business within the meaning of section 23. The 1940 statement of Inland Investors, Inc., of Cleveland, shows that this investment trust at the close of the year, had assets totaling $1,560,172, gross income of $135,000, management fees of $5,750, and other expenses of $10,380. All of these expenses were deductible if the income was taxable income. However, if an individual had owned the same securities and had the same expenses, such as investment advice, rent, stenographic services, and so forth, he could have deducted none of these expenses. His tax would have been based on the gross income—the investment trust's on the net.

I hesitated about presenting the next illustration, because at first I thought it was too extreme, but finally decided to do so for the purpose of showing what extremely unfair results are being obtained right now from this unintentional discrimination.

The gambling houses in Reno, Nev., with their roulette tables, dice games, and other gambling equipment, are permitted under the present Revenue Code to deduct bookkeeping, safety-vault, and all of their other ordinary and necessary expenses, but a widow, who is solely dependent upon the income from the securities left her by her husband, cannot deduct bookkeeping, safety-vault, and other expenses essential to the production of her income.

Again anyone may deduct gambling losses to the extent of his gambling gains, but he may not deduct one cent of expenses used for the purpose of investing safely in sound American enterprises. Don't you think that the premium is in the wrong place?

I am certain that the discriminations just mentioned were never so intended by Congress.

The subcommittee of the Ways and Means Committee of the House of Representatives in 1938 recognized the lack of clarity in the law and made the following recommendation:

Recommendation No. 33.—It is recommended that a deduction be permitted under section 23 of the Revenue Act of 1936 for expenses not attributable to the taxpayers' trade or business, but immediately and directly incurred in the collection or production of amounts included in gross income, limited to 50 percent of the amount collected or produced.

Immediate action was not essential then because the regulations and the field examiners treated deductions liberally. I understand that it was decided to postpone action on this recommendation until inquiries could be made of the States that have similar provisions in their tax laws. No doubt you or your advisory committee now have the result of these investigations. I have letters from the tax departments of several States stating that their provision which permits the deduction of these expenses has proven entirely satisfactory.

The Oklahoma Tax Commission wrote on April 23, 1941:

The provision to which you refer has been contained in the Oklahoma income-tax laws since 1933, and its fairness to the taxpayers and the State is shown by the fact that the commission has never recommended that such provision be eliminated to correspond with the Federal statute.

I might say that in Oklahoma these expenses are deductible.

The State Board of Equalization of Montana on April 22, 1941, wrote in reply to the question:

As compared with the Federal provision, has your provision opened the door to tax evasion?

Their answer:

We have never discovered a single case of tax evasion on account of this provision of our law.

Another question:

Has your provision operated fairly to both the State and the taxpayer?

Their answer:

So far as we are able to observe, our law has operated fairly to both the State and the taxpayer. After 15 years of administrative experience in the collection of both Federal and State taxes, we have some very profound convic-

tions that necessary expenses incurred in connection with investments are legitimate and should be allowed to the extent that they are necessary in the same way that a buyer of merchandise or a bill collector for a department store are necessary expenses incurred in producing income.

The Supreme Court decision, plus the present very high rates, make some such legislation imperative. Paying tax on gross income would be bad enough under the old rates, but to refuse the deduction of necessary expenses incurred in producing taxable income under the rates now being proposed is simply inconceivable.

The change which we are suggesting will require practically no change in the administration of the law—and I would like to accent this next remark—and will not deprive the Government of any income it has been receiving heretofore, because the regulations permitted such deductions prior to February 1941. This change will do little more than authorize the Treasury to continue its practice of many years' standing.

The present construction of the law not only affects these taxpayers adversely but it also affects the business of accountants, trustees, lawyers, investment advisers and real-estate owners.

As one example I might mention that many office buildings have been notified by tenants who are dependent upon income from investments, that they can no longer afford to maintain these offices. The same investors have also been forced to discharge employees who have been with them for many years.

The following form of suggested amendment is, we believe, one method of revising helpfully the present situation.

We are not urging that this particular amendment which I am about to read be adopted, but this is one method.

SUGGESTED AMENDMENT TO SECTION 23 OF THE INTERNAL REVENUE CODE

SEC. 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

(*a*) *Expenses.*

* * * * * * *

(3) *Nonbusiness expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year, other than those paid or incurred in carrying on any trade or business, to the extent that such expenses were paid or incurred with respect to the production or collection of, or to the management, protection, or conservation of property-producing income required to be included in gross income under this chapter.

I might further suggest that you give some consideration to making retroactive whatever provision you may decide upon. Otherwise, there will be a small gap during which taxpayers will be taxed on gross income, while those both before and after will be taxed on net income. Such retroaction should, I believe, greatly simplify the administration of the provision.

May I take a minute to summarize?

SUMMARY

1. The deduction of such expenses has been permitted for many years and has become a well-established practice.
2. If discontinued, it would require many taxpayers to pay tax on gross rather than net incomes.
3. The discrimination which permits an investment trust and a Nevada gambling house to deduct necessary expenses, while refusing the same deduction

to men and women who are solely dependent upon the production of taxable income from their investments, and which permits deduction of gambling losses without permitting expenses incurred in investing in sound American enterprises is unfair and was never so intended by the Treasury nor by Congress.

4. The extremely high rates now being proposed make the deduction of proper expenses more essential that ever before. It is imperative now and if not allowed, would be grossly unfair and would work serious hardships in many cases.

5. The statutes of several States permit such deduction and their experience under these statutes have been entirely satisfactory.

6. The amendment suggested would not result in the loss of revenue as compared with that collected heretofore, because such deductions have been permitted up to February 3, 1941.

7. I do not believe that your committee, the Treasury, nor Mr. Stam's staff can object to a change in the law which will result in reestablishing the Treasury practice.

I might say that I have discussed this subject with men in the Treasury staff, and with some of Mr. Stam's staff, and I have found no objection whatsoever to this general idea.

The CHAIRMAN. Have you finished your statement?

Mr. DAVIDSON. Yes.

Senator TAFT. Can the Treasury go back to 1940 and collect the additional taxes on account of this disallowance?

Mr. DAVIDSON. Yes; I think the examiners are so instructed. We find, from reports from all sections of the country that the deduction of such expenses is not being allowed on returns made in March of this year. On all returns that are coming up before the examiners, they are no longer permitting the deduction.

The CHAIRMAN. Mr. Davidson, you appeared before the House committee, I notice from the report. You covered this same question, did you not?

Mr. DAVIDSON. Yes, sir.

The CHAIRMAN. And the House made no amendment, the House did not make the amendment that you were urging?

Mr. DAVIDSON. That is right, sir. The reason I was told was that the House was not considering any administrative measures, but every member of the Ways and Means Committee with whom I discussed the matter agreed it was proper, and several said if administrative measures were agreed upon by the committee to be acceptable, they themselves were in favor of it.

The CHAIRMAN. You gentlemen of the Treasury will note this particular suggestion in this amendment so we may hear from you perhaps later on about it.

Thank you very much, Mr. Davidson. We will have time for one other witness before lunch.

Mr. Edwards.

Will you give your name to the reporter, please?

STATEMENT OF WALTER A. EDWARDS, PROVIDENCE, R. I., REPRESENTING THE PROVIDENCE & WORCESTER RAILROAD CO.

Mr. EDWARDS. My name is Walter A. Edwards. My address is 15 Westminster Street, Providence, R. I. I have a copy of my statement, if you care for it.

The CHAIRMAN. Would you care to present your statement as a whole, or put it in the record and make such comments as you wish?

Mr. EDWARDS. I think the subject matter of it is such that I had better present it as a whole.

The CHAIRMAN. Very well.

Senator BARKLEY. Do you represent any particular organization?

Mr. EDWARDS. Yes; I appear in behalf of the Providence & Worcester Railroad Co., which is one of the leased lines of the New York, New Haven & Hartford Railroad Co. It had been planned that I should appear this morning with Mr. Anton P. Wright, of Savannah, whose statement was to supplement my statement, to a certain extent. We had worked together to some extent in the preparation of it. He has been unable to appear this morning, but I understand will appear next week.

The CHAIRMAN. He will apear at a later date; yes.

Mr. EDWARDS. I simply want to call attention to the fact that our statements each supplement the other to a certain extent.

The CHAIRMAN. Yes, sir.

Mr. EDWARDS. The proposal which I am to make is one which I submitted at the public hearings of the Committee on Ways and Means of the House of Representatives on the revenue bill. Since it was not embodied in that bill I desire to repeat it here.

At the outset, let me say that I recognize the need for a drastic increase in the income tax. Yet I believe that this need should not preclude changes in the present income-tax law which would prevent injustices to the taxpayer, particularly in cases in which such injustices may be prevented at a relatively small cost to the Government.

For many years it was controverted between the Government and the taxpayer whether improvements to leased premises made by the lessee at his own expense and becoming the property of the lessor give rise to taxable income to the lessor either during the continuance of the lease or at its expiration or sooner termination.

In 1938 in *M. E. Blatt Co.* v. *United States* (305 U. S. 267), the Supreme Court held that such improvements do not give rise to taxable income to the lessor during the continuance of the lease. In 1940 in *Helvering* v. *Bruun* (309 U. S. 461), that court decided that such improvements give rise to taxable income to the lessor upon the premature termination of the lease to the amount which they add to the value of the leased property, and the Court's reasoning was such as to compel the conclusion that such improvements also give rise to taxable income to the lessor to the same amount upon the expiration of the lease if it expires by its terms instead of being prematurely terminated. By T. D. 4980, approved July 2, 1940, the Treasury Department gave effect to this decision of the Supreme Court by a regulation applicable both in the case of a premature termination of a lease and in the case of the expiration of a lease.

The question which confronted the Supreme Court in *Helvering* v. *Bruun* was a question of legal interpretation, viz, whether in the circumstances of that case, the lessor received income within the meaning of the sixteenth amendment. The question which confronts us here is whether the law as interpreted by the Supreme Court produces a just and desirable result and it is to that question that I shall now address myself.

There is a serious objection to treating improvements to leased premises made by the lessee at his expense and becoming the property

of the lessor as giving rise to taxable income to the lessor, either upon the expiration or upon the sooner termination of the lease. This objection arises from the fact that the leased property with the improvement at the expiration or the sooner termination of the lease may be and frequently actually is worth less than the cost of the leased property to the lessor or than the value of the leased property without the improvements at the commencement of the lease. Indeed, in the case of the premature termination of a lease—which, of course, is generally an event occurring because of the lessee's default—this is particularly apt to be the case since leases are most often terminated for the default of the lessee during periods of business depression. Yet the taxable income received by the lessor equivalent to the amount added to the value of the leased property by the improvements is not allowed to be offset by any shrinkage in the value of the leased property itself. The result is that the lessor is taxed as the recipient of the income arising out of the improvements when the result of those improvements is merely to diminish his impoverishment. In other words, in substance the lessor is taxed not because of his enrichment but because of the reduction of his impoverishment.

Moreover, treating improvements to leased premises made by the lessee at his expense and becoming the property of the lessor as giving rise to taxable income to the lessor, either upon the expiration or upon the sooner termination of the lease, is open to the objection that the amount of the tax is dependent upon the valuation placed upon the contribution made by the improvements to the value of the composite unit consisting of the leased property and the improvements; and it is often very difficult and sometimes impossible to determine what value should be assigned to that contribution. For example, let us take the case of a railroad which has been leased for a term of 99 years by a lease under which the lessee covenants at its own expense to make all necessary additions, betterments, and improvements and these are to become the lessor's property.

Many years pass; yards have been relocated, heavier rails have been laid, new signal systems have been installed, and new stations and other facilities erected and all the improvements necessary to adapt the road to changing conditions have been made. Mr. Wright, the president of Southwestern Railroad Co., which owns a railroad leased to Central Railway of Georgia, who will appear later at these hearings, will give you an actual example of such a case.

How much do all these changes contribute to the value of the railroad at the time the lease expires or is terminated? Nothing less than a complete and very expensive engineering study would furnish any answer to this question, and it may be doubted whether even such a study would furnish a satisfactory answer. In cases in which valuation is difficult the Commissioner of Internal Revenue is likely to make a somewhat arbitrary valuation which the taxpayer will be unable successfully to contest because of the presumption which the courts have held to exist in favor of the correctness of the Commissioner's action. In saying what I have said, I realize, of course, that no income tax law (especially no income tax law which takes into

account gains or losses on capital transactions) can be so framed as entirely to avoid difficult questions of valuation which can be solved only by conjecture. But surely the cases in which such questions may arise should be limited so far as possible.

There is also a third objection to treating improvements of the class under consideration as giving rise to taxable income to the lessor. Although, as I shall later explain, I do not believe that in the aggregate the Government will profit much from the decision in *Helvering* v. *Bruun*, in any particular case the tax imposed in reliance on that case is likely to be entirely disproportionate to the taxpayer's cash receipts at or about the time of the imposition of the tax. It is therefore, a tax for which it should be possible to make adequate provision in advance by means of a sinking fund out of earnings. Yet this cannot be done. If the lease is prematurely terminated, no such provision can be made, for the time when a lease will have to be terminated for the lessee's default cannot be foreseen. Even if the lease expires in accordance with its terms, it is impossible to foresee what values or tax rates will be at a time many years in the future or, in the case of a railroad or public utility lease, what improvements the lessee will make; and this impossibility prevents the computation (except by mere guess work) of the amount for which provision should be made by way of a sinking fund.

The three objections, which I have mentioned, to treating improvements to leased property made by the lessee at his own expense and becoming the property of the lessor as giving rise to taxable income to the lessor apply whether the lease expires according to its terms or is prematurely terminated. There is another objection which applies to treating such improvements as giving rise to taxable income to the lessor upon the premature termination of the lease. As has already been pointed out, such a termination is generally because of the lessee's default. Defaults by lessees are most likely to happen during periods of business depression. Consequently, the tax is apt to fall upon the lessor at a time when he is least able to meet it—at a time when very probably he can find no new tenant or has had to make a new lease of his property at a much reduced rent.

Whether or not the decision of the Supreme Court in *Helvering* v. *Bruun* was necessitated by the absence of any express statutory provision relating to the problem with which it dealt, the objectionable results of that decision indicate that the imposition of an income tax in accordance with the Treasury decision based thereon is unjust and undesirable and that there is need for a legislative remedy which will exclude from gross income income received by a lessor upon the expiration or termination of a lease by reason of additions, betterments, or improvements made to the leased property by the lessee. But it will be asked whether such a remedy would not prove expensive to the Government at a time when it cannot afford to lose any tax revenues. I do not believe that it would; and I shall attempt to justify this belief by showing the probable results of the application of the Treasury decision to three classes of cases which certainly include most of the cases coming within its scope.

The first class of cases consists of leases of land under which the lessees have erected buildings. In these cases, when the lease expires,

the building erected by the lessee is apt to have become so obsolete as not to add much to the value of the land and, therefore, not to result in a substantial tax. Nor do I think that upon the premature termination of a lease of this class for the default of the lessee, a substantial tax by reason of the building erected by the lessee is likely to be collected. My belief is that the result of the application of the Treasury decision would be that a lessor of this class coming within its scope, instead of terminating a lease for the lessee's default, would resort to some elaborate transaction to avoid the tax or would temporize or compromise with the lessee.

The second class of cases consists of leases of store property to merchants who have made improvements to the stores. Such improvements, I believe, are apt to become obsolete so quickly that they rarely add much to the value of the leased property. Moreover, if they do add to that value, it is difficult to determine how much they add. Consequently, it seems probable that the revenue derived from the Government's taxing what they add to the leased property would be small and would be obtained at substantial administrative expense.

The third class of cases consists of leases of railroads and public utilities which provide that the lessee shall make all necessary additions, betterments, and improvements. I believe that in general such leases have been made at such times and for such periods that they will not begin to expire for many years. The Treasury decision would certainly operate to prevent their termination because of defaults by the lessees.

Certainly a consideration of these three classes of cases indicates that legislation excluding from gross income, income received by a lessor upon the expiration or termination of a lease by reason of additions, betterments, or improvements made to the leased property by the lessee would involve no serious loss of revenue to the Government.

Such legislation may be simply expressed. Subsection (b) of section 22 of the Internal Revenue Code, as heretofore amended, lists in nine paragraphs certain items which are not to be included in gross income and are to be exempt from income tax. All that is necessary is to amend this subsection by adding at the end thereof a new paragraph reading as follows:

(10) Income received by a lessor upon the expiration or termination of a lease by reason of additions, betterments, and improvements to the leased property made by the lessee.

If such an amendment were adopted, paragraph (c) of section 721 which treats similar income as abnormal income for the purposes of the excess-profits tax, could be stricken out.

I most respectfully submit and most earnestly urge that in the revenue bill of 1941 subsection (b) of section 22 of the Internal Revenue Code, as heretofore amended, be amended by the addition of the paragraph which I have just mentioned.

The CHAIRMAN. Are there any questions?

Senator DANAHER. I have one, please.

The CHAIRMAN. Yes.

Senator DANAHER. I want clearly to understand that this income is treated as income and is imposed only for the year when the lease expires either by termination or default.

Mr. EDWARDS. That is so under the present decisions of the Supreme Court. There is no income realized by reason of the improvements under those decisions during the continuance of the lease.

The CHAIRMAN. Thank you very much, Mr. Edwards. The committee will recess until 2 o'clock.

(Whereupon, at the hour of 12:35 p. m., the committee recessed until 2 p. m., the same date.)

AFTERNOON SESSION

(Pursuant to adjournment, the committee resumed the hearing at 2 p. m.)

The CHAIRMAN. The committee will come to order. I believe Mr. Parton is next on the list.

STATEMENT OF GEORGE F. PARTON, NEW YORK, N. Y., MEMBER, EXECUTIVE COMMITTEE, NATIONAL SAFE DEPOSIT ADVISORY COUNCIL; PRESIDENT, NEW YORK STATE SAFE DEPOSIT ASSOCIATION

Mr. PARTON. My name is George F. Parton. I am appearing before you as a member of the executive committee of the National Safe Deposit Advisory Council, and also as president of the New York State Safe Deposit Association. Both are nonprofit associations, for the promotion of the general welfare of the safe-deposit business. I have prepared a statement, Mr. Chairman, which I should like to read, and I have also filed with the clerk copies of this statement for members of the committee.

The CHAIRMAN. Do you wish to enter the statement in the record?

Mr. PARTON. Yes, sir; I should like to do that.

The CHAIRMAN. Then discuss the matter?

Mr. PARTON. Yes; I should like to read the statement at this time.

The CHAIRMAN. You may do that; you may proceed.

Mr. PARTON. The membership of the National Safe Deposit Advisory Council consists of 25 State associations, which include in their respective memberships many hundreds of individual safe deposit companies. These State associations are located throughout the United States from New England to California.

One of the members of the advisory council is the New York State Safe Deposit Association of which I am president, and which in itself has a membership of over 500 safe-deposit companies in 34 States of the Union.

In addition, I am appearing before you on behalf of the 4,500,000 renters in the United States of safe-deposit boxes, for they are the people who pay this particular tax which I wish to discuss.

At the outset I should like to place in the record that the entire safe-deposit industry is wholeheartedly behind the present effort of the Government to raise every possible dollar by taxation and to raise it as quickly as possible, to help finance national defense. We believe there is no problem today which is of more vital importance. Therefore, whatever is said in this statement should not be interpreted as an effort on behalf of our industry to, in any way, sidestep our patriotic duty in this respect. We expect and we desire to do our full share.

It is proposed in the present tax bill to increase the tax on safe-deposit box rentals from 11 to 20 percent. This tax was first enacted in 1932, at the rate of 10 percent, as an "emergency" measure and it was generally understood at that time that the tax would expire when the emergency ended.

Senator VANDENBERG. When was that?

Mr. PARTON. I do not know, sir; I understand it is still continuing.

On each of the subsequent expiration dates the tax has been extended and in 1940 it was increased to 11 percent.

New excise taxes at the rate of only 10 percent are proposed on sporting goods, luggage, electrical appliances, photographic apparatus, business and store machines, rubber products, commercial washing machines, and optical equipment. In addition, the bill imposes a new excise tax of only 10 percent upon the retail sale of jewelry, furs, and toilet preparations.

The following are proposed increases in existing rates:

Passenger automobiles and motorcycles, from 3½ to 7 percent.

Trucks, from 2½ to 5 percent.

Parts or accessories, from 2½ to 5 percent.

Radio sets, phonographs, phonograph records, automobile radios, and musical instruments, from 5½ to 10 percent.

Refrigerators and air conditioners, from 5½ to 10 percent.

The proposed increase in the rate on safe-deposit-box rentals is from 11 to 20 percent and we cite these other instances in the bill because the safe-deposit rate is double most of them. In some cases, it is considerably more than double, and in no case is it less than double. In no other industry mentioned in the entire tax bill is the proposed excise-tax rate as high as that on safe-deposit box rentals.

The amount which it is expected to realize from this increased safe-deposit tax is $1,700,000, a relatively insignificant amount of money compared to the total amount to be raised. There are in fact only three items in the bill on which the estimated revenue is less, namely: Playing cards, on which the estimated yield is $1,000,000, representing an increase in the present rate from 11 to 13 cents; optical equipment, estimated to yield $1,000,000, representing a new tax of 10 percent; and washing machines (commercial) estimated to yield $1,100,000, representing a new tax of 10 percent.

In each of these three cases the proposed rate is very considerably less than on safe-deposit box rentals.

Is it equitable that there should be such discrimination between our industry and all these others which I have cited? I beg to submit that this is not in accordance with the statement made by the Ways and Means Committee that it has been their "aim and desire to distribute the additional tax burden as equitably as possible among the several classes of taxpayers." I also believe that, regardless of how large or how small may be the amount of revenue which it is hoped to receive from any one industry or commodity, it is not equitable to single out one of the smallest industries, from the point of view of tax revenue, on which to impose the highest tax rate.

In our opinion it is inconsistent and misleading to classify safe-deposit boxes as "luxuries," similarly as liquor, tobacco, cosmetics,

and so forth. Actually a tax on the rental of a safe-deposit box is a tax on the protection of valuables, and we believe it quite unfair to regard it as a luxury to rent a safe-deposit box.

In this connection it has been estimated by competent authorities that about 90 percent of all the box renters in the United States rent boxes averaging $4 a year. These box renters are not wealthy people; in the main, they are the people of small means and of the middle classes. They are not the people with stocks and bonds; they rent their boxes to put a savings bank passbook in, or a life-insurance policy, or a deed to their home. Their safe-deposit box is not rented as a luxury, but solely as a means of protection for their small possessions. It is conceded that the remaining 10 percent of the renters in the country may have more wealth to protect, but again, it is protection which they seek and I submit that the habit of protecting one's possessions is not something which should be penalized by heavy taxation. We believe that the protection of one's valuables, particularly in precarious times like the present, is a laudable objective and that it should be encouraged rather than discouraged.

Every method possible has been stressed by the Treasury Department to encourage the people to buy defense bonds. Nothing therefore should be done to build up sales resistance to this effort. But, if a man or woman is forced to give up his or her safe-deposit box because of an exorbitant tax on the rental thereof, the Government will, in a great many instances, lose that person as a potential purchaser of those bonds. If it may be argued that defense bonds will be held by the Federal Reserve banks free of charge, the purchaser will still want some secure place in which to keep his receipt for them. He will more frequently, however, wish to have physical possession of them. This was proven during the Liberty Loan period of the last war, when comparatively few purchasers availed themselves of the offer at that time of mutual savings banks to take care of the bonds without charge. Most of the Liberty Loan bonds were placed in safe-deposit boxes from which they could be removed by the owners at any time.

Purchasers of defense bonds will also wish to place them in their own safe deposit boxes. But without safe deposit boxes to place them in they are not as likely to be prospective purchasers.

There has been voiced general opposition to the proposal that a Federal general sales tax be levied on the grounds that it would severely penalize persons of moderate incomes. Yet it has been carefully estimated, as stated above, that about 90 percent of the entire number of box renters throughout the United States are people of small means. The well-known firm of McCann-Erickson, Inc., made a survey for our association a few years ago which showed that there were approximately 11,000,000 safe deposit boxes in the United States of which only 40 percent or 4,400,000 were rented. Therefore it will be approximately the 4,000,000 people of modest means and small incomes, constituting the 90 percent of all the box renters, who will be the ones severely penalized by this proposed tax.

From the economic standpoint, it is our belief, based upon facts and opinions gathered from all over the country, that the imposition of a 20 percent tax on safe deposit box rentals will defeat the purpose for which it is intended, for the reason that many thousands of the renters of the larger boxes will take smaller space, and also

because a great many of the little boxes will unquestionably be closed out entirely by people who will take their small possessions home, or otherwise endeavor to protect them, rather than pay such an exorbitant tax. In our opinion, therefore, the Government will fall far short of receiving the anticipated $1,700,000. In addition, the net profits which the individual safe deposit companies earn will be so reduced because of this loss of business that the Government will receive far less than it is receiving at present from corporate income taxes.

Throughout the Nation the safe-deposit industry will receive a crippling blow if this 20-percent tax is approved, and the question we wish to submit in this regard is whether it is right that any one industry, regardless of how large or how small it may be, should be entirely disrupted, causing unemployment, and so forth, just in the hopeful expectation that the Government may receive through that source a million dollars or so. Is that a fair price to pay for such a relatively small sum of money, speaking relatively, of course, in relation to the entire tax picture? It is our view that an industry which is dedicated to encourage savings, thrift, and protection is one which should be encouraged in wartimes rather than crippled.

Attached to this statement is copy of a letter which I mailed on August 7 to Mr. Roy Blough, Director of Tax Research of the United States Treasury Department, in which are given several facts to confirm our opinion that the Government will not receive the hoped-for revenue from this source, and that in addition, the industry itself will be dealt a most severe set-back at a time when its business throughout the country is at an extremely low ebb.

But perhaps, more important than the effect of this tax on the industry itself is the effect it will have on 4,000,000 of the middle-class people of the country, not only because the tax will be a distinct hardship to them to pay, in addition to all their other taxes, but also because it will react as an encouragement to these people to get away from the habit of protecting their savings and other valuables. In times like the present, we believe this would be extremely short-sighted policy. At the expense of repetition we again say that people should be encouraged in wartimes to protect their valuables, not to do anything which would tend to weaken that protection. Even in normal times they should be so encouraged.

Again we would stress that safe deposit box renters have already been paying this tax for nearly 10 years. We feel therefore, that they and we have been doing our part, and incidentally, it might also be mentioned that it costs the Government practically nothing to collect this tax, for we act as their collecting agents. We collect the money free of cost to them and remit the recollections each month, thereby saving the Government an immense amount of detail and expense. We are, of course, willing and anxious to contribute our fair share toward national defense, but we claim that our share should be on an equitable and fair basis. At the prevailing rate of 11 percent the tax is already in excess of most of the other excise taxes proposed in the bill. At 20 percent it would be the highest rate. We claim that this is neither fair nor equitable and we therefore most

earnestly recommend that the present rate of 11 percent be not increased. It should indeed be reduced to 10 percent to correspond with the other comparable ex e taxes as listed in the bill.

Mr. Chairman, I should like also, if I may, to read the letter to Mr. Roy Blough, to which I have made reference. It will not take more than a few minutes.

The CHAIRMAN. All right. Please be as brief as possible. We haven't placed any time limit, but we have a great many witnesses here.

Mr. PARTON. If you would prefer, I will not read it.

The CHAIRMAN. No; you may read it, particularly if it deals with matters other than those you have touched on.

Mr. PARTON. It does.

AUGUST 7, 1941.

Mr. ROY BLOUGH,
Director of Tax Research, United States Treasury,
Washington, D. C.

DEAR MR. BLOUGH: In compliance with your suggestion last Tuesday morning when I had the pleasure of discussing with you the proposed increase in the tax on safe-deposit box rentals, I give you below certain facts and information which have a bearing on this question.

A survey made within recent years by the well-known firm of McCann-Erickson, Inc., showed that at the time of the survey there were approximately 11,000,000 safe-deposit boxes in the United States. Of these about 40 percent or 4,400,000 were rented and the balance vacant.

Since that time figures of the Internal Revenue Bureau show that the gross income from safe-deposit box rentals has declined, from which it is evident that less than 4,400,000 boxes are rented at the present time.

According to the above-mentioned survey the average rental paid on those 4,400,000 boxes was $4 per annum.

It has been estimated that those who rent these boxes averaging $4 per annum constitute approximately 90 percent of all the box renters in the United States.

The survey also states that 87.2 percent of all box renters place insurance policies in their boxes; 67.5 percent place deeds to real estate; 57 percent place wills; 36.7 percent place contracts; 35.1 percent place jewelry, and lesser percentages apply to canceled checks, income-tax returns, heirlooms, birth certificates, and so forth. These facts are mentioned to show that safe-deposit boxes are used in very large measure for the protection of valuables other than securities.

Another point brought out in the survey is that 42.5 percent of all box renters have locked boxes of one form or another in their homes, from which it may be assumed that large numbers of the small-box renters will use those locked boxes in their homes for their valuables rather than retain their safe-deposit boxes and pay a 20-percent tax on the rental thereon.

It is stated that 41 percent of the box renters also keep personal possessions in their office safes, another reason to believe that many will close out their safe-deposit boxes and use the office safe rather than pay a 20-percent tax on the former.

In the opinion of safe-deposit and bank officials throughout the country, a 20-percent tax on safe-deposit box rentals will react as definite sales resistance against the purchase of defense bonds, inasmuch as there will undoubtedly be many who would purchase those bonds if they had a safe-deposit box to put them in, but who would refrain from purchasing them if they had no safe-deposit box. This statement is taken from the experience of the World War, when most of the Liberty Loan bonds sold at that time were placed in safe-deposit boxes from which they could be removed by the owners at any time, and this notwithstanding the offer of the mutual savings banks at that time to take care of the bonds free of charge similarly as the Federal Reserve banks are offering this service at the present time. Purchasers of defense bonds should not, in our opinion, be taxed for protecting them.

The safe-deposit business generally has been on the decline ever since the tax on box rentals was first imposed in 1932, as will be shown from the following figures obtained from the Internal Revenue Bureau:

Year ended June 30, 1933 (including collections of June 21, 1932, and thereafter—in other words, 1 year and 10 days)	$23,650,408.30
Year ended June 30, 1934 (bank holiday and gold hoarding)	27,158,506.70
Year ended June 30, 1935	23,176,193.00
Year ended June 30, 1936	19,974,096.70
Year ended June 30, 1937	20,397,143.70
Year ended June 30, 1938	20,131,587.30
Year ended June 30, 1939	19,805,250.30
Year ended June 30, 1940	19,889,337.90

The above figures indicate that there was a considerable jump in the gross income from safe-deposit box rentals during the year ended June 30, 1934, which we believe was largely and directly traceable to the gold-hoarding and bank-holiday period. This increase was, however, more than wiped out the following year and the figures will show that as of June 1940, there was a decrease in gross income from rentals of $7,269,000 from the high point over these past 8 years. If the 20-percent tax is placed on these rentals, the business will unquestionably be further reduced.

In our opinion, although we have no specific facts to substantiate it other than plain human nature, if the 20 percent is imposed, those who have the larger-sized boxes, as well as those who have the small ones, will examine them with the view of placing the contents in smaller boxes. This procedure will operate all along the line from the company or firm which rents a $500 box on down to those who rent the $3 box, and in our judgment many of those who rent the smallest size boxes will close them entirely rather than pay the tax. This was the experience of safe-deposit companies all over the country when the 10-percent tax was first imposed in 1932, although no actual figures are available to prove exactly how many of such boxes were reduced or closed out because of the tax. But every safe-deposit company to which I have made inquiry has stated that its experience was that their business fell off immediately after the tax was imposed.

A further falling off in business, which unquestionably will follow the increase in the tax to 20 percent, will result in less corporate income taxes paid to the Government by the safe-deposit companies.

Apart from the above there will, in our opinion, be extremely little likelihood of the Government raising the $1,700,000 from the tax on rentals because of the fact that so many of the little boxes will be closed out entirely.

Summing up, it is our best judgment, based upon facts and information obtained from safe-deposit companies over the entire country, that should this 20-percent tax be imposed the Government will fall far short of raising the additional revenue hoped for, and not only will this be true but the safe-deposit industry itself will come close to being crippled, with resulting unemployment in many of the companies, inasmuch as practically no safe-deposit company is making any money to speak of these days. We do not believe the Government would willingly be responsible for disrupting a national industry, small though it may be, just for the sake of raising a possible million dollars or so, especially when over 4,000,000 people of the middle classes would be the ones primarily affected.

The safe-deposit industry is in full sympathy with the Government's efforts to raise every dollar possible through taxation, but we submit that to increase by nearly 100 percent a tax which has already been in force for nearly 10 years, is not equitable or fair, nor is it at all in line with the proposed taxes on other lines of business as shown by the pending tax bill.

Yours very truly,

GEORGE F. PARTON, *President.*

Mr. PARTON. That concludes my statement.

The CHAIRMAN. Any questions?

(No response.)

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

Mr. PARTON. Thank you, sir.

The CHAIRMAN. Mr. John W. Hart.

STATEMENT OF JOHN W. HART, KENDALLVILLE, IND., PRESIDENT, COMMERCIAL REFRIGERATOR MANUFACTURERS ASSOCIATION

The CHAIRMAN. Mr. Hart, will you give your name to the stenographer?

Mr. HART. My name is John W. Hart. I am president, Commercial Refrigerator Manufacturers Association, about 30 members, who produce about 85 percent of the total commercial refrigerators in the United States.

Now, we have a brief which we are passing around and we would like to have it in the record. I have with me Mr. Sullivan, secretary of the association, who has all the statistics pertaining to our business. After reading this brief, we will be very glad to answer any questions and, with your permission, Mr. Chairman, and members of the Senate Finance Committee, I would now like to read this brief.

The CHAIRMAN. You would like to read it rather than comment on it?

Mr. HART. I would like to read it, and if there are any questions we would like to answer them. We think we have some very good points which perhaps you would like to hear and then ask some questions about.

The CHAIRMAN. Proceed.

Mr. HART. This presentation pertains to the proposal now before this committee under which section 3405 of the Internal Revenue Code is amended to read as follows:

SEC. 3405. *Tax on refrigerators, refrigeration apparatus, and air conditioners.*—There shall be imposed on the following articles (including in each case parts and accessories therefor sold on or in connection with the sale therefor) sold by the manufacturer, producer, or importer a tax equivalent to 10 percent of the price for which so sold:

(a) *Refrigerators, etc.*—Refrigerators, beverage coolers, ice cream cabinets, water coolers, food and beverage display cases, food and beverage storage cabinets, each such article having or being primarily designed for use with a mechanical refrigerating unit operated by electricity, gas, kerosene, or gasoline.

As representatives of the manufacturers of commercial refrigerators, a type of refrigerated equipment generally designated by that name, we respectfully object to that portion of the above-quoted general application which, although not describing commercial refrigerators specifically, suggests that it is the intent of this proposal to impose the 10-percent excise tax on all such products. This inference is conveyed in the reference to "refrigerators" and "food and beverage display cases" and to "food and beverage storage cabinets."

The foregoing terminology is not clear, inasmuch as we know of no commercial refrigerator or refrigerated store fixture designed for the combined display or storage of both food and beverages, if by the term "beverage" is meant soft drinks, beer, or liquid beverages other than milk or similar liquid foods. These questions of phraseology will be recognized as technicalities only. However, we cite them at this point with the thought that if it had been the intent of the framers of this bill to impose a tax upon the type of equipment manufactured by your petitioners, the proper distinction between commercial refrigerators and the other types of refrigerated equipment contemplated in the measure would have been clearly drawn.

Therefore, we cannot overlook the possibility that such was not the

intent, and that reference to "food and beverage display cases" or "food and beverage cases" was merely an attempt to clarify the application of the tax to a type of refrigerated storage and display cabinet or case commonly designated as a "beverage cooler," from which soft drinks are usually dispensed and sold in taverns, confectioneries, filling stations, and so forth.

A "commercial refrigerator" in the sense that we will use the term in this presentation, refers to such equipment used in retail food and meat stores, hotels, restaurants, hospitals, and other institutions as (*a*) cabinets or cases wherein perishable foods are protected against spoilage, and maintained at healthful temperatures until consumed or sold, (*b*) storage cabinets used for the same purpose, (*c*) refrigerator cabinets or cases specially designed for the safe storage and display of foods requiring particular temperature and humidity conditions, as in the case of fresh fruits and vegetables, milk, butter, cheese, etc., (*d*) cooling rooms or compartments of the portable type for the storage of perishable foods in large quantities, and (*e*) refrigerated cabinets for use in hospitals or other institutions for the preservation of serums, pharmaceuticals, "blood banks," and so forth.

It should be apparent from the above definition of our products that if the proposed excise tax is to be assessed against them, it will be placing a burden on two most vital factors in our national economy—food and the public health—both of which constitute America's first line of defense in the present emergency. We recommend, therefore, that if this committee is satisfied that it was not the intent of the authors of the bill to impose a tax on commercial refrigerators, the present phraseology of the questioned provision be clarified by eliminating all reference to food, or the use of the word "case" in describing any of the products intended to be covered. However, if the committee is not of this view and feels that commercial refrigerators should be subject to the tax, we offer the following reasons why we believe such a step is unjust and unsound:

I. *This tax is equivalent to a tax on food.*—There are approximately 500,000 retail food merchants in the United States, plus some 200,000 restaurants, hotels, and other establishments where food is stored under refrigeration for ultimate sale or consumption. The commercial refrigerator is the final link in the chain of distributive processes required to bring perishable foods from their point of origin to the point where it passes into the hands of the ultimate consumer. If this link is broken, as it will be if burdened with the proposed tax, it means that either or both of two things will result:

1. The retail food merchant or other purveyor of perishable foods will unquestionably pass on the tax, as reflected in the increased cost of his refrigerated equipment, to his customers—the 130,000,000 people who use the retail food store as their daily market basket. This can only mean higher food prices—at a time when every effort is being made to keep living costs from soaring. As with any other factor adding to the cost of our one indispensable living necessity, this tax will fall disproportionately on that vast segment of our population that is least able to shoulder the burden.

Sixty-two cents of every dollar spent for food on the American dinner table goes for perishable food—meats, vegetables, fruits, and

dairy products. Already burdened with mounting costs and narrowing profit margins, the average retail food distributor will have no recourse than to pass on the full amount of any addition to the cost of his essential investment in refrigerated equipment—for in order to remain in business and comply with American standards of health and sanitation, every food merchant or other purveyor of foods must make use of one or more types of commercial refrigerator.

2. Due to the increased cost of new refrigerated equipment, no doubt many food distributors will strive to get along with equipment that, by reason of age, obsolescence, and wear, is no longer capable of maintaining food under proper conditions. On an average, the retail-food merchant finds it advisable to replace his refrigerated equipment about every 10 years. Thus, in each year many thousands of commercial refrigerators have reached the point where they can no longer be used without endangering the health of the public. We are of the opinion that the deterrent effect which the increased cost of such equipment will exert on this normal replacement policy will be great, and that a very real health hazard is involved.

Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, in commenting on the effects of the defense program on our national economy, is quoted as saying:

> Low-income groups should not be made to make sacrifices in food, clothing, and other necessities, for they have had too little. The sacrifices must come from the more fortunate groups. Those who can get along with fewer automobiles and other goods needed for defense, but not essential for civilian well-being.

We are told by the same source that "nutrition has become a matter of national policy" and that nothing must interfere with the Nation's task of giving food priority as a war expedient, just as it should command the same priority in peacetime. These views, we feel, are indisputably sound and have a direct bearing on our own contentions here that the adoption of any measure that will have the effect of raising the cost of essential living necessities should be avoided.

Senator DANAHER. Right there, Mr. Chairman, I would like to ask a question. What percentage of your sales are installment sales?

Mr. HART. The percentage of the sales is about 70 percent.

Senator DANAHER. There was a report today that by Executive order, the President had conferred on Marriner Eccles power to suppress all installment sales. Won't that have an effect, more so than this tax, of discouraging sales?

Mr. HART. You mean suppress all installment sales?

Senator DANAHER. Well, the power——

Mr. HART. A tightening up. I may say that our industry has already begun to put its house in order by requiring larger initial cash payments with a shorter time to pay the balance. The C. I. T. has already tightened up in New York City.

Senator TAFT. That is, has tightened the terms?

Mr. HART. Yes.

Senator DANAHER. Won't that have the effect, won't that be a far greater deterrent to sales than this tax would be?

Mr. HART. I don't think so, as our industry has always followed a very conservative policy with respect to its installment sales, and our terms and down-payment requirements are much more restrictive than in the case of such products as household refrigerators and appliances and various consumers' goods items. We learned a month ago of the action contemplated by the Federal Reserve Board and have since tightened up our requirements still further by requiring an increased initial payment and cutting down the payment period.

Senator DANAHER. I had in mind that very argument you are offering against the tax, would apply equally to any order that would constitute a deterrent to installment sales.

Senator JOHNSON. Isn't it a fact that you are glad to have an opportunity to get away from so much credit?

Mr. HART. Yes; we believe there is a danger of inflation.

Senator DANAHER. Thank you.

II. *Will encourage waste and spoilage.*—The use of refrigerators that are no longer in condition to maintain proper temperatures to safeguard the contents results in rendering a portion of the perishable foods stored in them unsalable. This spoiled food must be thrown out. There is no substitute for food. At a time when the cry is already being raised, as it was in 1917, the "Food will win this war," we feel that the committee cannot conscientiously subscribe to any measure that will actually encourage inefficient methods in conserving the Nation's food supply.

The amount of revenue to be derived from the proposed tax on commercial refrigerators, as we shall presently show, is insignificant when compared with the probable waste in a commodity that is fully as important as tanks, planes, or cannon in successfully concluding our national emergency.

III. *Tax is inequitable.*—As it is proposed to tax refrigeration components, such as compressors, condensers, controls, and so forth, in a great many instances the amount of the tax will be pyramided. Under the old law, under which only household refrigerators were taxed, a credit was allowed for taxable components. While the intent of this portion of the measure is not clear, it is assumed that, unless this contingency is expressly provided for, a tax will be collected from manufacturers of such components as well as from the manufacturer of the complete assembly. Despite the present provision in the Internal Revenue Code designed to prevent this pyramiding effect, the manufacturer of components that would otherwise be taxable cannot always tell whether his products are going into the fabrication of a completely assembled product which is taxable, as many smaller manufacturers in our line of business depend on local dealers and jobbers for their supplies of such parts or components.

In the case of a commercial refrigerator, compressors and other parts of the mechanical refrigeration system are purchased from establishments specializing in such equipment, simply added to the cabinet or case. Thus, if these taxes are to apply separately to the finished product as well as to some of the components thereof, the manufacturers of the completely assembled refrigerator will have paid not one, but an accumulation of such taxes. The result will be a greater impact on food costs than would be the case were a single comprehensive tax to be imposed.

Perishable food must be maintained under refrigeration from its point of origin to its delivery to the retail consumer. Under the present provisions of this bill, every state of this process is affected.

The next paragraph is a very vital point.

IV. *A commercial refrigerator is not a luxury item.*—Other provisions of the excise-tax features of the bill lead us to believe that the framers of the bill intended to tax so-called luxury, or nonessential products. For example, a tax is imposed on sporting goods, phonographs, automobiles, and electrical appliances. By no stretch of the imagination do we feel that commercial refrigerators as distinguished from domestic refrigerators, should be so classified. As we have previously pointed out, adequate refrigeration is essential in all stages in the distribution of all forms of perishable foods.

When the excise-tax schedule was originally drawn, we are under the impression that a large portion of the revenue now expected from the taxes on refrigeration was to have been met by a tax on candy and confections. However, the proposed tax on candy was stricken out on the ground, we are told, that candy is a food. If candy is considered an essential food, then commercial refrigerators deserve similar consideration, for the candy industry makes liberal use of the benefits of refrigeration, and is a good customer for this industry's products. If it is inadvisable to place a tax directly on any kind of food, it is equally illogical to impose a whole series of such taxes on a class of commodities essential to the distribution and preservation of food.

V. *We also feel that the proposal is discriminatory.*—In the present schedule no mention is made of ice refrigeration; in fact, the tax is specifically limited to mechanical refrigeration. To the extent, therefore, that a refrigerator using ice as the cooling medium is not taxed, while the identical piece of equipment using a mechanical cooling means is taxed, this feature of the bill is discriminatory.

Another possible discriminatory factor is the failure of the bill to specifically name several types of refrigeration equipment, such as refrigerated locker systems, of which there are many thousands now in use. Presumably, the mechanical refrigeration cooling agency is taxable as such, but the complete locker plant is not, according to a strict interpretation of the language of the bill.

Senator VANDENBERG. On this question of discrimination and all the related subjects, what would you say of cleaning up the whole problem by eliminating the specific excises and substituting a general manufacturers' sales tax?

Mr. HART. I would sort of like that because, Senator Vandenberg, we are placing a burden on the small retail merchant.

In other words, if we take this small retail merchant 10 years ago—your neighborhood merchant, and if he is still in business today, and you analyze his business, you will find a 10-percent tax would be a tremendous burden on him.

Conclusion.—In conclusion, we wish to briefly restate some of the reasons why we believe this committee may consistently recommend the elimination of the 10-percent excise tax on commercial refrigerators—

1. Refrigerators of this type are essential for the proper preservation of food, as a protection against waste and spoilage and for the maintenance of proper health and sanitation standards.

2. The proposed tax will produce a total annual revenue from this one source of only about 1½ million dollars, a very small fraction of the savings in our food resources that the imposition of the tax would prevent.

3. The proposed tax will prove a burden on more than three-quarters of a million small business establishments throughout the country, by increasing the cost of the one piece of capital equipment they cannot do without.

4. A tax on commercial refrigerators is a tax on food—the Nation's first line of defense in the present emergency.

5. The tax will be borne by the great mass of low-income groups within our population—those least able to afford it.

6. We repeat a statement that is heard time and again from the lips of those concerned with guiding our Nation safely through the present emergency: "Food will win the war and make the peace. This life line must not be broken."

STATISTICAL EXHIBITS

I. *Comparison of commercial-refrigerator production with that of other refrigeration equipment subject to proposed tax*

	Units	Value	Estimated revenue
Household refrigerators	2,720,000	$118,880,000	$25,000,000
Water coolers	43,000	4,000,000	300,000
Ice cream cabinets	61,000	11,000,000	800,000
Beverage coolers	61,000	7,351,000	600,000
Milk coolers	10,000	818,000	70,000
Compressors	258,000	165,000,000	9,500,000
Air conditioning		25,000,000	2,500,000
Controls, coils, etc		10,000,000	700,000
Commercial refrigerators	45,000	18,500,000	1,500,000
Total		661,449,000	40,970,000

II. *Where commercial refrigerators are used*

Independent food stores	386,000
Chain food stores	40,000
Bakeries, fruit and vegetable markets, meat markets, dairy stores, etc	110,000
Restaurants and hotels	165,000
Hospitals and institutions	12,000
Total	713,000

III. *Commercial refrigerators are of three principal types*

	Purpose used
Refrigerated case (made in lengths to 16 feet.)	Storage and display of meats, sea foods, dairy products, fruits and vegetables, etc., in retail grocery stores and meat markets.
Sectional cooler (range in size up to several thousand cubic feet; are equipped with doors and windows, meat rails and hooks).	Bulk storage of all types of perishable food; used wherever food is stored in large quantities.
"Reach in" refrigerators (up to several hundred cubic feet).	Bulk storage of all perishable foods, in stores, eating establishments, etc. Special types of hospitals and institutions.

Now, in the back of your brief you will find some figures, giving you the comparative tax that would be raised in our industry as compared with other groups, and you will also find in your brief a descriptive folder of what I am talking about.

Commercial refrigerators—the case and the cooler you see in the small grocery store around the corner and around on "Main Street" here in Washington—is what I have been talking about.

If there are any questions, the secretary of the association, Mr. Sullivan, is here and will be glad to answer them.

Senator DANAHER. Can you tell me the comparative number of units of the noncommercial type produced in this country, as related to the household refrigerators?

Mr. SULLIVAN. According to published figures, the total output of household refrigerators in 1940 was 2,720,000 units.

Senator DANAHER. Can you tell us the amount of material u-ed by commercial, as compared with noncommercial, types of refrigeration?

Mr. SULLIVAN. It is a small fraction. I cannot tell exactly how much, but the small production of commercial refrigerators as compared with household and other types shows that the amount of material required by our industry is quite small. For example, our total consumption of steel last year was about 18,000 tons.

Senator DANAHER. You mean that the commercial industry hit by this bill uses only a small fraction of the material?

Mr. HART. That is substantially correct.

Senator TAFT. That is of all the refrigerators?

Mr. HART. Yes.

Senator TAFT. You are advocating then that even though we tax the household refrigerator, we exempt the commercial?

Mr. HART. That is essentially so, although it should be remembered that household refrigerators have been subject to an excise tax for some years, and this is the first time an attempt has been made to tax commercial types. In Ohio, for example, commercial refrigerators are exempt from the sales or use tax law you have in your State, on the ground that they are essential for the preservation of food, and to enable food purveyors to meet health and sanitation standards. To place this burden on the small merchant today is to drive many of them out of business.

Senator DANAHER. Are you having any trouble with priorities for materials?

Mr. HART. Mr. Sullivan can tell you about that.

Mr. SULLIVAN. We face, very naturally, a very serious shortage. The OPACS is now contemplating a severely curtailed allotment.

Senator DANAHER. The reason for my question is Secretary Morgenthau testified here that these items had been very carefully selected from a list because they were competing with national-defense needs.

Mr. HART. Still our point is, our product is essential to health. You have heard it said, "Waste is defense's enemy No. 1." You have heard that time and time again. We waste enough food here to feed some of these smaller peoples in Europe.

Senator VANDENBERG. Do you agree, Mr. Sullivan, with what the witness said, namely, that he preferred a general manufacturers' sales tax?

Mr. SULLIVAN. I do, sir.

Senator VANDENBERG. Do you think that reflects the viewpoint of your membership?

Mr. SULLIVAN. I do, sir. We have a number of them here and that point has been discussed.

The CHAIRMAN. Thank you very kindly.

Mr. John E. Hughes.

Mr. Hughes, give your name to the reporter and state the capacity in which you appear.

STATEMENT OF JOHN E. HUGHES, CHICAGO, ILL., REPRESENTING THE CHICAGO BAR ASSOCIATION

Mr. HUGHES. My name is John E. Hughes. I appear to present the views of the Chicago Bar Association, which has between 6,000 and 7,000 members, on the question of taxation of income received in 1 year but earned over a period of 5 or more years.

I have my statement in writing and if I may read it I shall not detain the committee over 10 minutes at most.

The CHAIRMAN. I will be very glad if you will make it as short as possible because we have other witnesses.

Income earned over a period of years.—Section 107 of the Internal Revenue Code purports to give relief in cases where a law fee is received in 1 year but earned over 5 or more years, but the section is worded so narrowly that it rarely gives any relief at all.

As you know, one who has held stock in a corporation for over 2 years may sell it and pay a tax of only 16½ percent of the profit. Inventors, authors, prospectors, and about everyone except lawyers may incorporate and get the benefit of this, but not lawyers because corporations cannot practice law.

A lawyer might work 10 years on a large case on a largely contingent basis. During the first 9 years he might be paid a total of $600 a year to carry him along. In the tenth year if he won the case and received a fee of $100,000, under the House bill he would owe a Federal income tax of $54,168.40. He might never again in his life get so a large a fee. As indicated above the law affords a means of relief to almost everyone else. A contractor working on a contract taking years to complete may pro rate his profit over the contract's life.

The following report of the committee on Federal taxation of the Chicago Bar Association was approved by its board of managers and I have been appointed to present it to you for your consideration.

FINDINGS OF THE CHICAGO BAR ASSOCIATION COMMITTEE

Your committee finds that the law was written and as interpreted in the regulations (sec. 19.107-1) has not served the intended purpose of extending relief to individuals who have realized a substantial income in a particular year for tax purposes as a result of services rendered over a period of years. No relief is provided under the present law unless two conditions are fulfilled—

(1) The services must cover a period of 5 calendar years or more, as distinguished from 5 taxable years;

(2) Not less than 95 percent of the compensation must be paid on completion of the service.

The fact that the services have extended over 60 months is not enough if these 60 months have not coincided with the beginning and end of 5 full calen-

dar years; nor does it matter whether the taxpayer reports income on a calendar- or fiscal-year basis. If the services of a taxpayer covered 5 full fiscal years, he cannot obtain the benefits of this section unless the services also at the same time covered 5 full calendar years. Your committee also finds that the phrase "for personal services rendered by an individual in his individual capacity" is susceptible of several interpretations and may in particular cases give rise to unnecessary litigation.

When the foregoing is considered along with the further requirement that not less than 95 percent of the compensation be paid upon completion of the services, it is believed that very few, if any, taxpayers would be given relief under section 107 as now worded.

In studying this question, your committee has taken into consideration the drastic increase in surtax rates under the first Revenue Act of 1940, as compared to surtax rates existing under several preceding revenue acts. Your committee has also recognized that it is the patriotic duty of every citizen to willingly assume his responsibility toward his Government at all times, but revenue laws should avoid unreasonable hardships wherever possible. Where possible taxpayers should be placed on a basis of equality.

In view of the fact that surtax rates graduate upward, a net income of $100,000 includible in 1 year would be subject to a much higher tax than if $20,000 of income was applied equally over 5 taxable years, or $33,000 over 3 taxable years. A taxpayer who has a stabilized or guaranteed income of $20,000 per year has greater economic security than a taxpayer whose income is largely contingent and frequently finds his income bulked in a particular year for tax purposes.

Therefore, for the purpose of equalizing the present tax burden and the avoidance of unreasonable hardship, your committee makes the following recommendations:

Section 107 should be amended in four ways—

(1) By striking out the words "95 per centum" and substituting therefor the words "75 per centum."

(2) Striking out the words "5 calendar years" and substituting therefor the words "36 months."

(3) Striking out the words "in his individual capacity."

(4) Inserting the words "taxable" before the fifth word from the end of the section.

Section 107 would then read as follows:

"In the case of compensation (*a*) received, for personal services rendered by an individual, or as a member of a partnership, and covering a period of 36 months or more from the beginning to the completion of such services (*b*) paid (or not less than 75 per centum of which is paid) only on completion of such services, and (*c*) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall be the tax that would have been payable had it been received in equal portions in each of the taxable years included in such period."

Now, Senator, I have views here on other sections of the tax law.

The CHAIRMAN. Yes; I believe we undertook to deal with this question in 1939 and we had quite a struggle to do what we did for you. I agree, so far as I am concerned, that the 95 percent provision is an unjust one; 75 percent would be more nearly correct, and the 5 calendar year provision is pretty rigid, but we did have considerable opposition. The Treasury did not like it—this considerable loss of revenue; the difficulty was not so much in dealing with lawyers as dealing with other taxpayers.

Mr. HUGHES. After me a representative of the American Bar Association and the Illinois Bar Association speaks on the same point to the committee. Of course, it is a discrimination. If I am prospecting for oil or an inventor seeking a patent for my invention, I can incorporate, issue stock, hold it 2 years, then sell it and pay a tax of only 16½ percent of the profit. Even an author can do that. He can sell his work to a corporation and then sell its stock, but

a lawyer has no such relief and he is about the only individual under this law who has no such relief. It strikes a poor man hard, particularly a poor man's lawyer. A corporation lawyer does not ordinarily handle cases on a contingent basis and is, therefore, not so apt to find himself in a position where this law will work a hardship on him. Such a lawyer may work on a patent case for several years and finally collect a fee only to find that he has to pay 60 percent of it to the Federal Government, with a further probability that he will have to pay an additional State income tax.

The Chicago Bar Association authorized me to present to this committee my suggestions for the improvement of the revenue law and its administration. No action has been taken by the board of managers of the Chicago Bar Association on the following views, and I present them solely on my own responsibility.

Taxability of insurance.—At page 467 of the House hearings Mr. George M. Morris, chairman of the tax committee of the American Bar Association, suggested section 811 be amended to impose the estate tax only on insurance in which decedent at the time of his death owned any of the legal incidents of ownership.

I suggest that such an amendment would be about the equivalent of exempting almost all insurance from estate tax.

In the United States there were outstanding on December 31, 1937, 120,000,000 life-insurance policies with a face value of $110,000,000,000. Most of this is family insurance and it is a very easy thing for a husband to transfer the incidents of ownership to his wife and rely on her to give them back to him in case of need. It will be done if this exempts it from estate tax. Every insurance agent will make it a talking point. It ought to boost insurance sales to wealthy people.

The present regulation, making payment of premiums the test of taxability was adopted after long experience and from the standpoint of practical administration should be retained and perhaps even written into the statute.

Suggested amendment to statutory definition of reorganization.—During the unprecedented depression starting in 1930 hundreds of hotels, apartment houses, and industrial corporations were unable to pay the interest on their bonds and the bondholders took over the property and reorganized it in an attempt to salvage their investment.

The Treasury ruled in I. T. 2071 published C. B. 111-2 at page 34 that such a transaction was "the most common form of reorganization," notwithstanding the stockholders did not participate, and the Treasury consistently held the bondholders could deduct no loss. This Treasury ruling was affirmed by the Circuit Court of Appeals for the Seventh Circuit in the case of *Kitselman* (89 F. (2d) 458) and the Supreme Court denied certiorari in 302 U. S. 709. The Government's brief in the Supreme Court opposing the taxpayer's petition was signed by Solicitor General Stanley Reed and made an able defense of the decision below. The Board of Tax Appeals has consistently followed this ruling and that of the sixth circuit in the *Newberry Lumber Co.* case (94 F. (2d) 447).

When Congress was considering the 1934 Revenue Act a subcommittee of the Ways and Means Committee proposed to eliminate the reorganization provisions from the law, but both the report of the Senate Finance and of the Ways and Means Committees stated these

provisions should be retained and—to quote the Finance Committee—"Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders."

Now, after the statute of limitations bars the right of bondholders to deduct losses, the Treasury is claiming in the Supreme Court in the *Marlborough House case* that the foregoing Treasury ruling and circuit court of appeals decisions, upholding its own vigorous contentions, were wrong and that bondholders should have deducted their losses in the year of reorganization and must now pay a tax on the difference between the figure to which they should have then written down their investments, but did not and could not do so, and what they now get, albeit such sum is less than the original cash cost of their bonds.

The Board of Tax Appeals and the circuit courts of appeal for the second, fifth, sixth, eighth, and tenth circuits have decided against this grossly inequitable Treasury contention, but the circuit court of appeals for the tenth circuit has upheld and it is now pending in the Supreme Court.

This matter was discussed at pages 479 to 486 of the House hearings on behalf of the superintendent of insurance of the State of Ohio.

If the Supreme Court upholds the Government, its decision ought, in all justice, to be speedily reversed by legislation, and taxpayers ought not to be subjected to the hazards of what the Supreme Court may do. There is abundant precedent for reversing unwise or impractical Supreme Court tax decisions by ordinary legislation. A few of the tax cases thus reversed are *United States* v. *Hendler* (303 U. S. 564), by section 112 (k) of the code; *United States* v. *Michel* (282 U. S. 656), by section 3772 (2); *United States* v. *Swift & Co.* (282 U. S. 468), by section 3770 (3). While the decision of the Court of Claims in the case of Toxaway Mills (61 Ct. Cls. 363) was pending in the Supreme Court, the Senate decided taxpayers ought not to be subject to the hazards of an adverse decision and reversed it by section 3770 (a) (2). (See Congressional Record, vol. 67, pt. IV, p. 3531.) Also the decision of the Tax Board that the installment sales regulations were illegal was reversed, pending court decision, by the 1926 act.

The proposed amendment is as follows (the changes from existing law being printed in italic):

Proposed amendment to reorganization definition.—Section 112 (g) (1) of the Internal Revenue Code is hereby amended to read as follows:

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all of the properties of another corporation, *including the acquisition through foreclosure, judicial sale, or receiver's sale, if after such acquisition an interest or control of 50 per centum or more in the assets transferred remains in the bondholders or stockholders of the prior corporation,* or (C) a transfer by a corporation of all or part of its assets of another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected. *The amendment made by this section shall be retroactive to January 1, 1930. Provided, however, that if a transaction amounted to a reorganization under the law existing at the time of its consummation it shall constitute a reorganization for purposes of this amendment.*

A special court of tax appeals.—It is suggested that your committee give consideration to the creation of a special court of tax appeals,

composed of tax specialists of at least 15 years' experience to have exclusive jurisdiction of appeals in all civil Federal tax cases and the decision of which is to be final except on constitutional questions, with respect to which review may be had in the Supreme Court by certiorari.

The Federal tax laws are extremely complicated and are becoming increasingly so. Furthermore, many of the problems presented are vitally involved with the Nation's commercial life. To properly understand and apply these laws so as to avoid inconsistencies and absurd results requires a background of years of extensive experience and a clear conception that most principles of tax law cut both ways. The members of the circuit courts of appeal do not have or profess to have this specialized experience, with the result that the decisions are conflicting and inconsistent on all important tax questions, and according to some of our leading law-school reviews some of them approach the borders of absurdity.

Further, the dockets of some circuits are far behind. For example, a tax appeal docketed in the sixth circuit court of appeals April 3, 1940, could not be heard before April 15, 1941, or over 1 year after it was docketed, despite efforts of counsel to push it to prompt hearings. Also the circuit judges frequently hold tax cases under advisement for weeks after they have been argued and submitted. Failure of our judicial personnel to keep pace in ability with the increasing complexities of life, and persistency in applying horse-and-buggy-age procedure in the decision of cases in an airplane age have been the main reasons for the debacle in judicial prestige during the past decade.

In addition, about one-fourth of the time of the Supreme Court is taken up considering Federal tax cases involving solely technical points of taxation. In the overwhelming majority of those in which the courts of appeals have differed from the Board of Tax Appeals the Supreme Court has sustained the Board, thus indicating the superiority of the judgment of an expert, specialist, administrative personal over that of a circuit court of appeals too often composed of lame ducks and country judges to whom tax law is as strange as patent law. With the exception of the very able personnel of the second circuit court of appeals and a few other scattered judges it may be said the judiciary is neither adequately experienced nor mentally equipped to cope with extremely complicated and technical tax problems. By this I do not intend to imply that all the circuit judges are not above the average of ability at the bar. What I mean to express can be conveyed by saying that if I or most members of Congress should be put on the bench of the circuit court of appeals tomorrow and the first case given us for decision was an extremely complicated and very involved technical patent case we would not be nearly so well equipped to decide it as a patent specialist with a background of 20 years intensive experience. So it is with tax cases. Certainly the people are entitled to the greatest competency in those deciding these questions.

A tax appellate court, composed of eminent tax specialists of similar caliber and national reputation to Randolph E. Paul and Robert H. Montgomery or of several of the present members of the Board of Tax Appeals or Court of Claims or of three circuit judges one could select, could comprehend the issue involved immediately and decide most of the appeals at the conclusion of the argument as the

English Courts of Appeal do and always have done. Continued specialization would increase the ability to do this. Over 50 percent of appeals involve no new principle and should be decided per curiam without a long-winded opinion, issued weeks after the argument. Candidly the reason the English courts are able to and do decide cases at the conclusion of the argument and ours are not is due primarily to a difference in the experience and mental ability of the judges. Men appointed to the bench should be of sufficient mental caliber that they do not need to hold cases under advisement for weeks and sometime months. If they were the equals in ability of English judges our decisions would also be delivered at the conclusion of the argument as they are in England. The English judges are paid about $25,000 a year, which buys more over there than it does here, and you are not going to get men of equal ability here to serve on such a proposed court for less than that. Salaries of $12,000 a year will, with some notable exceptions, get you lame ducks, country judges, and petty politicians, jacks of all trades and masters of none, experienced in personal inquiry suits and petty cases, and who never earned and never will or could earn $12,000 a year at the bar. The great difference in the respect for the courts here and in England is due to the difference in the mental caliber of their personnel. This special court might be given power to make rules for the Board of Tax Appeals so that it could expedite the decision of cases there.

This court of tax appeals could hold hearings throughout the country in the principal cities where the circuit courts of appeal now sit and by hearing only tax cases, making prompt decisions, and eliminating the long-winded opinions which now constitute the decision of almost every appeal, it would soon bring tax appeals current and hundreds of millions of uncollected revenue would not be tied up in pending cases, which drag on for years, often until the tax becomes uncollectible, as in the case under the existing procedure. Inquiry will disclose that hundreds of millions in revenue are tied up in pending tax appeals, the prompt settlement of which would greatly augment the revenue.

The committee on Federal taxation of the Chicago Bar Association voted in favor of this proposal for a special court of tax appeals.

Discrimination in favor of residents of community-property States should be abolished.—Under the House bill a married man with no dependents living in California or one of the other seven community-property States having an income of $100,000 from personal services pays a tax of $20,002.40 on half of it and the other half is reported in his wife's return and $20,002.40 paid on that. If this man had lived in any one of the other 40 States he would pay a tax of $53,310.40. It is indefensible that the accident of residence in one of the eight community-property States should result in $13,305.60 less tax on an income of $100,000. Where the income is higher the tax saving is proportionately greater. The President in his message of June 1, 1937, suggested this be corrected. The income tax on income from personal services is an excise and the Constitution bluntly says excises must be uniform throughout the United States. You cannot convince the ordinary citizen they are uniform when they operate that way. Members of Congress from the other 40 States ought to wake up to this

discrimination and eliminate it. One way you can get millions more in revenue is simply by putting all United States citizens on an equal basis.

Thank you, sir.

The CHAIRMAN. Thomas Owens.

STATEMENT OF THOMAS OWENS, CHICAGO, ILL., ON BEHALF OF THE CHICAGO BAR ASSOCIATION

Mr. OWENS. My name is Thomas L. Owens. I am here on behalf of the Chicago Bar Association. The American and Illinois State Bar Associations are in accord with the recommendations of the Chicago bar. I have brought with me a number of the Chicago Bar Association records for the month of June 1941 which I have turned over to the clerk for the use of the committee. The recommendation of the bar is included in the record.

Last month I was in Washington and took the matter up with the Treasury Department and with Mr. Stam. I feel that there are a few things which I can mention which are different from the points covered by Mr. Hughes.

I notice what was said about the 95 percent being changed to 75 percent, but I wish to say that the change in the number of years might be an even more important feature because the vast majority of lawyers do not deal with fees of $100,000 or $50,000 but rather with much smaller fees. Generally their work upon estates and on matters involving real and personal property taxes, refunds on public-utility matters, representative suits against bank stockholders, suits on behalf of minority stockholders, and so forth, occupies a period of 3 to 4 years during which time they barely make a subsistence or perhaps $3,000 to $5,000 at the most. Then in the third or fourth year they receive a fee of $20,000 to $25,000, whereupon they must pay two or three times as much tax under the law as if they had received the same fee in proportionate amounts in the years they worked for it. Under the present change in the tax rate the increase will be much larger.

The Treasury Department suggested changing the present section 107 by using the word "taxable" in front of the word "years" instead of the use of the word "calendar" as is now shown in the act. In other words, they advocated stating in the act "5 taxable years" instead of changing it to "36 months" or "3 calendar years." Mr. Stam suggested merely changing the word "five" to "three." At the present time, in order to come within the purview of the law it is necessary that a person actually work for 6 or 7 taxable years. I would say that 999 lawyers out of 1,000 would not be helped by the present provision. The reason the bar is suggesting 36 months is to bring the time within the fiscal instead of the calendar years. I believe one of the changes should be placed in the act. If you cannot see your way clear to make it 36 months then the word "five" ought to be changed to "three" or the word "calendar" should be changed to "taxable."

Some statements have been made to the effect that administrative changes are not going to be made until the next session. I realize the committee has worked very hard in completing the present bill and would not relish trying to fit the changes into it at the present

time. If it appears necessary to wait until the next session to make the change, may I suggest that it at least be made retroactive?

I wish to thank you very much for the privilege of appearing before the committee.

The CHAIRMAN. Thank you, sir.

Mr. MacDonald.

STATEMENT OF J. A. MacDONALD, NEW YORK, N. Y., REPRESENTING THE CONTROLLED COMPANIES OF THE AMERICAN DISTRICT TELEGRAPH CO. AND SUBSCRIBERS

Mr. MACDONALD. My name is J. A. MacDonald. I am here on behalf of the controlled companies of the American District Telegraph Co. and the 30,000 subscribers to their central station fire, sabotage, and burglary prevention services in 39 States of the Union. I also represent, in order to conserve the time of the committee, the Holmes Electric Protective Co. of New York and Philadelphia; the Central Station Signals, Inc., of New York City.

My appearance here concerns the imposition in H. R. 5417 of a 5-percent excise tax on wire and equipment services defined to include burglar alarm and all other similar services. We believe that this provision is broad enough in definition to include not only burglar-alarm service, including the best-known forms of sabotage detection, but also all types of fire protection. I have here some reasons why we believe the tax should not be imposed:

1. The companies supplying such services are not telephone, telegraph, or communications companies, are not engaged in interstate commerce, and are not vested with a public interest.

2. Wires used by companies supplying such services are leased from telephone and other wire-using companies, and the use of wires is an incidental part of the comprehensive services supplied. No messages are sent over these wires but fixed, unvariable signals, automatically transmitted by mechanical means to central-station attendants to indicate disturbances of the protection arrangements within protected premises. These signals would have no use or value, except for the subsequent action taken by central-station attendants in investigating their causes and dispatching investigators, guards, maintenance men, or the municipal fire or police departments, as required.

3. The services are not essential to the conduct of business as are electric, gas, water, transportation, or communication services supplied by public utilities. A concern can do without any special protection, or it may rely entirely upon insurance or upon watchmen or upon an alarm which merely rings a bell within or on the outside of the premises, all as substitutes for central-station protection, under continuous electrical and manual supervision and maintenance, which dispatches its own armed guards and summons the municipal fire and police forces when needed.

4. The services supplement municipal fire and police protection, providing special protection to concentrated values and against special hazards. The total paid by subscribers to such services amounts to a tax already self-imposed to supplement the protection afforded by the municipality to general taxpayers.

5. The effectiveness of the services in safeguarding lives and property is attested by their proven record in minimizing fire and burglary losses and in capturing burglars and by the substantial recognition of such agencies as the National Fire Protection Association, National Board of Fire Underwriters, International Association of Fire and Police Chiefs, Safety Councils, Fire Marshals, and all fire and burglary prevention authorities as well as the 30,000 prominent concerns who employ and pay for such services.

6. By adding to the cost of the services the proposed tax very definitely would discourage their retention and growth and encourage reliance upon inferior, ineffective substitute protection measures or none at all. The fact that there are only 30,000 subscribers to central station services—a small fraction of the number of prospective users—is eloquent proof that cost definitely limits the extent of their use despite their far-reaching and immeasurable value.

7. The value of properties protected, excluding banks, exceeds $21,000,000,000. It is obvious that one single and comparatively small loss through a single fire, act of sabotage, or burglary where central station might have been employed and prevented the occurrence but for this proposed tax, could destroy far more in property value, alone, than the total revenue contemplated by the proposed tax. Plants can be rebuilt in time, but sacrificed lives cannot be restored nor can lost hours of production be regained. The far-reaching effects of interrupting business, production, and employment in a single plant upon the production of other plants and the whole program for safeguarding the national safety and health is quite obvious.

8. The Federal Government, through its military and naval commands, Federal Bureau of Investigation, Office of Civilian Defense, and other agencies, is sparing no effort to have all plants which are vital to national defense and to national health and safety made as safe as possible against destruction or interruption through fire, sabotage, and kindred hazards. Other agencies are working with the problem of procuring more buildings, machines, and materials to produce armaments. It would be most unfortunate and inconsistent to discourage the retention and growth of this invaluable protection at this time when there is such stern necessity to expand and speed up production and to surround it with every reasonable safeguard against unnecessary interruption from any cause, among which fire and sabotage are greater than ever and constantly increasing.

9. It is estimated that the proposed tax would yield a gross return of about $750,000 but that would be reduced more than a third by reason of the consequently reduced tax payments of the concerns who pay it; and it might very well result in a final net loss of revenue to the Government—because a plant that has burned doesn't make profits or pay taxes, the taxable incomes of its employees cease and they may add to unemployment and relief rolls, the incomes of those whom the concern and its employees patronize are reduced, and if an insurance company pays the loss, its taxable income in turn is reduced. The possibility of increased revenue in reasonable prospect seems a puny justification for such a great gamble.

10. It is respectfully requested that the words "burglar-alarm service" be deleted from the bill, and that the following sentence be

added: "Nothing herein shall be construed as imposing this excise tax upon amounts paid for central station fire or buglar protection services."

Senator TAFT. How many subscribers are there to the other services?

Mr. MACDONALD. The controlled companies have about 30,000 subscribers. I should say in the aggregate all other suppliers of central-station service do not serve in excess of 15,000.

Senator GUFFEY. What is the average cost to these 30,000 subscribers?

Mr. MACDONALD. It depends entirely on the extent of protection provided.

Senator GUFFEY. Well, there must be some average.

Mr. MACDONALD. Yes; I should say $300 or $350 a year.

Senator TAFT. This would therefore increase the charge by from $14 to $17.50 per subscriber?

Mr. MACDONALD. The use of averages is always misleading, the amount runs from sums such as you mention to sums in excess of $1,000 per subscriber.

The CHAIRMAN. You do not own the wire, you simply lease the use of the wire?

Mr. MACDONALD. Yes; the services are supplied almost entirely over leased wires.

The CHAIRMAN. You are not therefore directly competing with any defense or emergency production project for strategic materials?

Mr. MACDONALD. We do employ some very small quantities of material within the properties protected and in that respect the Government has recognized the importance of the services we supply in protecting plants engaged in defense rearmament work, and the need which we have for certain materials. Right now we are furnishing service to Glenn Martin, North American, United Aircraft, Curtiss-Wright, Lockheed, and a number of other aircraft manufacturers; we are protecting shipyards as well as many other concerns engaged in rearmament, including General Motors, Chrysler, Ford, Hercules Powder, American Cyanamid & Chemical, to name but a few. The Office of Production Management has recognized the importance of this service and they have given us great assistance in procuring such small amounts of material required by us in order to give this service. We feel it would be a grave mistake to attempt to tax this service at this time.

The CHAIRMAN. All right; if there are no further questions, we thank you.

Mr. MACDONALD. Thank you, sir.

The CHAIRMAN. Mr. Dorrance.

STATEMENT OF CHARLES DORRANCE, CINCINNATI, OHIO, PRESIDENT, WEST VIRGINIA COAL & COKE CORPORATION

The CHAIRMAN. Will you give your name to the reporter, please?

Mr. DORRANCE. My name is Charles Dorrance. I am president of the West Virginia Coal & Coke Corporation, a company incorporated under the laws of West Virginia and engaged in the production and sale of bituminous coal. This petitioner has been engaged in such business since 1929 as successor to a company of the same name which

went through bankruptcy proceedings during the years 1927 to 1929. In 1941 we will produce in excess of 3,000,000 tons of bituminous coal.

This petitioner wishes to show the unfairness and discrimination to itself and to a major portion of the bituminous-coal industry which would result from that proposed provision for excess profits, "Special rule in certain cases where invested capital is used," title II, Excess Profits Tax Act, section 201, amending 710 (a) of the Internal Revenue Code.

The Ways and Means Committee of the House has recommended this special rule because—

> Many corporations which are making added profits directly or indirectly attributable to governmental expenditures for national defense are paying no additional taxes upon such profits. It is felt that such corporations benefiting so substantially from defense expenditures should make a larger contribution from their increased income, even though their income for the taxable year is still less than their invested-capital credit.

The petitioner recognizes the urgent need for revenue by the Federal Government and is glad to support any tax measure that would be just and which would not discriminate as between individuals, corporations, or industries. As far as this petitioner and the major portion of the bituminous-coal industry are concerned, the specific reason given for this special rule by the Committee on Ways and Means does not apply. The ability of this petitioner to earn a reasonable profit is not attributable directly or indirectly to governmental expenditures for national defense, but its ability to do so is directly due to the establishment of minimum coal prices on October 1, 1940, under the Coal Act of 1937. The total earnings of the petitioner may be affected by governmental expenditures for national defense, but only to the extent that they are not a reasonable return. In this case earnings would quite rightly be subject to the regular excess-profits tax provisions of the act.

In the 10 years since 1929 up to and including September 30, 1940, the petitioner has shown a net loss from its operations in the amount of $1,427,000. In only 2 years, namely, 1934 and 1935, under the National Recovery Administration, has the petitioner shown a profit. On October 1, 1940, the minimum prices under the Coal Act of 1937 (Guffey bill) finally were made effective, and as a consequence thereof the last quarter of 1940 showed a net profit for the petitioner of $172,000. It is important to point out that in those periods in which the company showed a profit its main business, namely, the production and sale of bituminous coal, has been regulated by a Government agency, and further, that in all these three periods of profit the operations of the petitioner were not benefited by any unusual governmental expenditures.

To show that the ability to earn a reasonable profit by the petitioner is not dependent on increased purchases demanded by national defense, a comparison is hereby given of the tonnage and earnings made in the last quarter of 1939 and the last quarter of 1940:

> Last quarter of 1939, tonnage 794,000; income $87,000.
> Last quarter of 1940, tonnage 642,000; income $172,000.

It will be noted from the above tabulation that with a 24-percent decrease in tonnage, fixed minimum prices effective on October 1, 1940,

caused a comparative increase in income of 98 percent. Also please note that in neither of the above periods did governmental expenditures for defense have any bearing directly or indirectly on the results of the petitioner's business.

In the first 6 months—October 1940-March 1941—when the industry was under regulation and minimum prices were in effect under the Bituminous Coal Act, the petitioner's coal sales realization averaged $1.92 per ton. In the similar period—October 1939-March 1940—when prices of coal in the industry were not regulated by the Government, the average sales realization of the petitioner was $1.65 per ton. This increase of 27 cents per ton in sales realization through governmental regulation is clearly the predominating factor in producing a profitable operation as compared with the losses in the past.

To emphasize further that stabilized Government prices, and not national-defense expenditures, are the reason for the bituminous coal industry, and for this petitioner, showing reasonable profits at the present time, we wish to give herewith a statement showing that the petitioner during the base period for excess-profit credit, namely, from 1936 to 1939, inclusive, would have shown, with Government-regulated prices, a profit of $1,494,000 instead of a loss of $1,114,000.

	Actual net losses	Tons coal sold	Average realization per ton	Estimated additional revenue based on code prices (average, $1.92 per ton)	Adjusted income (profit) had sales been made at code prices
1936	$80,000	2,544,000	[1] $1.64	$712,000	$632,000
1937	344,000	2,369,000	1.71	498,000	154,000
1938	530,000	1,772,000	1.60	567,000	37,000
1939	160,000	2,443,000	1.58	831,000	671,000
Total	1,114,000	9,128,000	1.64	2,608,000	1,494,000
Deduct actual losses from estimated additional revenue				1,114,000	
Estimated earnings based on average code price of $1.92				1,494,000	1,494,000

[1] Adjusted upward 10 cents per ton to take care of wage increase in 1937.

The petitioner, like other members of the bituminous-coal industry during the above base period from 1936 to 1939, was the victim of what the Supreme Court called a free competition degraded into anarchy. The industry and its members were freed from this condition only by minimum prices made effective October 1, 1940, by the Coal Division of the Department of the Interior.

As the stated reason given by the Ways and Means Committee justifying this special rule is clearly shown not to be true in the case of the bituminous-coal industry, its adoption would discriminate against the petitioner and against a large percentage of the bituminous-coal industry.

It is not the aim of the petitioner to oppose tax measures which fairly distribute the burden of defense among the individuals and corporations of this country. We do feel that the facts which we have given show clearly that the adoption of such a special rule would be unfair

and discriminatory to the great bituminous-coal industry. We feel it would be a mistake to impose such discrimination upon a vital industry whose background of poverty and the reasons therefor are so well known.

The CHAIRMAN. Mr. Dorrance, you say that a large percentage of your industry finds itself pretty much in your position.

Mr. DORRANCE. Yes; I understand that the executive secretary of the National Coal Association is to appear here later on, and also some other members of the industry.

The CHAIRMAN. The nature of your industry, of course, requires you, and your past history requires you, to take the invested-capital rule.

Mr. DORRANCE. Yes; but this rule put in the bill by the Ways and Means Committee says that if we do that, if we elect to take the invested-capital credit and have no earnings, as we have—the petition has no such earnings—and suppose we made $500,000, we would then have to pay 10 percent on it.

The CHAIRMAN. Although you don't earn as much as you are entitled to earn under the invested-capital credit, nevertheless, as long as you are making more than you formerly did, they would think it right to impose this 10 percent on your.

Mr. DORRANCE. Now, I am not speaking for the stockholders of the particular company I represent, although I may say that such stockholders should be entitled to some consideration, having invested $10,000,000 in the purchase of its securities, bonds, and stocks, but I am thinking of the vital industry, and I know of no more vital industry to the defense program than ours, which has been starved for 10, 15 years; and I can give you, I think, as good a concrete example of what I want to do with the large amount of the money I make as you would want. Our entire properties are dependent on one powerhouse. We are now running two boilers that run the turbines that make the electricity for our mining at 300 to 400 percent rating. They have never been properly overhauled or renewed because of the fact that we cannot shut them down. We cannot supply power to our mines unless we have these boilers going. I have wanted to put in an extra spare boiler that would allow for that for all of the years that I have been with them, and my predecessors have done the same, and we have never had the money to do it. We have got innumerable calls on our money in order to keep the flow of bituminous coal flowing in the quantities necessary for this defense movement.

The CHAIRMAN. Well, I understand the reasoning of the Ways and Means Committee and Treasury Department, but it is a very difficult tax to justify at all, because you haven't made any extra profit, and that is the answer to it. Your tax has gone up 24 to 30 percent on your normal. You are paying for that a considerable percentage over in increased rates on the normal, and you haven't reached your credit base because you have done a little better, which you attribute to other reasons than defense, which probably has great force, but in any industry it is hard for me to reconcile this thing because you haven't earned your credit and that seems to me to be the answer and an answer I cannot argue around. You simply haven't any excess profit until you reach the amount where your excess profits begin.

Any other questions?

(No response.)

The CHAIRMAN. Thank you, Mr. Dorrance.
Mr. DORRANCE. Thank you.
The CHAIRMAN. Mr. Flanagan.

STATEMENT OF WALTER J. FLANAGAN, BROOKLYN, N. Y.

The CHAIRMAN. Will you give your name to the reporter and state for whom you appear if you are representing anyone other than yourself?

Mr. FLANAGAN. No; I do not.

My name is Walter J. Flanagan. I am a natural-born citizen, resident, and elector of the State of New York. I tried to appear before the House Ways and Means Committee, but was too late, and made application immediately to appear here. What I wished to say then didn't come up before the House Ways and Means Committee; therefore I appreciate this opportunity to do so now.

My views are mine alone, yet I think the committee is honoring itself because there are many millions just like me, who have children, more to give than dollars.

We know the President was authorized by law, and justified by the wars raging, to declare an unlimited national emergency, asking all to pledge, if need be, "our lives, our fortunes, and our sacred honor." That the national-defense program is imperative; that its planned cost has already reached $50,000,000,000; that taxes must be levied at the highest rates yet invoked; that this bill now before the committee is the first major step to achieve that purpose—an act to provide revenue, and for other purposes. I am not concerned with the revenue item; my interest is in "the other purposes."

Now, all the experts, both of our own departments and foreign experts, and of the Nation, have spoken for what I may summarize as the disciplines that govern them. I will make that clear as I go on. The work cannot be reviewed, yet I disagree, and that disagreement is general and specific.

Before, during, and after the last World War you made tax laws of this same type and character containing the same identical pattern of disciplines, and what was the result in the light of the experience now? You cannot be untruthful about it. It is real, cold, and hard facts, and this is it: The people of the United States were not protected as they should have been. This is evidenced by the fact that they have been paying for 25 years, interest on $13,000,000,000 of debts of nations that govern half the world's population and rule over half the earth's territory. The gold content of the dollar was then reduced to 59.6 cents.

Now, if you retrace your steps and follow the same identical pattern of disciplines, what is going to happen? You are apprehensive of it yourselves. I don't have to sit in judgment on you because you have passed the law renewing the President's right to lower the gold content of the dollar in any way he chooses. These are the facts that you have to consider.

This conquest will be evidenced by legalized money demands against the people, against their homes, their farms, and factories, all their enterprises, all the physical properties in excess of 100 percent of their possessions. They will not be debts due themselves, except in a minor

degree; they will be due the tax-free wealth holders of the world.

Taxes are levied to protect a free people; they gladly pay taxes with that characteristic. If that characteristic is missing, or the people are not free, all taxation is an abomination.

When the disciplines of the experts clash and are in conflict with the fundamental rights of a people, when they are so great as to be measured by the scale of appropriations now being made for national defense, the disciplines must be abolished and abolished forthwith.

It is here before this committee, free America has its last chance to be vigilant against a conquest from within.

On that account the bill before you, gentlemen, is defective. What is wrong is ascertainable. It is not a mystery. It must be pointed out and identified.

The tax bill does not protect the people; it protects first, last, and always, omnipotent wealth. The President calls it omniscient wealth, without a definition. It is the tax-free wealth in all countries. It can operate anywhere on the face of the earth; it has no laws binding on it; it gives allegiance to no flag. Any nation that goes to killing on account of these disciplines is wrong. What good does it do to kill 4,000,000 Russians? To kill 4,000,000 Chinamen? Are you being asked to have 4,000,000 Americans killed to settle the ownership by tax-free wealth of the rubber, tin, oil, and quinine in the Dutch Indies? China, at the price paid, should own it all.

The American people are ready, able, and willing to give you their sons and daughters to defend America, to protect their own families and neighbors against attacks, and to uphold and defend the Nation's honor, to aid the Union oppose ruthless aggression by any nation. We give you them as free men and women, not slaves, serfs, or a captive or subjugated people. None of their fundamental constitutional rights are surrendered and you cannot ask such surrender. We do not give you them to fight an undeclared war and protect the tax-free wealth of the world; or to fight for and defend the tax-free wealth which operates to make a conquest of our country from within. We abhor their unknown commitments, because untaxed wealth in industry, regardless of the piety or wickedness of the owner, saint or sinner, is always lawless. In all ages of civilization, under every flag, untaxed wealth refuses by foul means only—and some of the disciplines or provisions of this bill are in that category—to give to Caesar the things that are Caesar's, and against every race, nationality, creed, and color fights man giving to God the things that are God's. It makes all wars; breeds all rebellions; and provokes all revolutions. It considers all governments crooked; none straight. It deems itself mightier than any government; putting kings on thrones and knocking them off.

It therefore follows that a new and higher intelligence must write the tax laws; an intelligence that is concerned in protecting the many and not safeguarding the few; an intelligence that will not allow free America to be conquered from within. Let anyone in America make a million, ten million, or a hundred million, or have that much; that's America; but under an unlimited national emergency let him pledge every dollar of that to American defense—not to make more profits but to pay like taxes as compared to others—and the only proof he has of honorably fulfilling that pledge is in paying taxes each year on every dollar he has and on every dollar of income.

It is not necessary that any people be killed. It is wrong for any nation to kill people to get rid of protected tax-free wealth. The disciplines that do the hurt can be abolished by proper legislation. The people have a right to demand it of you as their representatives. We do demand it. We want to remain a free people. We do not want to be put in bondage. We are determined to remain a free people. That's what we'll fight for, even if you plan a conquest.

The preservation of these disciplines imposes involuntary burdens, does injury to all the people. They allow the tax-free wealth of the world to alienate the mastery and control of American productive labor and industry from taxation. It is the foundation stone of ruthless aggression within the Nation. One hundred and twenty-six thousand Americans died in the last war to abolish all such disciplines and involuntary burdens. You cannot ask Americans to die twice to get rid of those disciplines.

We do not need another war to have faith in our country. None need die again for freedom. That was our heritage from the Revolutionary War. None need die again to abolish slavery here. That was our heritage from the Civil War. None need die to stop a conquest of the United States of America from within or without by ruthless aggression, swindling, and plundering. It was our heritage from the first World War. We cannot break faith with the honored dead.

Without being specific as to the other pertinent provisions in the bill, I ask that you read in conjunction with this contention the following American principles for taxation by reason of the national-defense program:

1. It is a crime of the blackest hue for the national-defense billions to create new wealth untaxed in any one year by whomsoever received—and that includes all religious, charitable, literary, scientific, and educational institutions or their convenient holding company, with a Federal or State charter.

2. It is a crime for any wealth in the United States to go untaxed in any one year—including stock bonus to officers—during this crisis, which derives an income from the production of arms, munitions, and implements of war.

3. It is a crime of a blacker hue, because treasonable in character, for American wealth wherever located and by whomsoever owned to go untaxed, which is engaged in furnishing arms, munitions, and implements of war to those nations whose policies are admittedly the cause of making this Nation expend billions for defense, *to procure* a two-ocean navy, and mobilize our youth in the millions for 30 or more months for training in war.

I therefore petition you to strike out subdivision 14 of section 101, Internal Revenue Code, 1940, reading as follows:

> Corporations exempt from taxation:
> 14. Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the taxes imposed by this chapter—

having special reference to subdivision 6 of section 101 in conjunction therewith, reading in part:

Corporations exempt: Religious, charitable, scientific, literary, or educational purpose. No part of net earnings which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation.

4. It is a crime for any wealth to exist in the United States or income to be derived therefrom tax-free by any foreigners or alien corporations or institutions, used in industry or in competition, lawfully or lawlessly—treaties to the contrary notwithstanding.

As to that specification, I refer to section 107, reading:

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States—

calling attention to the fact that all treaties are within the jurisdiction of the Senate and that all provisions of such treaties sustaining disciplines abolished by the death of Americans in the last World War should be outlawed; also, in that connection, it should be borne in mind what is being done under the lease-lend bill—what the R. F. C. and its corporations are doing for countries of the Western Hemisphere. These are burdens that fall on the taxpayers.

We protest against the issuance of watered stock against the taxpayers' dollars. Let me illustrate:

The Government wants a million-dollar defense item. It has selected the "free enterprise" to undertake the job. The "free enterprise," perfectly competent, hasn't the necessary capital. The Government loans an adequate sum, say, a million dollars for round figures. It can be more or less. It then permits the borrower to amortize that debt over 5 years. With prospects of other orders, the borrower decides to capitalize his venture, or increase his capital if a going concern, by the issuance of more stock, to which the public subscribes. This is the situation: The Government is operating on a deficit; it hasn't the money to buy the $1,000,000 item; it hasn't the $1,000,000 to loan the borrower. What happens? For a single service costing $1,000,000 the Government has permitted legalized money demands to be thrown out against the productive toil and industry of America—an indebtedness of the Government bearing interest for $1,000,000—an indebtedness perhaps made by the R. F. C. of $1,000,000, also bearing interest—an indebtedness of $1,000,000 for a "free enterprise" entitled to earn 8-percent claims against the American people; a total of $3,000,000 for a single $1,000,000 service.

That is not all. I am referring now to the disciplines in your tax bill. Under the amortization the borrower does not repay $1,000,000 cash. He pays part of it every year, and on the fractional part paid the first year the Government must earn interest at the same rate it charges the borrower for 4 years; on the second installment, interest for 3 years; the third installment, interest for 2 years; and for the fourth installment, interest for 1 year; so that with the fifth installment the Government has 100 percent of the debt to liquidate the loan wherever it was obtained. This is the rub: As each installment is paid, the Government spends it; and the interest is never earned—4, 3, 2, and 1 years' interest—now multiply that in the billions and tell the people these disciplines are justified.

Abraham Lincoln said:

But it has so happened, in all ages of the world, that some have labored and others have without labor enjoyed a large portion of the fruits. This is wrong

and should not continue. To secure to each laborer the whole product of his labor or as nearly as possible is a worthy object of any good government. * * *

The burdens you are putting on the taxpayers by these objectionable disciplines are unjust, unreasonable, and oppressive, and transgress the blood sacrifices they made in the last World War. You can only do it by an abuse and usurpation of office.

In an executive session, under oath, I would like to submit evidence to concretely substantiate the grievances against which the people have a just complaint to obtain redress either here and now or in the Supreme Court.

The CHAIRMAN. Mr. Doyle.

STATEMENT OF RICHARD S. DOYLE, WASHINGTON, D. C., REPRESENTING THE CAPITAL YACHT CLUB

Mr. DOYLE. I represent the Capital Yacht Club of this city, Washington, D. C. Mr. Chairman, I am not here seeking relief. I am just asking this committee if it will kindly consider the clarification of a provision in this section 543, which undertakes to enlarge the definition of "dues." The Capital Yacht Club is representative of boat clubs, many of which are on this coast and on the other coast and on Chesapeake Bay, and it and its members pay taxes on dues. Under section 558 of this bill there is also imposed a graduated tax on the use of boats, so that by enlarging the definition of "dues" in this act, section 543 (b), we presume that the Ways and Means Committee did not intend to tax as dues a facility which boat clubs generally afford to their members, and that is the provision of berths for dockage and storage of boats. Now, the definition as enlarged in this act reads:

> The term "dues" includes any assessment, irrespective of the purpose for which made, and any charges for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities for any period of more than 6 days.

We believe that the Treasury Department may undertake to tax the rental of berths for dockage and wharfage facilities as "additional dues."

The CHAIRMAN. You mean include the fees payable for those services in the regular dues?

Mr. DOYLE. Yes. Now, those are distinctly service privileges as distinguished from these other services. While the proposed amendment is evidently intended only to cover club charges for social athletic, and sporting privileges and facilities, as distinguished from service charges, yet the language of the section is not too clear, and the reason I call it to the committee's attention is this: It is a service rendered members, and if a boat owner is taxed for that service as part of his dues, he will naturally take his boat to a shipyard or some commercial place and store his boat there in preference to leaving it at the club.

The act as it now stands defines "dues" to include assessments, and doesn't specifically include these other classifications.

Senator CONNALLY. The point is that if they didn't do that they would just charge nominal dues. The charge would be for these other services with nominal dues.

Mr. DOYLE. That may be true; but I call your attention to section 558 of this same act, that imposes a graduated tax on boats ranging from $5 to $200. Now, we don't think that the Ways and Means Committee intended to impose an added tax on the service of boats where they have imposed in the same bill a graduated tax on the use of boats. Now, we are not asking for relief; we would like to have this clarified.

Senator CONNALLY. You mean yacht clubs and such?

Mr. DOYLE. We are not asking for relief. If it is intended to tax the use of boats, let us put it all in one place and not leave it open in such a way that these services may be construed to be such as liable for dues, because the services of dockage and wharfage are not sporting or social privileges; they are service privileges.

I want to correct one impression that seems to exist, namely, that every yacht owner is one of the wealthy class who may be easily hit for revenue. That is not true. In our club of 126 members there are only 8 members in the club that maintain a boat hand on their boats. The large number of boat owners up and down the coast and on Chesapeake Bay are young men who have small boats that they build, operate, and maintain themselves; they do not have a crew.

Senator CONNALLY. That is because they like to run the boats themselves.

Mr. DOYLE. Well, they don't have anyone on the boat as an employee.

Senator CONNALLY. That is because they want to do the work themselves; they don't go to work in the boat, do they? It is not a necessity.

Mr. DOYLE. No; it is a luxury and taxed as a luxury when they pay their dues—their tax on the use of the boat.

Senator CONNALLY. What are the dues in your club?

Mr. DOYLE. Just nominal; $25 a year.

Senator CONNALLY. Exactly. We wouldn't get any tax.

Mr. DOYLE. You get a tax under this bill, an increased tax. They have lowered the exemption in this bill.

Senator CONNALLY. You want either the dues exempted or the boats exempted; is that the idea?

Mr. DOYLE. No. We are asking that the dockage and wharfage charges not be included as a part of the dues.

Senator BAILEY. In other words, it is a question of definition. You think dockage and wharfage should by definition be excluded from the term "dues"?

Mr. DOYLE. Yes; as services, as I have indicated.

Senator GUFFEY. What is the average charge for a berth?

Mr. DOYLE. From $2 to $22 a month, depending on the size of the boat.

Senator GUFFEY. How many months of the year?

Mr. DOYLE. Twelve months of the year. The average is $10 to $15 a month. Those men won't pay that. They will go right over to a shipyard or some place on the bay where they aren't taxed, and they will get the same service.

Senator BAILEY. In other words, it is your contention they wouldn't have to pay the tax if they berthed their ships some place else?

Mr. DOYLE. Correct.

Senator BAILEY. But under a possible construction they would or might have to pay a charge if they berthed it at the club?

Mr. DOYLE. That is right.

Senator CONNALLY. You mean they would go to those other places for 10 or 11 percent tax?

Mr. DOYLE. Yes; all they have to do is to go one block.

Senator CONNALLY. You mean to say that to save 10 or 11 percent, to save that small amount, they would take their boats some place else?

Mr. DOYLE. Yes; it would be cheaper.

Senator GUFFEY. How much cheaper?

Mr. DOYLE. I don't know how much exactly. A berth here costs $15 a month; you can rent one for $3 a month in Galesville.

Senator CONNALLY. A man wouldn't go to Galesville to save that small amount of money. Do you think he would go over there to save 11 percent?

Mr. DOYLE. Well, they do. It is better cruising; it is a better place all around.

Senator CONNALLY. Well, that is another element, better cruising, but that wouldn't mean that they would go over there just to save this 11 percent. How far is it?

Mr. DOYLE. About an hour's drive.

Senator CONNALLY. An hour's drive. An hour's drive each way and gasoline. You think they would travel 2 hours and the gasoline they would use on the ground to save $1.65?

Mr. DOYLE. Well, he gets better service there than he gets here.

Senator CONNALLY. Well, then the tax wouldn't be driving him from Washington, would it?

Mr. DOYLE. No; I don't think so.

Senator DANAHER. How much does it take to put a boat in the water and take it out again?

Mr. DOYLE. That depends on the length of the boat.

Senator DANAHER. Approximately.

Mr. DOYLE. On the railway, 25 cents a foot.

Senator DANAHER. You don't include that in dues?

Mr. DOYLE. No; that is a service charge.

May I ask that the letter addressed by the club to the committee under date of August 7 be included in the record?

The CHAIRMAN. Yes; that will be included.

(The letter is as follows:)

CAPITAL YACHT CLUB,
Washington, D. C., August 7, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Senate Office Building,
Washington, D. C.

DEAR SIR: Section 543 (a) of the proposed Revenue Act of 1941 (H. R. 5417, 77th Cong., 1st sess.) proposes to amend section 1712 (a) of the Internal Revenue Code to enlarge the definition of the word "dues" in order to tax as club dues certain privilege fees and assessments not now subject to tax; specifically any charges "for special privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities, * * *."

While the proposed amendment is evidently intended only to cover club charges for social, athletic, and sporting privileges and facilities, as distinguished from service charges, yet the language of the section is not too clear, and we therefore respectfully request that a clause be added to the amendment definitely stating what is meant by the term "facilities."

This club makes a charge to members for berths for dockage and storage of their boats, which is a service in direct competition with privately owned and operated shipyards and wharfage companies, and such service charge should not be taxed as club dues.

We suggest that there be added to section 543 (b) (a) the phrase, "not including charges to members of boat clubs for dockage, storage, or other servicing of their boats."

Section 558 of the bill imposes a tax graduated in amounts from $5 to $200 on the use of boats, and it is reasonable to assume that Congress does not intend to impose a further tax on the service and dockage charges for care and storage of such boats.

We respectfully request the privilege of appearing before your committee in this matter.

Very truly yours,

DANIEL H. FOWLER, *Secretary.*

The CHAIRMAN. Anything else?

(No response.)

The CHAIRMAN. That is all. The committee will recess until 10 tomorrow morning.

(Thereupon, at 4 p. m., an adjournment was taken until Wednesday, August 13, 1941, at 10 a. m.)

REVENUE ACT OF 1941

WEDNESDAY, AUGUST 13, 1941

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Judge Fletcher, I believe you are the first.

STATEMENT OF R. V. FLETCHER, WASHINGTON, D. C., GENERAL COUNSEL, ASSOCIATION OF AMERICAN RAILROADS

Mr. FLETCHER. Mr. Chairman, my name is R. V. Fletcher. I live in Washington. I am a lawyer, after a fashion, and counsel for the Association of American Railroads.

The Association of American Railroads is a voluntary organization composed of substantially all of the class I railroads of the United States, and, of course, by a class I railroad, I have reference to railroads who have total annual operating revenues of $1,000,000 or more.

Senator CONNALLY. Is that the classification of the Interstate Commerce Commission?

Mr. FLETCHER. That is the Interstate Commerce Commission classification, Senator.

I might say in that connection that there are some railroads that belonged to that class originally because they had a revenue of over $1,000,000 a year that still remain in that class technically, although their revenues have dropped below that figure in recent years.

I suppose the Association of American Railroads represents substantially 98 percent of the operated mileage in the United States, and I appear on behalf of that important group not for the purpose of expounding any kind of philosophy of taxation but for the purpose of discussing two or three amendments to this tax bill as it passed the House which seem to us to be sound.

Of course, we appreciate the fact that there is the necessity of increasing the revenues of the Government substantially. Nobody can hope to escape the increasing burden of taxation, and everybody should be willing and glad to make his contribution toward the expense of the Government. It is not my purpose, therefore, to talk about the general aspects of the tax bill nor its objectives. I assume that this committee will endeavor to increase the amount of taxes by a substantial amount.

With that objective we are certainly in sympathy.

I have understood, however, Mr. Chairman, that it is also the aim of the Congress to distribute this tax load in such a way as to make it equitable, insofar as equity can be accomplished under the present circumstances, and particularly that the tax burden should fall upon those who have the greatest ability to pay, and that it should not be imposed in such a way as to retard industry or destroy it to any greater extent than is absolutely necessary. There is the principle of diminishing returns that has to be kept in mind. It would be useless to tax to the point where revenue would dry up by reason of the burden of taxation, and I take it that the ability to pay being one important consideration. The committee is also interested in finding out whether any particular proposal in this tax bill bears with peculiar hardship upon some particular industry.

I shall discuss principally in this statement of mine the so-called special 10-percent tax on excess profits applicable to business enterprises that deem it proper to select the invested-capital method of determining the excess-profits tax. I shall have nothing to say about the income tax, or the rates on ordinary excess-profits taxes, but, as I have said, I will try to show to the committee, if I can, that this special 10-percent excess-profits tax, so-called, bears with peculiar, and I think with unfair and discriminatory, hardship upon the railroad industry that I try to represent.

However, before I address myself to that most important topic, may I take just a minute to refer to one phase of the bill which deals with excise taxes, and particularly with the 5-percent tax on passenger transportation, as that appears on page 73 of H. R. 5417, in the print which came to the Senate committee.

You will note that there is imposed upon the transportation of persons a 5-percent tax, to which we take no exception since the act is so written as to make it apply equally to transportation by motor vehicle, by air, by water, and by rail, and that is eminently fair.

Senator CONNALLY. Does it, or not, apply to all of them?

Mr. FLETCHER. It does.

Senator CONNALLY. What page is that on, Mr. Fletcher?

Mr. FLETCHER. Page 73. That is section 3469, paragraph (a). But in paragraph (b), where there are some exceptions or exemptions from the tax, you will note that there is an exemption in the case of commutation or season tickets for single trips of less than 30 miles. We think that 30-mile limitation is too short. The purpose of the exemption, I take it, Senators, was to exempt that class of season or commutation tickets which are used every day, or practically every day, by persons who work in the city and who live in the suburbs.

Senator CONNALLY. You will have to raise the 35 cents, will you not?

Mr. FLETCHER. I will come to that in a moment, Senator, with your permission.

I do not think so.

Senator CONNALLY. I do not think that it is important how far they go, if they charge not over 35 cents.

Mr. FLETCHER. That is for single-trip tickets, the 35 cents, and there is a distinction made between ordinary passenger transportation and the transportation which is accomplished through the com-

mutation and season tickets in what might be called suburban territory.

You see, that 30-mile limitation does not take care of suburban territory in cities like Chicago and New York. If you leave that 30-mile provision in there you have persons who are using season tickets and commutation tickets, some of them living 29 miles away and others living 31, 35, and 40 miles away, and it is a clear discrimination in favor of those who are nearest the metropolitan centers and is a discrimination against others. In Chicago, for instance, with which city I am perhaps more familiar than any other in the United States, the suburban territory on the Northwestern Railroad runs as far as Kenosha, Wis., and that is 51 or 52 miles. Now, all the way from the city of Chicago to Kenosha, there are great numbers of people who work in Chicago and buy these season tickets, 10-ride tickets, tickets that are good for a month, tickets that are sometimes good for a greater length of time, and to accomplish the ends sought by the House committee I think that 30-mile provision should be changed to 60 miles.

Senator LA FOLLETTE. As a matter of fact, Judge, does the railroad sell these commutation tickets only to people who are regular commuters?

Mr. FLETCHER. No; they do not. They sell them to anybody else who wants to use them, Senator.

Senator LA FOLLETTE. So the mileage limitation really is not very important.

The CHAIRMAN. It is intended, Judge, to take care of that situation by the language "or to amounts paid for commutation tickets for 1 month or less."

Mr. FLETCHER. Some of those commutation tickets, Senator, are good for periods of a month, some of them are sold for 2 months, and even for a year in many cases.

Senator GERRY. Do not you have very strong competition in those distances with automobiles?

Mr. FLETCHER. Oh, yes, Senator; indeed we have.

Senator GERRY. Therefore, to increase this limit would be liable to decrease the automobile traffic, and where they want to conserve gas, that might be helpful.

Mr. FLETCHER. That is a very good suggestion.

Senator CONNALLY. Judge, it looks to me like the language "or to amounts paid for commutation tickets for 1 month or less" would include those. If you strike out "for 1 month or less," you would have it, would you not?

Mr. FLETCHER. Possibly so, Senator.

Senator CONNALLY. It says "or to amounts paid for commutation tickets for 1 month or less."

Mr. FLETCHER. As the thing is written now; yes. We had construed that language to mean to have two classifications, one where there were ordinary commutation or season tickets regardless of the length of time that they might be good for but limited to 30 miles.

Senator CONNALLY. Why not say "for 1 month or more," instead of "less"?

Mr. FLETCHER. Some of them might be for less.

Senator CONNALLY. There may be tourists up there.

Mr. FLETCHER. It would be better to strike out "for 1 month or less" entirely.

Senator CONNALLY. If a man buys a ticket for less than a month he is not a permanent residential commuter, he is on a joy ride, and he ought to pay.

Mr. FLETCHER. Here is what happens: You buy 10-ride tickets sometimes in these commutation cases and they are good for any period less than a year, and he may use up that 10-ride ticket in much less than a month.

Senator CONNALLY. He is not doing it regularly on his business or he would want it for longer.

Mr. FLETCHER. He does, Senator, because those 10-ride tickets are usually unlimited, and his family can use them.

Senator CONNALLY. All right.

Mr. FLETCHER. Anyhow, that is my suggestion, that the committee give consideration to extending that distance from 30 miles to 60 miles to take care of situations that I am sure would be thereby relieved in Chicago and New York, and perhaps other places.

One other slight suggestion on that. You notice the peculiar language used there, "shall not apply to amounts paid for transportation which do not exceed 35 cents." Now, suppose a man goes up to a ticket office and says, "I want to buy four tickets here, single tickets." The fare in each case is less than 35 cents per person, but he says, "I want to buy one for myself, one for my wife, one for each of my two children." In that case he will pay out $1.20 for the four tickets, or very likely he would want to buy a round-trip ticket.

Senator CONNOLLY. He would just hand the money to the old lady and let her buy them.

Mr. FLETCHER. That is one way to do it, Senator. You can distribute them around like you distribute your tickets for a baseball game, each person holding his own ticket. I realize that; but that would be an unnecessary and awkward arrangement. Furthermore, the round-trip ticket situation enters into it.

What we are suggesting is—I do not want to take too much time on it—after the word "transportation" in line 17 there be added the words "for trips where the regular railway fare does not exceed 35 cents." If the committee will have its experts look at that suggestion, I shall be very much obliged.

Now, the next suggestion I want to make, and I make it with a little hesitation——

Senator SMATHERS (interposing). Before you leave that subject, Judge, do not you think the draftees and soldier boys ought to be excluded?

Mr. FLETCHER. I was just coming to that, Senator.

Senator SMATHERS. I thought you were leaving that out.

Mr. FLETCHER. I was about to put forth that suggestion. The special rate the railroads have made, after conference with the Government officials, is 1¼ cents per mile for selectees, or perhaps I should say for anyone who is serving his country in military camps, if they buy round-trip tickets, the purpose being to make as low a rate as possible to persons now in the camps serving their country in a military capacity, when they want to go home, or go back on holidays, week ends, or upon occasions of that kind. There have

been bills introduced into the Congress to make that rate 1 cent a mile. One bill was thoughtful enough to say that the Government would make up the difference between the 1 cent a mile and the regular rates on the railroads. I do not know whether those bills will prevail or not, but if you put this 5 percent tax, in the form in which it is here, in the act, providing, as it very properly does provide, that that tax shall be paid by the buyer of the transportation, that will make the cost fall on the selectees, if I may use that term to represent all of those in the Army, and we had thought that the committee might very well give consideration to exempting from the 5 percent tax amounts paid under these special tariffs which have been filed with the Interstate Commerce Commission by the railroads applicable only to persons now in military service. I am very much afraid if you put that additional tax on the soldiers it will result in a good deal of complaint, and perhaps a demand that the Government should pay that tax or in some form or other changing the present law, which would be a disadvantage to all concerned.

Senator CONNALLY. You would provide that it must uniform?

Mr. FLETCHER. That is right. I think the tariff provides, in making the 1¼-cent rate applicable it must be uniform.

Senator VANDENBERG. The soldier also has to get a certificate from his commanding officer?

Mr. FLETCHER. That is right. He has to be in uniform, he has to get some kind of credentials identifying him as making one of these trips home and back. He has to buy a round-trip ticket.

Senator VANDENBERG. It is called a furlough rate and applies only to furloughs?

Mr. FLETCHER. That is right. I do not think there should be any difficulty in the committee finding language which would exempt that, if the committee so decides.

The CHAIRMAN. That exemption was made in the admission tickets.

Mr. FLETCHER. I was going to refer to that. I will not particularly stop to refer to that, but on pages 44 and 45 of this bill, section 541, soldiers in uniform are allowed to go to amusement places without paying the amusement tax, which is a pretty good precedent, I think, for the suggestion I am bringing forward.

I have one other observation before I attempt to discuss the 10-percent tax, and that is with reference to the capital-stock tax, applicable to all corporations. That has been substantially increased in this bill, and I am not making any complaint about that at the moment, but you will recall that in the act of 1938 which imposes a capital-stock tax it is provided that the taxpayer shall have the right to make the declaration of value every 3 years. That is, he can make a declaration of value in 1938, he can make a declaration of value in 1941. So that coincides in time, I mean, with this particular bill. So that in 1941, as I recall the provisions of the 1938 statute, taxpayers have a right to make a declaration of value, I mean a new declaration of value.

Now, it is provided in the law that taxpayers may have a right to make a declaration of value in 1939 and in 1940, but only upward. You can make a declaration upward in 1939 and 1940, but you

cannot make a declaration except to increase the amount of valuation placed upon the capital stock.

Now, I think that the members of this committee understand the theory that underlies this capital-stock tax. No effort is made by the Government to police the matter. It is not a question whether you have declared in fact the real value of the capital stock, it is an arbitrary selection you are permitted to make. You can put your own value on the capital stock. If you make it high it increases your capital-stock tax but decreases your tax elsewhere under certain circumstances. If you make the capital stock value low, why, you decrease the amount of your capital-stock tax, but it increases the tax in other directions if certain things happen.

Somebody over in the House spoke of this tax as being a crap-shooting proposition. You gamble, so to speak, risk your judgment on what is going to happen.

Now, what we are asking here, Mr. Chairman and members of the committee, is that this law be so written that the taxpayer be permitted in 1942 to make a new declaration of value. I say that for the reason that we are now facing a new law, many of the provisions in this act having to do with excess profits and other kinds of taxes, and we are facing a very uncertain state of affairs. Nobody knows what is going to happen in business; nobody knows what is going to happen in the field of international relations; nobody knows whether 1942 is going to be a period of increased or decreased prosperity. It seems to me, in face of the fact, that we have a new law, introducing very uncertain factors into the situation and by reason of the present troubled and uncertain condition of the world, there ought to be given the privilege to the taxpayer of making a new declaration of value in 1942 at least, when they can see a little more clearly just what is going to happen, and I make that suggestion hopefully.

I come then to the subject to which I wish to devote most of my attention, and that is this 10-percent excess-profits tax. I think that was discussed yesterday, Senators, by Mr. Dorrance, I believe it was, who was a coal operator. I had the pleasure and profit of reading his testimony, and I thought he made it very clear to this committee just how that would operate most injuriously to the coal industry, by reason of the fact that in the so-called base period the prices of coal were fixed by a very remorseless rule of competition, whereas in the present time, in the current year, they are fixed by public authority, and by reason of that the coal industry is able to show better returns in the current year than in the base period years, 1936, 1937, 1938, and 1939. Along that same line I want to make a special plea for a few minutes on behalf of the railroad industry of the country. I do not think it is necessary, Senators, for me to spend time in trying to explain just how this excess-profits tax works out, further than to say that there is given to all corporate taxpayers the right to select whether their excess profits shall be calculated according to the average earnings method, sometimes called the income method, or whether they shall select the invested capital method. That has been the subject of much debate. My recollection is that the Treasury, in its appearance before the House committee and before this committee, looked with disfavor upon the right to select the average

earnings method and favored very strongly the invested capital method.

Of course, there are two schools of thought on that subject. If you consider that this excess-profits tax should be imposed only upon those who are earning money in the current year, in amounts substantially in excess of their normal earnings, if that is the theory of an excess-profits tax, then the average earnings method seems to me to be sound. On the other hand, if you are going to say that all earnings are excessive if they exceed a certain proportion of the investment, whether in time of peace or in time of war, or normal times, or in disturbed times, if that is to be the theory upon which you proceed then the invested capital method would have its appeal.

But the point I am making, Mr. Chairman and Senators, is that the Congress ought to decide one way or the other. So far it has held to the view that the taxpayer should have the option of selecting which one of these methods he prefers, but this bill, as it comes to you from the House, combines the two methods in a way which I shall try to explain, and if the taxpayer selects the invested capital method and finds that the credit which the act allows him wipes out his earnings to the point where there is no excess profits taxable income, it is not satisfied with that but goes on then and applies to him the average earnings method to the extent of taxing him at 10 percent on the amount which his earnings in the current year exceed average earnings in the base period. So it gets the poor, unfortunate taxpayer going and coming, and for that reason it seems to me it presents a real injustice.

The committee will find on page 43, the bottom of the page, and over on page 44 of the House report (H. Rept. 1040, 77th Cong., 1st sess.), not the bill but the House report, how this works, and it is explained very clearly. I shall not take the time of the committee to go over that, but it is there very clearly stated as to just how you go about taxing the man whose interests demand that he should select the average earnings method over and beyond the taxes imposed by that method to the extent of 10 percent of the excess of his earnings in the current year over the base year.

Well, that means this: Here is a corporation, or a line of business with comparatively large investments. Somebody has described that as business built in a high-cost period. They have had, for one reason or another, an exceedingly unfortunate experience in the base period, 1936, 1937, 1938, and 1939. At the present time their earnings are better; they have gone through a period of starvation, so to speak, and the time has come when there is an opportunity for them to rehabilitate their property, reduce their debt, and recuperate to a certain extent. This tax bill comes in and says, We will penalize you by reason of the fact you are earning more now than in the base period. Although it appears you are not earning any more than a fair return upon the value of your property at the present time, although the 7 percent credit which the act permits has wiped out your excess earnings, still, by reason of the fact that you are earning more than you did in the starvation period, we will find out how much more you are earning now than you did then and tax it at the high rate of 10 percent. That is the one thing about which I most bitterly complain here at this time.

I do not think, gentlemen, that this method can be justified on any logical basis. I do not think it can be justified with due regard to consistency. Either you are to be taxed in accordance with your experience in the base period compared to the present time, or you are to be taxed upon the theory that you are entitled to earn, without being subjected to excess profits tax, some return upon your invested capital. I say with great deference that I cannot understand how the Treasury can justify such a theory as this, which is inconsistent either with the one method or the other.

There is support, of course, as I have tried to say, in logic and in reason, for the selection of the average earnings method, or in many cases for the selection of the invested capital method, but to combine the two together I do not think is sound.

Senator WALSH. Do you care to state which one you prefer?

Mr. FLETCHER. Now, that is a question, Senator Walsh, that each corporation must decided in the light of its own experience.

Senator WALSH. Suppose Congress decided to make its policy one of these methods, which one would you prefer?

Mr. FLETCHER. Looking now at the interests of my clients, if you mean that, Senator Walsh, all of the railroads, except three or four, possibly a few more than that, are compelled to select the invested-capital method, by reason of the fact that they have relatively a large capital investment and very poor earnings in the base period. I would not be here if that was not the fact, I should not be troubling this committee.

Senator BYRD. Do you think that you can apply that to many other corporations?

Mr. FLETCHER. In regard to many other corporations it would be very different.

Senator BYRD. It might be the reverse.

Mr. FLETCHER. It might be quite the reverse. I hope I violate no confidence when I say I was informed yesterday by a well-informed gentleman, much more familiar with business conditions than I am, that probably three-fourths of the corporations in the country would prefer the average-earnings method. That is not true of the coal industry, that is not true of the lumber industry, and that is not true of the railroad industry. By reason of the poor earnings in the base period, for reasons which I could explain if I had the time and you had the interest, and by reason of the comparatively large investment in this class of business, they are compelled to select, for the most part, the invested capital method.

You understand this special tax, Senator, does not apply if you take the average-earnings method.

Senator WALSH. I understand.

Mr. FLETCHER. That has no room in the picture at all. It only applies to those who select the invested-capital method.

Now, of course, there would not be so much injustice in this, Mr. Chairman, if the base period was other than the years 1936, 1937, 1938, and 1939. If we had some way of finding out what was a really normal period for the railroad industry it would be different. If you take 2 years in that period and 2 years in the 1920's it would make a very different picture, or if the committee could see proper to give the taxpayer the right to select 3 years out of the 4 and divide

his total by 3 rather than to require all 4 years, maybe it would furnish a certain measure of relief, although I earnestly ask the committee to exclude from the bill entirely this special 10-percent tax.

Now, as I have said in reply to Senator Walsh, there are a few railroads that would be able to survive, or at least not be subjected to great hardship by reason of this special tax, and in fact there are a few railroads that will probably select the average-earnings method. I refer particularly to railroads that are located in what we call the Pocahontas district and have had a good deal of luck in hauling coal even during the period of depression, roads like the Norfolk & Western, and others of that type; but in that connection, also, I would like to mention a question which inevitably arises here and to which I would like to address myself a little later more in detail.

This bill changes the method of deduction. Under the present law you deduct income tax from the excess profits taxable income before you make your calculation as to the excess-profits tax, but you are not allowed to deduct from the taxable income, in determining the income tax, the excess-profits tax. This bill proposes just the reverse of that process. It proposes to prohibit you from deducting the income tax from earnings to get a base to calculate the excess-profits tax, but to permit you, as a compensation for that, to deduct the excess-profits tax from the income-tax base. Now, that fact, of course, as the House committee has pointed out, reduces the 7-percent credit in reality to 4.9, because you pay 30 percent income tax and 7 percent of 30 percent is 2.1 percent, and subtracted from 7 percent leaves you 4.9 percent.

This situation would be corrected to some extent if the committee could see proper to go back to the present rule and allow the deduction of income tax before excess-profits tax is calculated.

Well, I started to say, as illustrating the unfairness to railroads—if that is not too strong a term—of applying this 10 percent excess profits to the excess of their income in the current year over the base year, to the poor earnings of the railroads in the base year; I have a table before me, and I do not want to encumber this record, Mr. Chairman, with too many tables, but I have a table before me here which shows the situation on the railroads, class I railroads, in the United States in the years 1936, 1937, 1938, and 1939.

In the year 1936, the net railway operating income—and that means the income of the railroads before you deduct their interest and rents—was of such a figure that it allowed only 2½ percent upon the property investment. The net income of the railroads that year, which means income of the railroads after they have paid their interest and rents, amounted to only $164 630,000. But that does not tell the whole story. To that amount there had to be charged profit and loss debits in very considerable amounts representing, for the most part, the cost of retirements, which reduced the taxable figure for that year down to $6,819,000.

Senator BYRD. What year is that?

Mr. FLETCHER. That is 1936, and that is the best of the 4 years for the railroads, by far the best of the 4 years.

Senator BYRD. You mean all the railroads only had a net income of $164,000.000?

Mr. FLETCHER. All the railroads had a net income of $164,000,000, after they paid their interest, before any dividends were paid, but out of that they had to pay the cost of retirements, capital charges, profit-and-loss charges, as it is called, which reduced the taxable income down to $6,819,000 in the year 1936, the best of the 4 years.

Senator BYRD. What is the capitalization? What is the investment?

Mr. FLETCHER. The investment upon which that is counted—I have the exact figure here, but stating it generally, it amounts to about $25,000,000,000.

Senator BYRD. That means a profit of $6,000,000 on an investment of $25,000,000,000?

Mr. FLETCHER. That is the picture. That is taxable income, you understand.

Senator BYRD. That is approximately the actual profit, is it not?

Mr. FLETCHER. That is right. Now, in 1937, when business had begun to fall off, the return on the investment was 2.27 percent for the railroads of class I, with the figure of $98,000,000 of net income which, after making profit and loss charges, produced a deficit of $11,870,000 in taxable income.

Now, 1938 was the poorest of the 4 years. There the return was only 1.43 percent upon the investment. There was an actual deficit, after the payment of fixed charges, of $123,471,000, which figure grew to a deficit of $224,000,000 after the payment of the cost of retirements and other charges to profit and loss.

In 1939, when the return was 2.25 percent, business had picked up a little; the net income was $93,000,000, and after making the proper deductions for retirements there was $202,813,000 of a deficit. The average deficit for those 4 years on the class I railroads was $108,000,000.

Now, the result of that was, with these charges to profit and loss, that the capital investment on the railroads was reduced something like a billion dollars in those 4 years and the previous period of depression.

Senator BYRD. Do those figures contemplate deduction for depreciation and anything that is allowable under the Federal income tax?

Mr. FLETCHER. Yes; that is true. That is, the last figure I gave does so contemplate.

The point I make here is that these 4 years which, if taken for the base period, certainly do not represent, at least I hope they do not represent, a normal period for the railroad industry.

Senator BYRD. Why, Mr. Fletcher, are you so much concerned about that when you can select the invested-capital method?

Mr. FLETCHER. For this reason, Senator: We are making a little money this year, for the first time in a long time. You take the earnings of a railroad and you use the invested-capital method, and you apply a credit of 7 percent—it is 8 percent on the first $5,000,000 but in most of the large railroads that does not go very far—you find that wipes out the excess profits, we will assume for the purpose of the argument, but here comes along this law and says, even though you do not have any tax to pay in the way of legitimate excess-profits tax—if I may use that expression—after you have selected the invested-capital method we are going to apply the average earnings

method to you. We are not satisfied with the fact that you have earned nothing over and above 7 percent of your invested capital, you are earning now more money than you earned in the base period, and we are going to get after that. So they subtract from the amount you earn in the present year the amount earned in the base period, which in most cases was zero in the case of the railroads, and they put a special 10 percent tax on that excess. It is that last 10 percent I am talking about and nothing else.

Senator GERRY. What is the condition of your roads due to that low earning period? Has that made it difficult for you to make replacements?

Mr. FLETCHER. Senator, the tendency, the natural tendency, when earnings were poor, with so many freight cars not being used, was not perhaps to neglect the maintenance of the cars that were actually in use but to allow a larger accumulation of what we call bad-order cars. Now, at the present time, the bad-order car situation of the American railroads is the best in the history of the industry. Normally, you would think of 6 percent as a pretty fair condition, when only 6 percent of the cars are in bad order; they are now down to less than 3 percent. That is brought about by the expenditure of money in repairing cars, trying to get ready for the traffic which now confronts them and the emergency with which they are now confronted, the emergency being the necessity for handling the traffic in the interest of national defense.

Senator HERRING. To what do you attribute the earnings this year as contrasted with the 4 base years?

Mr. FLETCHER. That is a hard question to answer. I would say, with all candor, perhaps, that question has qualities of embarrassment, in the light of just what the philosophy of this act is. In other words, it might be said if it is all attributable to the defense program of the country you ought to pay a special tax on it. I am not able to say to what extent the increased earnings are attributable directly to the defense program. Doubtless to some extent. I have no doubt that program has increased it, but I do not think it is responsible for all the increase. Take for instance 1938 as compared with 1936. There was no defense program in 1936, and yet the earnings of the railroads were so much better than they were in 1938 that I venture to entertain the hope, Senator, that if we had no complications abroad and no special emphasis upon national defense at this time there would have been an increase in the normal business of the country. At least I hope so. How much was attributable to the one and how much to the other, I am not sufficiently able and prophetic to state.

The CHAIRMAN. Judge, you know full well it is exactly on the theory that while you have not reached the credit you would decide to take on the invested capital, nevertheless it is due to the defense effort, the defense spending. Many of the large, heavily invested capital corporations have made very great progress, and there has been a great increase. It was on that theory that this added 10 percent was placed on it.

Mr. FLETCHER. In other words, it is not an excess-profits tax but a defense tax.

The CHAIRMAN. That is what it is. It is not an excess-profits tax at all.

Mr. FLETCHER. It could not be an excess-profits tax.

The CHAIRMAN. No; because the answer to that is you have not made excess profits under any definition of the law.

Mr. FLETCHER. Quite so.

The CHAIRMAN. Whether it is a logical tax or not, I have great difficulty in sustaining it.

Mr. FLETCHER. We might all agree if we were not, some of us at at least, embarrassed by obligations in one way or another, we might all agree it is not logical and it is not an excess-profits tax, but I am wondering whether there is merit or justification or justice in putting a tax upon an industry which has, perhaps, we might concede for the purpose of the argument, improved its earnings by reason of the defense effort, whether that alone is sufficient. We must bear this in mind, Senator, which I purposed to express a little later, but in order to qualify ourselves for a defense effort there has had to be a great expenditure of funds in getting ready to do that defense work. The railroads of the country have spent enormous amounts in repairing their cars, as I just stated a moment ago, and in purchasing new cars, and they have given orders now, Senator, for the acquisition of new equipment which taxes the capacity of the car manufacturing plants, and the only thing that is holding them back toward the acquisition of a large amount of new equipment is the scarcity of steel. There are no priorities, you know, in transportation.

Priorities have been granted with respect to the manufacture of steel and the production of aluminum, this, that, and the other, but the transportation agencies of the country, railroads and trucks and the like, have asked for no priorities, and they have been required to put into effect no priorities, because they are taking care of the load and burden offered to them even with the difficulties that surround them, and they would be perfectly able to take care of it at their own expense and not Government expense; at their own expense if they were able to obtain the material to make new cars and repair the old cars.

I wish I had time, because I think it would perhaps be interesting, to call the attention of the committee to the earnings of individual railroads, some of which you know about, in this base period. I have three sheets, which I shall merely mention and pass over, classified as eastern railroads, southern railroads, and western railroads, and in the case of the western railroads, a very important section of the country in which I have lived most of my life and for which I have a great deal of concern, I think you can, even from that position, see the red figures on that statement [indicating], and those red figures represent deficits rather than income during the base years. But I will pass that over.

Now, there is this thing also to be considered in the case of the railroads: Remember it is a regulated industry, it is an industry affected with the public interest, as the lawyers say. The railroads do not determine their rate of return, they do not fix their rates, they are fixed by public authority. Not only are their rates fixed by public authority, but their wages are fixed by public authority to a very great extent.

We have here on the one side the income of the railroads determined by their rates fixed by the Interstate Commerce Commission,

and on the other side the expenses of the railroads fixed by the Railway Labor Board, fixed by boards, rather, under the Railway Labor Act. It is a public utility essential to the public interest. The country has to have their services. They owe this obligation to the public. They owe the obligation to give service in a time like this when national defense is being particularly emphasized. So that, without the ability to control their expenses, and without the ability to control their revenues, they were not in the position during this base period to improve their condition, and in that respect I think it becomes a rather unique industry.

One thing I would like to mention and that is that during this very period when they were having these poor earnings the railroads made substantial expenditures for additions and betterments. They had to do it. Here was the year 1936, the railroads spent $298,000,000 for additions and betterments to their property. That does not mean ordinary repairs now. Ordinary repairs are charged to operating expenses. That means additions to capital.

In the year 1937 they spent $509,000 000. In 1938, that poor year I spoke about when the deficit was $123,000,000, they spent $226,000,000 for additions and betterments.

Senator BYRD. Mr. Fletcher, in that poor year how many railroads in the United States had a net income?

Mr. FLETCHER. I have that figure here, Senator, as it happens.

Senator BYRD. That is 1938.

Mr. FLETCHER. That is 1938. Judging just from my memory—I happen to have it here—57.57 percent of the class I railroads had a deficit that year, and, of course, the difference between that and 100 percent is 42.43 percent who were able to show some net income in that year.

Senator BYRD. How many class I railroads are there?

Mr. FLETCHER. There are about 130. Somebody could give me that figure. I dare say, among my colleagues here. I do not happen to have it myself.

Why were these additions and betterments necessary? They were necessary, of course, in order to go on and serve the public and give the service that the public interest demands and get ready for emergencies that may come along. As the result of those large expenditures, and particularly by reason of the fact that in the 1920's, when there was a comparatively prosperous time, the railroads spent $8,000,000,000 in improving their property, but for that they would not be able to carry the load they are carrying now. They would not be able to carry the load but for the fact that these additions and betterments had been made not only in this base period but previously to such a large extent that they were in a position to increase the traffic that they handle without undue difficulty.

Senator BAILEY. Can you tell me what has been the average dividend paid to railroad stockholders?

Mr. FLETCHER. Senator, that is a minus figure.

Senator BAILEY. What?

Mr. FLETCHER. That is a minus figure, if you take all the railroads into consideration.

Senator BAILEY. Take the class I railroads.

Mr. FLETCHER. I mean the class I railroads. Some railroads have paid dividends pretty steadily. The Pennsylvania Railroad maintained its record of paying a slight dividend.

Senator BAILEY. But most of the railroads have not been paying dividends?

Mr. FLETCHER. Oh, the "dividends" is a kind of lost term. We do not use it any more. Nobody thinks about it any more in the railroad business.

Senator BAILEY. How many roads are in default on their bonds?

Mr. FLETCHER. About one-third of the railroad mileage in the United States.

Senator BAILEY. How many are in the hands of a receiver?

Mr. FLETCHER. Just about that figure.

Senator BAILEY. How many?

Mr. FLETCHER. About one-third. If you are in default that almost automatically puts you in the hands of the court. The sheriff takes charge of you if you are in default, unless you can borrow the money somewhere.

Senator BAILEY. What portion of the railroads' revenue goes to railroad wages?

Mr. FLETCHER. About 47 percent.

Senator BAILEY. Practically all the other goes for supplies and material?

Mr. FLETCHER. That figure runs much higher if you add those together. I think I have those figures here, Senator. My recollection is that figure is about 23 percent, but I would have to verify that by check.

Senator BAILEY. The other is for taxes, is it?

Mr. FLETCHER. The rest of the revenue, a good deal of it—some of it goes to interest, some of it goes to taxes, a very considerable amount of it goes to taxes, about 9 percent of the whole amount goes to taxes.

Senator BYRD. At that point, what percent goes to State and local taxes and what percent goes to Federal taxes?

Mr. FLETCHER. A much greater percentage goes to State and local taxes than to Federal taxes, Senator. There is no doubt about that.

Senator BARKLEY. They all have to pay taxes on the physical property. The Federal Government does not levy such a tax.

Mr. FLETCHER. That is right. In New Jersey they pay an enormous amount of taxes on physical property.

Senator BARKLEY. There has been some recent publicity about that in the papers.

Mr. FLETCHER. Quite a bit. The leaders of the party to which you and I belong, Senator, do not seem to get along so well on that proposition.

Now, I must hurry through this statement here. I wanted to lay emphasis, however, upon the necessity, even in bad years, of spending considerable amounts for additions and betterments to the property.

Now, what are these earnings that are made now being used for? That is one thing I want to be just as clear and as emphatic about as possible. Undoubtedly the railroads in 1941 are making more money than they have made for some time, making more money

than perhaps they made since 1929 or 1930, I would say. What are they using that money for? In the first place, as I have already intimated in reply to questions from the committee, a goodly part of that sum is being expended in improving their plant, particularly the acquisition of new cars and the repair of present cars, although that does not tell the whole story. They are also spending considerable amounts in building longer sidetracks to handle the traffic they have now, and improving their yard conditions, and things of that kind. I want to say this, if I may say so without impropriety, that the railroads have not called upon the Government to bear any part of that expense.

Senator Herring, I believe, asked me about the effect of the defense program on increased earnings. In many cases plants have called upon the Government to bear part of the defense load, to do the defense work. They have arranged for the Government, properly enough I think, to take the risk. They have said, "You have asked us now to expand our plant here for the manufacture of munitions of war. We do not think we are going to need that plant after the emergency is over. That is a burden you ought not to ask us to bear"; and the Government will have to come in and furnish the money to expand the plant. I think that is fair enough. But the railroads have not asked that. They have, at their own risk and at their own expense, undertaken to expand their facilities, and particularly their supply of equipment to take care of this additional defense load, without making any arrangements with the Government to pay for that increased defense effort.

Senator BYRD. How much have the railroads borrowed from the R. F. C.?

Mr. FLETCHER. Altogether, Senator, they borrowed $810,000,000 and they paid back $345,000,000, and now they owe the R. F. C. $465,000,000. I am disregarding the thousands.

Senator BYRD. Have they borrowed from any other Government agency?

Mr. FLETCHER. Well, the P. W. A. folks had at one time, you know, gotten into the picture and loaned the railroads $200,000,000. They paid $189,000,000 of that back, and they still owe the P. W. A. $11,835,000.

Senator BARKLEY. What was that for? Elimination of dangerous crossings, building underpasses, and things of that kind?

Mr. FLETCHER. You mean the P. W. A. now, Senator Barkley?

Senator BARKLEY. Yes, the P. W. A.

Mr. FLETCHER. That money was largely for the purchase of equipment, as I recall. I have not looked it up lately, but I think that is what it was.

Senator WALSH. What interest are they paying the R. F. C.?

Mr. FLETCHER. That differs with different companies.

Senator WALSH. What is the average?

Mr. FLETCHER. My idea of the present rates—I hope I will not be accused of insincerity if I guess wrong—it is in the neighborhood of 5 percent.

Senator WALSH. Average?

Mr. FLETCHER. Average.

Senator BYRD. Some of it is as low as 3 percent, is it not?

Mr. FLETCHER. I believe there have been equipment loans at 3 percent. That is the most desirable loan from the investor's point of view that the railroad has—the equipment loan. Their loans on equipment are paid back currently by amortization.

Senator BYRD. When you said 5 percent you were speaking of the money the railroads owe the R. F. C.?

Mr. FLETCHER. Yes.

Senator BYRD. The average would be 5 percent?

Mr. FLETCHER. That would be my guess. It might be higher. I am sure it is not lower.

Senator BYRD. My impression is it is lower.

Mr. FLETCHER. I would not be so such about that. May I ask my colleagues here about that figure? Either Mr. Thomas or Mr. Ettinger would be able to answer that.

Mr. THOMAS. It is between 4 and 5 percent, but that is dependent upon certain conditions that are specified in the R. F. C. loans.

Mr. ETTINGER. The original loan started at 6 percent. It ran that way 2 or 3 years, and then, under certain conditions they made a reduction as low as 4 percent.

Mr. FLETCHER. I am going to stick to 5 percent. The R. F. C. is administered by a very careful man, you know. He applies banking principles to his transactions.

Senator BAILEY. Are the railroads able to borrow money now privately?

Mr. FLETCHER. Senator, it is almost impossible to speak of railroad credit as a mass. Some railroads can borrow money without a bit of trouble, and others could not borrow a nickel. It depends altogether on the credit of that particular railroad. Generally speaking, almost any railroad can borrow money for equipment, because those obligations are sold on a special kind of security. They have very good security, and the railroads are required, from time to time, out of earnings, to pay installments on the purchase price, which readily amortizes the debt.

The CHAIRMAN. Judge, I do not want to cut you off at all.

Mr. FLETCHER. I know, Senator.

The CHAIRMAN. We have several other witnesses here today.

Mr. FLETCHER. I am sorry. I will try to hurry through. I was going to say if this 10 percent could be saved much of the money would be paid back to the Government. These railroads are anxious to discharge this debt to the R. F. C. It is not a pleasant thing to owe the Government.

Senator BARKLEY. It would not go to the Treasury, though, would it? It would go to the increased income on the part of the Government agency?

Mr. FLETCHER. It could be made available for loans or any use the R. F. C. wanted to make of it, Senator. I want to say in that connection, I know of two important railroads that have recently been able to discharge their obligations to the R. F. C. by borrowing from private sources.

Senator VANDENBERG. It would also save the Treasury something if you never paid back your loan.

Mr. FLETCHER. I should think so. I think the R. F. C. is going to collect practically all the money. They made a lot of money in

profit on the railroad loans. In other words, they loaned the railroads money and took their notes, bonds, and the like, and sold them at a premium now and then. It is a self-liquidating proposition with the R. F. C. The expenses do not come out of the Treasury, they come out of the profits.

Senator BAILEY. They made a profit of $200,000,000.

Mr. FLETCHER. Yes; that is right. I want to say on this particular point, however, that the railroads do pay a very considerable amount of taxes. Their tax bills amount to over a million dollars a day. I have a statement here that shows what their taxes were for 10 years, and they were in excess of their net income.

Senator BYRD. This is true, is it not, Mr. Fletcher, that if the railroads were not able to pay taxes it would disorganize the tax system of practically every State in the Union, and in every county and in every city?

Mr. FLETCHER. If the railroads stopped paying taxes, it would disorganize the tax system and you would have to close the schools in a great many parts of the country.

Senator BYRD. Nothing could be more serious to the tax system of the States. I believe we who have studied that know that if something happened to the railroads that they could not pay taxes there is nothing that could be more serious to the tax systems of the States and local communities.

Mr. FLETCHER. We have lots of figures on that. We contribute so much to the schools, especially the rural schools, that it would be disastrous if the railroads ceased to be taxpayers. It is true, as you suggested I think, Senator Barkley, that the greater part of the taxes goes to the States, being based on the physical properties of the railroads.

Well, that is our story, Mr. Chairman, on the subject of the 10 percent tax.

Senator VANDENBERG. Mr. Fletcher, let me ask you one question at that point. Let us admit, for the sake of the argument, that it would be unfair to the railroads to penalize them by an extra 10 percent when they chose the invested capital method. Let us admit that for the sake of the argument.

Mr. FLETCHER. Yes.

Senator VANDENBERG. Then let us admit that there are some of our corporations which obviously do not carry their equitable share of the taxes when they choose the invested capital method. Could you suggest any formula by which you could reach one and exempt the other?

Mr. FLETCHER. I could not, Senator. If I did have such a formula I would hesitate, if you will pardon me, to suggest it. It would be a little more than the average witness can assume to say, "I want to be exempted from taxes, but here is a fellow over here that you ought to put them on to." I do not think that would be quite right for me to do.

Senator VANDENBERG. Well, we have the two sets of facts. The 10 percent tax clearly is unfair in one instance, and it is clearly justified in another. I am wondering if there is a middle ground?

Mr. FLETCHER. I had not known, Senator, until you just stated it, that that 10 percent would be clearly justified in some cases. I do not

question your statement, but I do not have the information. I do not know how to answer that question.

Senator VANDENBERG. I am not sure that there is an answer.

Mr. FLETCHER. I am not sure, either.

Senator, I have some other points that I would like to make about amendments to the revenue act as it stands now. Would it be permissible if I address a letter to the committee and make those suggestions in writing and have them incorporated in my testimony so that the committee might see it?

The CHAIRMAN. Yes.

Mr. FLETCHER. I appreciate the fact that I have used all the time that your indulgence would permit.

The CHAIRMAN. Yes; that would be all right. Furnish it to the clerk of the committee and it will be incorporated in the record.

Mr. FLETCHER. I have a few suggestions that are important, looking toward the amendment of the revenue code as it stands now.

In concluding what I have to say with respect to the injustice of the special 10 percent excess-profits tax as applied to railroads, I offer the observation that if this tax is retained at all in the act, corporations with poor earnings in the base period and with large capital investments should, in any event, be relieved from paying the 10 percent tax, if their taxable income is less than some fair percentage on the invested capital. It would be difficult to justify imposing this special tax if the return was no more than 6 percent upon the invested capital. In the Transportation Act of 1920, railroads were permitted to earn under the plan set up in the act at least 5¾ percent upon the value of property. The invested capital base carried in the act is less than the value of the property.

I suggest, therefore, that even if this 10 percent tax is retained in any form, there should be a further provision that it should not apply so as to tax earnings which are below the figure of 6 percent upon the invested capital. Perhaps this might be accomplished by adding after the figure "713" in the nineteenth line on page 16 of the bill as it came from the House the words "or with the use of a credit of 6 percent of invested capital determined under section 715, whichever is the larger, exceeds, and so forth.

Earlier in my testimony I made reference, briefly and incidentally, to some objections to the provisions in the House bill which do not permit deduction of the income tax from the excess profits net income subject to excess profits tax. The present law permits the deduction of income tax before excess profits tax is calculated. The House bill reverses this process and does not permit the deduction of income tax from excess profits income, but permits the deduction of excess-profits tax from the normal income-tax base. We think this is an illogical conclusion. Excess profits should not be assessed until after the income tax has been paid. As the House committee report points out, the effect of a provision which does not allow the deduction of income tax from the excess-profits income, in effect, reduces the rate of credit from 7 percent to 4.9 percent. Some of the difficulty would be avoided if the Senate committee would retain the provision of the present law, permitting the deduction of income tax before the excess-profits tax is calculated.

I desire to say a word on behalf of two railroads, to wit: the Baltimore & Ohio and the Lehigh Valley, that have taken advantage

of the Chandler Act, which permits certain railroads, with the consent of the Interstate Commerce Commission and the court, to defer payment of certain interest, provided an overwhelming majority of the security owners consent. Under this Chandler Act, these railroads have escaped bankruptcy, not by repudiating or reducing their obligations, but by deferring them. Under the terms of the decree of the court approving the agreed arrangements, currently and annually a considerable amount of net income must be set aside for payments to sinking funds, capital funds, and deferred interest payments, with the result that in the year 1941 and in subsequent years there will be very little net income which these railroads can devote to any purposes except taking care of these sinking funds, capital fund, and contingent interest charges. Special consideration should be given to the situation of railroads in this class.

Another situation is worth mentioning and this situation involves not a change in the law now under consideration but some amendment to the act of March 7, 1941, making certain amendments to the provisions of the law dealing with excess profits. The suggestion I am about to make applies particularly to railroads in New England that suffered a great loss of revenue by reason of unusual storms and floods in the year 1938. The railroads were washed out, traffic had to be routed through circuitous and expensive routes, railroad bridges had to be rebuilt and a great deal of expense incurred, in an extraordinary measure affecting revenues in the base period. As a result of these expenses, the base period earnings were greatly reduced and if the special 10 percent excess profits feature is to be retained, it would work with peculiar hardship upon these lines.

The 1941 amendments to the Excess Profits Tax Act provided in section 722 that a taxpayer within 6 months following the filing of its return may apply to the Commissioner for relief by way of a readjustment of its average base period net income in the following circumstances:

SEC. 722. Adjustment of abnormal base period net income.

(a) *General rule.*—In the case of a taxpayer whose first taxable year under this subchapter begins in 1940, if the taxpayer is established—

(1) That the character of the business engaged in by the taxpayer as of January 1, 1940, is different from the character of the business engaged in during one or more of the taxable years in its base period (as defined in sec. 713 (b) (1)); or

(2) That in one or more of the taxable years in such base period normal production, output, or operation was interrupted or diminished because of the occurrence of events abnormal in the case of such taxpayer; and

(3) The amount that would have been its average base period net income—

(A) If the character of the business as of January 1, 1940, had been the same during each of the taxable years of such base period; and

(B) If none of the abnormal events referred to in paragraph (2) had occurred; and

(C) If in each of such taxable years none of the items of gross income had been abnormally large, and none of the items of deductions had been abnormally small; and

The amendment further provided—

(b) *Rules for application of subsection* (a).—For the purposes of subsection (a)—

(1) High prices of materials, labor, capital, or any other agent of production, low selling price of the product of the taxpayer, or low physical volume of sales owing to low demand for such product or for the output of the taxpayer, shall not be considered as abnormal.

(2) The character of the business engaged in by the taxpayer as of January 1, 1940, shall be considered different from the character of the business engaged in during one or more of the taxable years in its base period only if—

(A) There is a difference in the products or services furnished; or

(B) There is a difference in the capacity for production or operation; or

(C) There is a difference in the ratio of nonborrowed capital to total capital; or

(D) The taxpayer was in existence during only part of its base period; or

(E) The taxpayer acquired, before January 1, 1940, all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished.

The foregoing appears to make no provision for any adjustment on account of rehabilitation of property damaged or destroyed by casualty, unless it can be shown under paragraph (a) (2), that "normal production, output, or operation was interrupted or diminished because of the occurrence of events abnormal in the case of such taxpayer." The difficulty with this language read in connection with that quoted above from section 722 (b) is that the emphasis is on disturbance of production and not on increase in expenses. This might not meet the situation of a railroad whose maintenance expenses had been substantially increased by a casualty but had been able through rerouting or otherwise to handle its traffic. This difficulty might be met if after the words "production, output or operation was interrupted or diminished" were inserted the words "or expenses increased."

In section 23 of the Internal Revenue Code among the deductions allowed from gross income is the following:

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

In section 711 it is provided that in determining the income for the base period:

(E) *Casualty, demolition, and similar losses.*—Deductions under section 23 (f) for losses arising from fires, storms, shipwreck, or other casualty, or from theft, or arising from the demolition, abandonment, or loss of useful value of property, not compensated for by insurance or otherwise, shall not be allowed;

This provision, however, does not militate against the suggestion that deductions should be allowed for losses occasioned by abnormal events. We are not dealing with allowances on account of property damaged or destroyed, but with abnormal charges to maintenance account as to which there would ordinarily be no occasion for any special allowance. There should, however, be a clear provision that in determining the net income in the base period special allowance should be made for the effect of abnormal events on expenses as well as on income.

One other matter contained in the present Revenue Code deserves attention. I refer to the familiar fact that taxpayers are often called upon to execute agreements to extend the statute of limitations beyond the period named in the statute, if the statutory period does not permit the adjustment of controverted questions within the 3 years provided.

The statute of limitations with respect to the assessment of deficiencies is now the same as in the case of refunds; to wit, 3 years. However, it is frequently necessary for taxpayers to agree to waive the limitation provisions with respect to deficiencies in order that their returns may be adequately investigated and their claims con-

sidered. This will happen more frequently when excess profits-tax returns, involving many moot questions, valuation problems, and so forth, are under review.

Such waivers or extensions of statutory period should be mutual as frequently (especially when several years are involved and interrelated problems have arisen) it is impossible to know in advance whether the result for any particular year will be a refund or a deficiency. Often the net result for several years will be a deficiency, though the final determination for one of those years will indicate a refund due.

Unless a taxpayer is properly advised by Treasury representatives or others, the statute may bar a refund which may not have been anticipated when an extension of time was agreed to with respect to deficiencies.

Despite the foregoing, the Treasury cannot make a two-way agreement. This situation often leads to either a summary determination not properly considered, the filing of many wholly unfounded but "right protecting" claims for refund or to unjustifiable losses by taxpayers, few of whom can be well informed of the intricacies of the finer points of tax procedure.

It is therefore recommended that the Code be amended to provide that upon the execution of any valid extension of the statute of limitations with respect to deficiencies, the period for the timely filing of refund claims be similarly extended automatically.

There is another subject that I would like to discuss briefly, which does not arise out of any provision of the proposed bill, but rather out of the provisions of the present law. This is the adjustment for inadmissible assets that must be made in determining the amount of invested capital. Section 720 of the Internal Revenue Code, as amended, gives the following definition of the term "inadmissible assets":

> (A) Stock in corporations except stock in a foreign personal holding company, and except stock which is not a capital asset; and
>
> (B) Except as provided in subsection (d), obligations described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income.

The term "admissible assets" means all assets other than inadmissible assets.

Under the further provision of section 720, the average invested capital for any taxable year must be reduced by an amount which is the same percentage of the average invested capital as the percentage which the total of the inadmissible assets is of the total of admissible and inadmissible assets. This rule is, however, subject to the further provision of section 720, paragraph (d), which lays down the rule that if the excess profits credit for any taxable year is computed under section 714 (invested capital basis) the taxpayer may in its return for such year elect to increase its normal-tax net income for such taxable year by an amount equal to the amount of the interest on all obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income. In other words, the taxpayer may elect, at its option, to include in normal-tax net income the amount of the interest received on Government obligations, State or Federal, and if it does so, the investment in such obli-

gations may be treated as an admissible asset and included in the invested capital credit. No such election is permitted, however, with respect to stocks in other corporations (except stock in a foreign personal holding company) and the investment in such stocks must be treated under the present provisions of the law as inadmissible assets in any event.

The failure to allow any option with respect to stocks and the dividends received therefrom works a particular hardship and injustice on many railroads which, pursuant to the consolidation provisions of the Transportation Act of 1920, made substantial investments (less than 95 percent) in stocks of other carriers for the purpose of ultimately acquiring control thereof under orders issued by the Interstate Commerce Commission. While these acquisitions were in a sense voluntary, Congress had laid down the policy that the consolidation of all the railroad properties of the United States into a limited number of systems was in the public interest. Under the act, the Commission was instructed to issue an order, approving and authorizing the acquisition of control by one carrier in another, only if, after hearing, it found that such acquisition was just and reasonable and would be in harmony with, and in furtherance of, the plan for the consolidation of railway properties previously mentioned and would promote the public interest. Accordingly, after passage of the Transportation Act of 1920, wherever a railroad acquired a stock interest in another carrier as a step toward control of such carrier, it did so only pursuant to a finding of the Interstate Commerce Commission that such acquisition was in the public interest and in accordance with the aforesaid plan of consolidation.

In practically all instances of this sort the railroad that acquired stocks of another carrier has had little, if any, return in the way of dividends from the stocks purchased. Indeed, the stocks were not purchased as an investment, but rather to carry out the policy of consolidations that had been adopted by Congress.

Therefore, in all fairness, the present law should be amended to give the taxpayer an option with respect to stocks and dividends thereon in the same manner as the option is given with respect to Government securities under section 720 (d).

For a long time the railroads have been burdened, we think unfairly, by the inability to include in consolidated returns lessor railroad corporations belonging to an affiliated group where the stock ownership is less than 95 percent. The property of these lessor companies is operated by railroad lessees, with an obligation in the lease contract under which the income tax of the lessor is paid by the lessee.

The statute in its present form recognizes the propriety, in view of the peculiar situation of the railroads, of dealing with railroad systems as economic units, where substantially all the stock of the constituent companies is owned within the affiliated group. The proposed amendment would extent the privilege of consolidated returns to situations in which it would appear that such privilege is eminently warranted.

Many of our railroad systems include roads that were leased by the proprietary companies for long terms of years. The leased line

is operated as part of the railroad system, just as any operating division, whether owned or leased, and is usually part of a through route. The moneys out of which the rental is paid to the lessor come from the operation of the integrated economic unit which constitutes the parent of lessee carrier. These leases, for the most part, were concluded a generation or more ago, during times when income taxes, at least on the current scale, undoubtedly were not in contemplation. These leases usually provide for rental measured by interest on bonded indebtedness of the lessor and dividends on its capital stock. Some of these leases also provide that the lessee shall pay taxes imposed not only on the leased premises but also on the rentals.

In such cases the lessee is under obligation not only to pay the stipulated rental but, as well, any income tax imposed on the lessor based on the rental income. It thus transpires that although the income tax is measured by the income of the lessor, it is not payable by such lessor or its security holders but by the lessee by virtue of its tax-assumption covenant. The rate or amount of income tax is a matter of complete indifference to the lessor. In truth and substance, the tax is imposed on the lessee. Under the law in its present form, it has transpired that operating railroad companies which have earned no net income and have suffered deficits have nevertheless been required to pay income taxes computed on the rentals which they paid to their lessors; indeed, they have been required to pay pyramided income taxes on the amount of income taxes of the lessors. In these circumstances, it would appear abundantly proper that there should be the privilege of a consolidated return so that there may be no inequity of assessment and so that, being an income tax payable by the lessee, it may be measured by the consolidated net income, if there be any, of both lessor and lessee.

We think the point we are urging would be accomplished by adding a paragraph to the present law in the appropriate place which would provide:

Any corporation (less than 95 per centum of the stock of which is owned by one or more of the other corporations in the affiliated group) may, at the option of the lessee hereinafter referred to, also be included in the affiliated group if it is a common carrier by railroad and its railroad properties are leased to the common parent corporation or another member of the affiliated group under a lease whereby the income taxes of the lessor are an obligation of the lessee: *Provided however*, That any corporation so included in the affiliated group shall not be liable for any tax in excess of the liability that would exist on its part if it had filed a separate return.

I thank the committee most sincerely for its patient attention.

The CHAIRMAN. There are two other witnesses here on the same question. Mr. Stowell, if it is agreeable, we will call you first.

STATEMENT OF L. C. STOWELL, NEW YORK, N. Y., REPRESENTING OFFICE EQUIPMENT MANUFACTURERS INSTITUTE

Mr. STOWELL. Mr. Chairman and members of the committee, my name is L. C. Stowell. I am here on behalf of the makers of business and store machines, and particularly the thousands of purchasers of this equipment who must bear the 10 percent excise tax on business and store machines proposed in the bill now before you.

Let me say at the outset that the Treasury Department did not recommend a tax on these machines, nor did any representative of the users and makers of these machines have an opportunity to appear before the House committee with respect to such a tax. This proposed excise tax of 10 percent on business and store machines was added to the bill after the close of the public hearings before the House Ways and Means Committee. For your convenience, there is inserted in the record, as a part of this statement, a list of articles on which excise taxes were recommended by the Treasury Department.

Beginning on page 65 of the bill and continuing on page 66, there will be found a list of 54 types of business and store machines upon which the tax is to be imposed. Various types of these machines are used in all kinds of businesses. They are used by Government, the lawyer, the manufacturer, those engaged on defense contracts for the Government, in your own offices, by the merchant, and even by the bootblack. You will find some of them in small hardware stores, groceries, bakeries, restaurants, barber shops, small manufacturing plants, and every retail establishment in the States you represent, as well as in each school, college, and hospital located within your State. In fact, as you know, there is hardly a single small enterprise in the country that does not use one or more of these machines. All of these users and others in the same category are potential purchasers.

These business and store machines are the "machinery of management," just as machine tools are the machinery of production. The machinery of management must be obtained and used before the machinery of production can be obtained and put into use, as well as all during the time the machinery of production is operating. For example, one of the world's largest plants for the manufacture of aeroplane motors, the Wright Aeronautical Corporation, rose like a mushroom. Before a spade full of earth was turned, however, management set up temporary quarters and installed temporary office equipment to provide vital control. There, as huge orders were placed for production machinery, some of the largest orders ever written for office equipment were placed at the same time. This is proof, indeed, that however fine its production machinery might be, this great plant could not operate or even prepare to operate without equally modern machinery of management.

These machines, the machinery of management, are the tools of business, small and large, standing equally in that regard with all other types of tools. They bear the same relationship to business that machine tools do to factories, that farm machinery does to the farmer, or the hammer and saw to the carpenter, or the plumber's tools to the plumber. There is no more reason for taxing these machines than there is for placing a tax on the tools of labor.

THE TAX AND THE NATIONAL DEFENSE PROGRAM

William L. Batt, of the Office of Production Management, as reported in the press recently, said:

> Many folks might scoff at the idea that the typewriter was an engine of war, but I submit that in the language of total war the typewriter, according to its proper meaning, is indeed in a sense an engine of war, for what sort

of a defense program could we conduct without typewriters? All of the paper work in defense industries would have to be laboriously done by hand. We would need several times the amount of paper and employees for clerical work. That would mean diversion of labor from other fields and a huge extension of the paper industry with all its implications in terms of economic dislocation.

He argued that typewriter production must increase because, obviously, with an increase of 25 or 30 percent in our national income we are going to need more typewriters for industry to function efficiently. The same applies to the entire list of business and store machines.

A trip through any of the numerous Government departments in Washington or elsewhere, or any business establishment, will give an adequate picture of the importance of office machines today. It is not too broad a statement to say that the United States Government could not be run without modern office machines. It will be obvious to anyone making a study of the situation that office machines should not be selected as a separate and distinct group to be the subject of taxation when the tools of production, agriculture, and defense are not taxed. The release of manpower arising from the use of office machines alone makes the contribution of office equipment to the national-defense program unique. This saving should be encouraged in every possible way and not discouraged by adding a substantial tax to its cost.

A representative of this industry has recently been called to Washington by the Priorities Division of the Office of Production Management to discuss the application of the A–10 preference rating plan to all those companies which need it. The officials of the Priorities Division of the Office of Production Management have become convinced that dynamic office equipment needs the assistance of a preference rating. These officials define as "dynamic office equipment" the exact machines which are listed in the tax bill.

The Priorities Division of the Quartermaster Department of the United States Army has recently requested that "business machines—all types" be placed on the critical list of items needed in the national-defense program.

These actions on the part of the Office of Production Management and the Quartermaster Department of the United States Army indicate clearly the vital importance of these products to all Government activities, business activities, and the national defense.

We believe this proposed tax is uneconomic. A 10 percent tax will fall with particular weight on the small retailer, businessman, and individual employer, because he must have modern business and store equipment, and the cost of it looms larger in proportion than in the larger business establishments. Numerically the small business men would be by far the largest payers of the tax.

Business machines are tools in the use of which over 2,000,000 people earn their living. No other tools with which people earn a living are being taxed.

We also believe there is a misunderstanding as to the amount of taxes to be collected.

Public announcements have given the estimated tax collections on business and store machines of $21,000,000. Conservative estimates of experienced men in the industry, with many facts to support their judgment, estimate that the tax collections will be $7,500,000, and to

the extent that the national-defense program requires increasing amounts of office equipment that total will be reduced.

Approximately 50 percent of all office machines being made today are going directly to immediate defense agencies of the United States Government and the direct defense industries, on which purchases no tax would be collected. This amount is growing rapidly.

A study of a cross section of the office equipment industry shows that taking 1938 as a base, the sales to the United States Government have increased 2½ times already, and will be above the 300 percent mark soon.

It is estimated conservatively by some of the companies in the office-equipment group that 70 percent of their total production will soon be going into either one of these two channels—namely, direct to the United States Government or to the defense industries on Government requisition, both of which would be nontaxable. Furthermore, where the equipment is not purchased on Government requisition, and is used in defense work, there will be no net tax, since the increased cost will be reflected in the cost of the goods manufactured.

Let me summarize:

1. This tax is discriminatory because these are the only tools, with which people earn their living, which it is proposed to tax.

2. Numerically it will fall heaviest on the many small businessmen, who are least able to bear it.

3. It will not produce the revenue estimated.

4. The tools of management are as important as the tools of production to national defense.

In conclusion, we feel strongly that this is an ill-advised tax as we have pointed out both from the standpoint of Government and small business. It must be remembered that this tax is not borne by the manufacturer but by the purchaser.

May I quote a statement made by a representative of the Treasury Department before the Ways and Means Committee of the House of Representatives, as follows:

> In the field of excise taxation, it is proposed that a number of new taxes be imposed and the rates of some existing taxes be increased. We have endeavored to avoid excises which would fall on the basic necessities of life and excises which, while productive, would constitute an increase in the cost of doing business and thus would be passed on to the Government and to the public in general price increases. We have, however, selected certain luxury articles which, though widely used, are not necessities.

The tax proposed is a direct violation of this principle.

We respectfully request your committee to eliminate this tax on business and store machines.

EXHIBIT A.—*Recommendations of the Treasury Department with reference to excise taxes*

Tobacco:
- Cigarettes: Additional 75 cents per 1,000.
- Cigars, tobacco, and snuff: Double rates.

Liquor:
- Distilled spirits: $1 per gallon additional.
- Fermented malt liquors: $1 per barrel additional.
- Wines, cordials, and liqueurs: Increase of 16⅔ percent.

Other excise taxes:
- Gasoline: 1 cent per gallon additional.
- Soft drinks: 1 cent a bottle and equivalents.
- Passenger automobiles, parts, and accessories: double rates.

Check tax: 2 cents per check.
Admissions: Reduce exemptions from 20 to 9 cents.
Tires and tubes: Increase rates from 2½ and 4½ to 5 and 9 cents.
Telephone, telegraph, cable, etc.: Lower exemptions and increase rates.
Passenger transportation: 5 percent of amount paid (35 cents exemption).
Telephone bill: 5 percent.
Furs: 10 percent of retail-sale price.
Jewelry: 10 percent of retail-sale price (1932 act exemption).
Matches: 2 cents per 1,000.
Radio sets and parts: Increase rate from 5½ to 10 percent.
Toilet preparations: Revise basis.
Trunks, suitcases and other luggage: 10 percent.
Phonographs and phonograph records: 10 percent.
Candy, chewing gum: 5 percent.
Musical instruments: 10 percent.
Bowling alleys: $15 per alley, billiard or pool table.
Club dues, initiation fees: Lower exemptions and redefine base.
Playing cards: Increase rate from 11 to 15 cents.
Safe deposit boxes: Increase from 11 to 20 percent.
Cabarets: 4 percent of total charge.
Photographic apparatus, etc.: 10 per cent.
Clocks, watches, etc.: 10 percent.
Mechanical refrigerators: Increase rate from 5½ to 10 percent.
Sporting goods: 10 percent.

Senator VANDENBERG. Mr. Stowell, what would you say to substituting a small general manufacturers' tax for all of these special excise taxes?

Mr. STOWELL. Senator, I am afraid I am not a tax expert, but it seems to me if there is going to be a sales tax or a manufacturers' tax it should be on everything.

Senator VANDENBERG. I agree with you.

Senator WALSH. Is there a great variety in the price of these machines?

Mr. STOWELL. Yes, sir; a very great variety. The typewriter sells for $115.50 and the highest priced bookkeeping machine probably for $2,500, and there is every range between those two.

Senator WALSH. There would be a tax of $250?

Mr. STOWELL. That is correct.

Senator BAILEY. Can you tell me to what extent our Federal Government and the State governments rent these business machines rather than purchase them?

Mr. STOWELL. Yes; there are various types of machines that are leased, tabulating equipment, and so forth.

Senator BAILEY. That is one machine that the Government leases. It is not allowed to buy that.

Mr. STOWELL. There are certain other types of machines that are leased, the tabulating machines being the principal product of all.

Senator BAILEY. The State of North Carolina leases a great many tabulating machines.

Mr. STOWELL. And business machines, too.

Senator BAILEY. This applies only to machines sold?

Mr. STOWELL. My personal interpretation of the act is it applies to both.

Senator BAILEY. I notice in the title here, the introductory language, it says "sold."

The CHAIRMAN. Pardon me, Senator. My understanding is that a sale is, in the regulations, interpreted to mean lease. It covers leases as well as sales.

Senator BAILEY. I was going on the language in line 4, the word "sold." Of course, it could be construed that you sell it on time, and that is a lease.

Mr. STOWELL. I think there is general language, either in the back of the bill or the front part of it, which covers that, but I am not certain.

Senator BYRD. What do the Treasury experts say to that? Does it include leased?

Mr. WRAY. I believe the sale there is defined to include certain types of leases.

The CHAIRMAN. The sales to the States are not taxed?

Mr. STOWELL. They are not taxed.

The CHAIRMAN. Nor the leases to the States?

Mr. STOWELL. No; I believe that goes to States, subdivisions thereof, and municipalities.

The CHAIRMAN. Yes; this tax law was recommended by the Defense Committee, was it not?

Mr. STOWELL. I am not sure. Mr. Leon Henderson appeared before the Ways and Means Committee and expounded a theory of cutting down on the use of office equipment. I do not know that he mentioned office equipment, I know he mentioned automobiles. That was on the theory that if you tax them the people will buy less and there will be more of the raw materials going into those machines available for defense.

The CHAIRMAN. Yes; I think it came from Mr. Henderson. He made the recommendations. He supplied a list subsequent which included the store machines.

Mr. STOWELL. Actually, Mr. Chairman, the office-equipment industry uses very little material when compared to the total material of the country. I made an estimate the other day. I will admit it is purely an estimate, but my estimate is we use about one-twentieth of 1 percent of the steel of the country, which of course is nothing in the main program. Labor is the big thing that goes into office equipment.

Senator BARKLEY. How many concerns are there manufacturing office equipment?

Mr. STOWELL. There are 35 concerns that are members of the Office Equipment Manufacturers Institute. It depends on how you define office equipment, but probably there may be 15 others. Most of the concerns, however, the important ones, are in the 35 group.

Senator BARKLEY. Are there one or two of the 35 who are members of your association that do a large amount of business?

Mr. STOWELL. A number of companies do a large business. There is no one company that dominates the field, if that was the import of your question.

Senator LA FOLLETTE. Mr. Stowell, could you furnish for the record an amplification of your contention that it will not yield the revenue estimated?

Mr. STOWELL. I will be very glad to do that.

Senator DANAHER. Mr. Chairman, a question.

The CHAIRMAN. Yes.

Senator DANAHER. Did you happen to see the United States News for August 8, 1941, in which it depicted the tools of defense?

Mr. STOWELL. Yes; I did.

Senator DANAHER. In 1939, Mr. Chairman, the record, as reported by the United States News, shows a total purchase of $24,000,000 by the Government of machines for office equipment. In 1940, $35,000,000; and in 1941, $100,000,000. The Government's use is so great, in the article that appeared in the United States News issue of August 8, 1941, the matter is so important, that I would ask that the balance of the article be introduced in the record, unless there is some objection.

The CHAIRMAN. It may be inserted.

(The article referred to is as follows:)

[From the United States News, August 8, 1941]

TOOLS OF DEFENSE

Increasing Government Purchases of Office Equipment

(1939, $24,000,000; 1940, $35,000,000; 1941, $100,000,000)

Behind the grim front-line machines of modern war are peaceful-looking office machines which handle a vast amount of paper work for the Army and Navy. The click and whirr of typewriters and tabulating machines at military headquarters are as much a part of machine-age fighting as the scream of dive bombers and the rumble of tanks in the front lines.

In fact, William L. Batt, Deputy Director of Production, of the Office of Production Management, says the typewriter in total warfare has become an engine of war. Without machines for its office tasks, the Army would get snarled in its paper work. Then large-scale organization for total war would be impossible.

Mechanization of paper work is keeping step with use of machines for land, air, and sea fighting. As the pictogram shows, Government purchases of office machinery have increased tremendously under the national-defense program.

Trade authorities estimate direct Government purchases of office machines this year will approximate $100,000,000, or one-third of all office-machine sales. Directly or indirectly, defense may account for three-fourths of this year's estimated $300,000,000 office-machine sales. Previously, Government purchases took about one-sixth of the industry's output.

Army purchases of office machinery in the fiscal year ended last June 30 jumped to around $6,500,000, compared with $565,000 in the previous year. For an Army of 1,500,000 men, more than 50,000 typewriters alone had to be acquired.

Defense purchases of office machines were added to the Government's usual large requirements. Even in peacetime, the United States Government is the greatest single buyer of office machines in the world. Uncle Sam's office force of more than 500,000 clerical workers uses thousands of typewriters, adding and addressing machines, and mimeographs. Much tabulating machinery of advanced types had to be installed for the New Deal ventures in social security, public works, crop control and other undertakings involving big-scale accounting.

Now the increasing scope of Government activity for war accelerates the shift of machines in the office as well as in the field. Most of this machinery has been developed since the World War. In the 1914–18 conflict office machinery meant chiefly such mechanical aids as the typewriter. The main record-keeping jobs were done by hand.

Now tabulating machinery is specially designed for the huge accounting tasks of Government and military organizations. The Adjutant General's office in the War Department, profiting by the experience of private business, is using machinery in handling the records of individual soldiers.

Keeping tab on the movements of 1,500,000 men in itself is a heroic task of record filing and sorting. Tabulating machines have solved this problem for the Army. Electrically operated machines sort and classify cards which record the endless changes in the Army's manpower. Office machines likewise have lightened the task of the Quartermaster Department in keeping up-to-date inventories of thousands of items of supplies.

Senator DANAHER. I would like to ask the witness one other question. On page 63 of the bill let me read lines 3, 4, and 5:

> There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold * * *.

Then it includes this business equipment. Is there any undue advantage given to a manufacturer under that language provided he sells through direct outlets rather than through jobbers and distributors?

Mr. STOWELL. No, sir. He will collect the tax if he does not sell it. I am expressing only a personal opinion. The industry is divided on that. There are companies in the industry that sell through dealers, and all the companies, practically speaking, sell through dealers in some of the smaller points in the country districts. I assume that the dealer will collect the tax in that case, and there are a great many office equipment dealers throughout the country.

Senator DANAHER. If a manufacturer sold directly, through, would he not be able to sell at a great deal less, by virtue of the fact that he is selling through his own organization rather than through distributors?

Mr. STOWELL. There are some economies. On the other hand, manufacturers cannot afford to have their own distributing point in some districts, because they would only be distributing their own product, and in a country district a man may distribute typewriters, adding machines, store machines, and other things all in one store and I would say he would collect the taxes. The manufacturer would only collect the taxes when he would sell direct to the consumer himself. That is my interpretation of the law.

Senator DANAHER. Under section 3441 of the Internal Revenue Code, there is provided a method for determining the sales price. It says, and I quote the pertinent portion:

> If an article is sold otherwise than through an arm's-length transaction at less than the fair market price the tax under this chapter shall, if based on the price for which the article is sold, be computed on the price for which such article was sold in the ordinary course of trade by manufacturers or producers thereof as determined by the Commissioner.

Do you know of any difficulty in the administration of that particular provision which gives the Commissioner the right to set up the price for which the manufacturer sells?

Mr. STOWELL. I do not know of any, because within the confiines of the United States the companies that sell direct, or sell a portion of their product direct, would sell, roughly, at the same price at which the dealer would sell. We do not compete with the dealer. It is not a matter of the dealer selling one of the machines, in my view, and we are selling in the same district with him. If we have an office we do the selling. We have an office in Washington, there is no dealer in Washington. In Hagerstown we have a dealer, perhaps. We do not deal with anybody else in the District. He is the representative of our company.

You have to render service on these things, too, and we have to all have a very large service organization, and that means you have got to have a substantial establishment.

Of course, another point which I did not make in my brief is the matter of export sales. Export sales would not be taxable. Our

export business, as you gentlemen know, has shrunk, but we still do more business than the general public thinks we do. The investing public thinks the export business has gone overboard completely. It has not. It has not; it is much less than it was before the hostilities in Europe. There is no tax collected on that business, at least if I am correct in my statement.

Senator BYRD. What percent of the export business do you have now as compared to normal times?

Mr. STOWELL. In normal times our own company had 30 percent, Senator, outside the confines of the United States.

Senator BYRD. What has that shrunk?

Mr. STOWELL. That has shrunk two-thirds.

Senator BYRD. What is the percentage for the industry as compared to before the war?

Mr. STOWELL. It is two-thirds to one-third. That would be about 15—between 10 and 15 percent, probably. That varies for different companies, of course. My own company, however, in normal times exported one-third of their product outside the continental United States.

Senator BYRD. Now you export about 10 percent?

Mr. STOWELL. Yes. It varies between 10 and 15 percent sometimes.

The CHAIRMAN. Any further questions?

Mr. STOWELL. Thank you very much, gentlemen.

The CHAIRMAN. Thank you for your appearance.

(Mr. Stowell submitted the following letter for the record:)

UNDERWOOD ELLIOTT FISHER CO.,
New York, August 15, 1941.

Hon. WALTER F. GEORGE,
United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: As you suggested in our conversation after I had appeared on Wednesday, August 13, before the Senate Finance Committee on behalf of the Office Equipment Manufacturers Institute in opposing the proposed 10 percent manufacturers excise tax on business and store machines, I am submitting to you an explanation of a paragraph of my statement before the Senate Finance Committee which reads as follows:

"Public announcements have given the estimated tax collections on business and store machines of $21,000,000. Conservative estimates of experienced men in the industry with many facts to support their judgment estimate that the tax collections will be $7,500,000 and to the extent that the national-defense program requires increasing amounts of office equipment, that total will be reduced."

The Office Equipment Manufacturers Institute is in possession of data from 24 of its present 34 member companies, the 24 companies representing all of the larger companies in the membership of the Institute with but one exception. This data makes it possible to give the following reasonably accurate estimate. Total estimated volume of sales of the items listed in the tax bill.

1941, at retail	$176,000,000
Sales to Government, Federal, State, county, municipal (not subject to tax)	100,000,000
Total	76,000,000
Possible tax	7,600,000

Figures were submitted during July by the Secretary of the Institute, Mr. E. D. Taylor, which were used in a letter which was addressed to the Honorable Colin F. Stam, of the Joint Committee on Internal Revenue. These figures showed a possible tax of $4,500,000. The reason for the difference in our present estimate of $7,600,000 and the $4,500,000 estimate mentioned just above is as follows:

On arriving at the $4,500,000 estimate, 40 percent was deducted from the $76,000,000 figure in the above table to arrive at a so-called manufacturers price upon which to base the tax. Because we are not certain what basis might finally be allowed for computing the manufacturers price and, further, because we wished to make our statement before your committee a very conservative one, we have disregarded this item completely and have used a round figure of $7,500,000.

I trust the above information will be satisfactory to you. If there are any other questions you may wish to have answered, I will be happy to supply you with the needed information.

I wish to emphasize again our strong belief that the proposal to tax business and store machines should be eliminated entirely from the bill by the Senate Finance Committee and your assistance toward accomplishing that end will be sincerely appreciated.

Sincerely yours,

L. C. STOWELL.

(The following letters relating to the proposed new manufacturers' excise taxes (sec. 522), as applying to "(6) Business and store machines," are typical of many received by the Senate Committee on Finance. The other letters of this nature are on file and have been brought to the attention of the committee.)

BAUMANN WHOLESALE DRUG CO.,
Shreveport, La., August 21, 1941.

THE SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: I have been considering the purchase of some cash registers and bookkeeping equipment to help me keep the information necessary to control my business and make out all the reports now demanded by State and Federal agencies—now I see in the papers that Congress proposes to place a 10-percent tax on such machines.

If you are going to tax us in order to meet the expenses of this war, and I think most people around here will agree with me on this, why not place a tax on everything so that each person will bear his and her share?

These business machines are just as necessary to us businessmen as planes and tanks are to our Army, so please don't pick us out as the particular class who will have to pay more than its share of the bills.

Respectfully yours,

L. J. BAUMANN.

EXCHANGE OASIS CAFE,
Houston, Tex., August 21, 1941.

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

GENTLEMEN: At a recent meeting of the Houston chapter of the State Restaurant Association of Texas, of which I am president, I was appointed to write you regarding our position on the proposed bill now before Congress contemplating a 10 percent excise tax on cash registers.

We have a membership of 87, mostly small restaurant operators. While we realize that increased taxes are inevitable and we expect to carry our part of the load; all members present at the meeting felt that cash registers least of all should be taxed and that 10 percent was entirely out of line.

Cash registers are a business necessity and a merchant could not operate successfully without the protection and information they provide.

They are an intricate machine and already carry a price that is almost prohibitive.

Since the tax that the Government will receive will depend largely on the systems used by merchants, it should encourage rather than discourage the purchase of cash registers.

We feel that a tax of 10 percent on a business necessity is exorbitant and will deter rather than aid tax receipts.

Very truly yours,

C. M. LINDSEY,
President State Restaurant Association of Texas.

LAWRENCE COUNTY RETAIL DRUGGISTS ASSOCIATION,
New Castle, Pa., August 20, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: Our organization is opposed to the 10-percent excise tax bill as applying to store equipment.

We feel that the retail business is already burdened with more than its just share of tax.

We earnestly request that your committee not recommend such tax.

Respectfully,

LAWRENCE COUNTY RETAIL DRUGGISTS ASSOCIATION.
By CARL S. PAISLEY, *Secretary.*

FARMERS' & CONSUMERS' CO., INC.,
Fort Worth, Tex., August 21, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: We have been reliably informed that your committee has approved a tax to apply on calculating and office business machines. If this is true we wish to register a vigorous complaint. Among the overhead we bear is the expense in connection with the food stamps, a charge by the banks to make collection at Dallas, all the excise taxes applicable. Business machines are an absolute necessity and surely there is no need to tax a businessman with the tools for use in his business.

Please reconsider your approval of this tax.

Yours truly,

FARMERS' AND CONSUMERS' CO.,
By W. E. GUINN, *Comptroller.*

SEABOARD OIL CO., INC.,
Fairfield, Conn., August 22, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: I have watched with growing concern the increased taxes on the small independent merchant in this country.

The contemplated tax on office equipment, cash registers, and similar items that are not luxuries but absolute necessities to my business seems to me to be directed at the small businessman. All of these articles are necessary to conduct a business and make enough profit to pay the heavy taxes we already have to bear.

I would appreciate any effort that you may make in changing this tax legislation so that it would be fairer to the independent merchant of this country.

Very truly yours,

GEORGE N. SERRE,
Vice President and Secretary.

Mr. VANDENBERG. Mr. Chairman, at this point in the record, may I ask that there be inserted for the information of the Senate a short statement made by Mr. Stam on the general subject of a general manufacturers excise tax as printed at pages 86 and 87 of the House hearings? It is very illuminating and covers the entire proposition.

The CHAIRMAN. The clerk will give it to the stenographer, Senator Vandenberg.

(The statement by Mr. Stam is as follows:)

GENERAL STATEMENT AS TO GENERAL MANUFACTURERS' EXCISE TAX PROPOSED IN 1932

As an emergency depression measure, a general manufacturers' excise tax was proposed in 1932 in H. R. 10236, Report No. 708, Seventy-second Congress, first

session, and reported to the House of Representatives by the Committee on Ways and Means. In general, it was modeled on the principles of the Canadian sales tax and was designed to prevent pyramiding or imposing several taxes as a product passes from manufacturer to manufacturer, dealer to dealer, and so on, resulting in cumulating or duplicating the tax. Manufacturers and producers were to be licensed. Goods passing from a licensed manufacturer, producer, or registered dealer to another manufacturer, producer, or registered dealer were to be free of tax. Foodstuffs, farmers, and small businessmen were to be exempt. Otherwise it was considered advisable to restrict exemptions and keep the base very broad. The rate proposed at that time was 2¼ percent on the manufacturers' price determined at the factory or place of production and was designed to raise for 1933 about $595,000,000. The proposal was debated in the House and defeated.

Features of 1932 proposal

Rate.—Rate was to be 2¼ percent, to raise, in 1933, $595,000,000.

Imposition of tax.—The tax was to be imposed generally upon the price at which the manufacturer or producer should sell the commodity. Provision was made for determining the sale price which was to be the basis of the tax. In general, it was to be the manufacturer's or producer's price at the factory or the place of production. It was to be imposed upon the sale of every article sold in the United States by the manufacturer or producer thereof, except manufacturers or producers exempt from licensing under the bill, with certain exceptions necessary (1) to prevent pyramiding and (2) exceptions required by the Constitution.

Exceptions to imposition.—1. Exceptions necessary to prevent pyramiding included provision for the tax-free transfers between licensed manufacturers of articles for further manufacture. Licensed manufacturers were to be allowed to sell to registered dealers, free of tax, articles to be resold to licensed manufacturers for further manufacture.

2. Sales for exportation and sales by manufacturers to States and political subdivisions thereof, and agencies thereof, were exempted for constitutional reasons. (Sales to the United States, the Territories, and the District of Columbia were not exempt.)

Exemptions.—Necessity for a wide base was considered necessary and emphasized. There were a few specified exemptions, including:

1. Farmers.
2. Staple food products.
3. Small manufacturers.

Farm products and foodstuffs exempted are set out in section 602 of the bill, H. R. 10236. Farmers were exempted from licensing (sec. 606). Small manufacturers and producers, with gross sales of less than $20,000, were exempted to lessen the administrative burden which would be occasioned by licensing them (sec. 606).

Essential tests of a sound plan

The Committee on Ways and Means set up, as six fundamental tests of a sound manufacturers' tax, the following (Rept. No. 708, 72d Cong., 1st sess.):

(1) The rate should be low, so that undue burden will not be imposed.

(2) Certainty, both as to liability and account, must be attainable in advance of the sale.

(3) Pyramiding must be prevented.

(4) The tax must be imposed uniformly and without discrimination.

(5) Provision must be made for the least administrative difficulty (such as classifications arising in connection with exemptions).

(6) Adequate authority must be granted to assure a sound, smoothly functioning, and flexible administration.

Certainty.—It was considered essential that persons required to make returns and pay the tax must know in advance of the sale whether the sale is taxable and the amount of tax liability. Also he must be able to rely on such determination. Retroactive imposition or change in method by which the tax is computed were to be avoided, as likely to result in hardship and break-down of the tax.

Certainty was provided by authorizing advance decisions by the Commissioner by preventing retroactive changes and rulings and regulations, and by authorizing final closing agreements.

Elimination of pyramiding.—Imposition of several taxes with respect to any article (pyramiding) was considered to have been eliminated by a system of licensing, described below.

All manufacturers and producers (other than those whose gross receipts were less than $20,000, who were exempt) were to be licensed. Provision was made for sale of articles tax-free from one licensee to another. By this method, the product of one manufacturer which was to be used as a material by a second manufacturer, could pass through all stages of manufacture without the imposition of a tax. Thus, the tax was to be imposed but one, and that upon the final sale of a finished product as it entered the channel of consumption.

Also, in order that partly manufactured goods could pass through wholesalers, dealers, or importers, the licensing system was applied also to persons of this class, or "registered dealers." They could purchase tax-free articles which they were to resell to licensed manufacturers for further manufacture. In this respect, the 1932 proposal differed from the then existing Canadian system, where all wholesalers were licensed and could make all their purchases tax-free. By this feature of the 1932 proposal the heavy administrative burden of issuing licenses and supervising licenses was to be avoided.

Uniform application of tax.—It was desired that each member of a competitive group pay tax upon substantially the same basis as all of his competitors. Manufacturer's or producer's price at place of manufacture or production was to be the base of the tax.

Avoidance of administrative difficulties.—Such avoidance was considered necessary in order that the tax work fairly. For instance, a large exemption list would have required an administrative agency to pass on proper classification, such determination would involve delay and retroactive application, with hardship on business.

Wide scope of tax.—By section 617 of the bill the articles on the sale or importation of which the tax would be applied included commodities of every description, thus spreading the incidence of the tax over a broad field.

Additional administrative personnel.—Such personnel was authorized.

Effective date of the tax.—It was provided the tax would be ecffective 30 days from the date of the enactment of the tax.

Sales tax not to apply to articles already taxed.—Articles already subject to Federal excise taxes were not to be subject to the tax.

STATEMENT OF ALVIN E. DODD, NEW YORK, N. Y., PRESIDENT, AMERICAN MANAGEMENT ASSOCIATION

The CHAIRMAN. Mr. Dodd, will you give your name, please?

Mr. DODD. Alvin E. Dodd, president, American Management Association.

The CHAIRMAN. You are addressing yourself to the same subject that Mr. Stowell discussed?

Mr. DODD. Yes, Mr. Chairman.

The CHAIRMAN. You may proceed with your statement.

Mr. DODD. What I would like to do, Senator, is to give a sort of highlight of this 4-page memo I have. I do not need to go into all of it.

The CHAIRMAN. Yes.

Mr. DODD. Rather, I want to speak for management, both business and industrial, and to try to interpret the feeling that management reflects through the organization of which I am the president, rather than speaking for any special group of manufacturers making these machines or anything related to that sort of thing, because this 20-year-old association of which I am the head has, as its objective, better management. That includes everything it contributes to make efficient business operation, more skillful and economical manufacturing, more intelligent and productive selling. Composed, as it is, of about 4,000 industrial and commercial companies and their execu-

tives interested in advancing management techniques, we are interested in all phases of management. We make no profit; we do no lobbying, and advance no propaganda, nor espouse any causes except that of better management. So our sole interest is the solution of management problems.

Of course, let me state parenthetically, we recognize that money has got to be raised, and also, I want to indicate full support of the principles set forth by the Treasury Department to this committee on April 24. In other words, what I am going to say is hung on the principles enunciated by the Treasury rather than on being against something per se. Rather, I think that this excise tax that Mr. Stowell was talking about is somewhat against the principles that I believe the Treasury enunciated very correctly, and those were two cardinal principles really: That the money should be raised equitably and should be raised with a minimum of disruptive effect, that is, should be collected with a minimum of interference with the effective mobilization of all our manpower, managerial capacity, business enterprise, and national resources, and that the additional tax burden necessitated by the emergency should be distributed equitably among the several segments of our population.

While the Treasury gave some other observations on principles that I have down here, I will skip some of them, but in the field of excise taxation, it is proposed that a number of new taxes be imposed and the rates of some existing taxes be increased.

The Treasury said they would endeavor to avoid excise taxes which would fall on the basic necessities of life, and excises which would constitute an increase in the cost of doing business and thus would be passed on to the Government and to the public in general price increases. The Treasury said they had selected certain luxury articles which, though widely used, were not necessities.

Then they also pointed out that the program outlined would do effectively the job, and in fairness to everyone. So that I believe you will agree with me that the Treasury's suggestions—and I am now quoting from what Mr. Sullivan said when he was representing the Treasury, that—

> The Treasury's suggestions distribute the burden in a fair and equitable manner and that this entire tax program will be accomplished without disrupting or dislocating industry or our economy.

The passages of this quotation which I have stressed are clear indications of the intention to be equitable and to be nondisruptive.

Now, as authorities on industrial management and on defense have pointed out—Mr. Stowell did it very well—the typewriter and business machine are engines of war. For what sort of a defense program could we conduct without typewriters? Some of the people in industry suspected that something was going on in Iceland weeks and weeks before, because they were all ready to send typewriters and business machines up there before any soldiers sailed to Iceland. For what sort of defense program could we conduct without the business machines? All of the paper and calculating work in defense industries would have to be laboriously done by hand. The production of business machinery must increase because, obviously, with huge increases in our production we are going to need more in order for industry to function efficiently. We are very much concerned

about the speed-up in this whole production situation, or the lack of it. Such efficiency, in turn, is another of those principles set forth by the Treasury Department.

So, I submit for the consideration of this committee that the imposition of an excise tax upon business machinery—certainly today, at least, in the light of today's endeavor toward the epitome of all-out defense—is contrary to the very tenets to which both Government and management are trying to adhere.

In the Treasury Department's April statement to the House Ways and Means Committee, the point was brought out that "one important motive" in the imposition of excise taxes should be to curtail consumption—hence, of course, production—of items which compete with an all-out defense program. Is this not a contradiction of purposes? We must have more, not less, of business machinery to do our defense job. You look at the questionnaires that the O. P. M. sends out and what is the first line on top? "Put in typewriting."

I believe there is no plan to impose excise taxes upon plows, harvesters, or the lathe or milling machine, or upon the shipbuilder's tools or the loom that weaves the soldier's uniform. The business machine is just as basic an implement of war, an instrument of defense, a vital tool for keeping other tools going, for we certainly exist by records. Such records as we must have to do a proper defense job are possible only through business machinery of various kinds. Why put an excise tax on one small segment of our defense machinery? Indeed, the Government finds business machinery so important a factor in direct defense that the Priorities Division of O. P. M. has pronounced it an "essential industry defense supply" with a rating of A–10.

Furthermore, the Government is today taking aproximately 50 percent of the production in this field. That picture you are going to have put in the record is a very dramatic example of that sort of thing. Of course, as the Government does not pay taxes on that high percentage of the output they are taking, the revenue would be relatively small, and, I suspect, very much less than was originally thought of, because when that was figured out it is doubtful that they had realized what those pictures show and how much less it would bring. But that is not the important point. The important point is that it is a very discriminative tax, as I have pointed out.

So may I urge in summary your consideration of the fact that management—the commercial and industrial management whose views I have tried to give you—will pay a tremendous share of the defense bill in any case. It can produce more revenue from increased business than from an inequitable excise tax on one small segment of essential defense machines.

I come back to the thought you raised a while ago, Senator Vandenberg.

Senator VANDENBERG. You mean you agree to a small manufacturers' sales tax in substitution for the excise taxes?

Mr. DODD. Yes; I think, that is, on an equitable basis. I sincerely believe, however, that the time has come for us to have the political courage to bring the income tax down into the lower brackets. I also believe that an excise tax (that will be inequitable anyway) will contribute little toward solving the problem of increasing revenue.

Thank you very much.

Senator VANDENBERG. If this bill goes through, there is a manufacturers' sales tax on probably 3,000 items of commerce, so we have already abandoned any thought that it is against the law to discuss a sales tax, and if you are going to have a half you might as well have a whole one.

Mr. DODD. A lot of people do not like sales taxes; I do not believe Congress likes them, but what are we going to do?

Senator VANDENBERG. We do not like any of the taxes.

Mr. DODD. Mr. Chairman, I desire to read into the record a letter addressed to the committee by Mr. William H. Evans, secretary, National Office Management Association, expressing opposition to the proposed excise tax on office equipment.

(The letter referred to is as follows:)

NATIONAL OFFICE MANAGEMENT ASSOCIATION,
Philadelphia, Pa., August 11, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: Your clerk, Mr. Johnston, has suggested that this association, composed of approximately 1,750 individuals interested in better management, express to you through Mr. Dodd, its reaction to the proposed excise tax on office equipment.

Our members are opposed to the imposition of such a tax because of its evident effect upon office efficiency. Modern industrial and financial activities are dependent almost completely upon the paper work of the office. In a thousand different ways, from the computation of pay rolls to the conduct of correspondence, machines play an important part in business. Typewriters, computing devices, addressing apparatus, and the countless other mechanical aids enable the office manager to discharge his responsibilities in a fraction of the time which would otherwise be necessary.

Furthermore, office help which would be required to replace machinery is not now available. This condition has already severely handicapped private and governmental organizations.

In these times no obstacle should be thrown in the way of increased productivity, and no industrial enterprise can move any more freely than its office routines permit. It is our belief that the problems of the office would be greatly intensified if such a tax were to be levied.

On behalf of the members of our association, therefore, I request the rejection of the proposed tax.

Respectfully yours,

WILLIAM H. EVANS, *Secretary.*

The CHAIRMAN. Thank you very much. Mr. Lawrence.

STATEMENT OF JOHN V. LAWRENCE, WASHINGTON, D. C., GENERAL MANAGER, AMERICAN TRUCKING ASSOCIATIONS, INC.

Mr. LAWRENCE. Mr. Chairman and members of the committee: My name is John V. Lawrence. I am general manager of the American Trucking Associations, Inc., with offices at 1424 Sixteenth Street NW., Washington, D. C.

The association is a federation of 50 individual associations representing our industry in the various States, the District of Columbia, and the Territory of Hawaii. Among its members are represented all of the various types of trucking service.

Members of the various State associations are members of the national organization, and they exercise their franchise through such local associations.

Power in the national organization lies in a board of directors, consisting of seven members from each State, Federal district, or Territory, drawn from all the various classes of truck operations.

At the outset, let me state that the motor-carrier industry stands solidly behind the efforts of the Congress to give the Nation an adequate defense, a defense which will enable it to successfully meet any eventuality which the future may bring. We realize, of course, that this means spending vast sums of money, some of which must be raised by increased taxes, and all of which must eventually be paid by such levies.

The trucking industry, at the present time, pays each and every one of the general business taxes which other industries are subjected to.

In addition to these ordinary taxes paid by all businesses, the truck operators are, and for sometime past have been, paying to the Federal Government the annual sum of over $100,000,000 in the form of excise taxes on trucks, accessories, parts, fuels, and lubricants, a form of taxation to which no other industry is subject.

We appeared before this committee on the excess-profits tax proposal of 1940. We want to again thank you for the very sympathetic consideration that was then given our problem by you. Because of the capital structure peculiar to this industry, we were not in most cases able to use the invested capital basis for computing this tax without punitive results. Because of low earnings, with many carriers in the red—we are in very much the same situation that Judge Fletcher's people were in—in the base period the average earnings method under the original act of 1940 rested heavily on our people. Considerable relief was granted them in the 1941 amendments which were passed by the Congress. We do hope that the average earnings method will be retained as an alternative to the invested capital basis of computing the excess-profits tax.

Adequate truck transportation facilities are an essential factor in carrying on the present defense program of this country. A quick survey conducted by the motortruck committee of the Automobile Manufacturers Association, the results of which were included in a brief filed with William S. Knudsen, Director General, Office of Production Management, on April 24, 1941, showed that 36 companies engaged in defense production had 4.3 percent of their incoming traffic and 22.1 percent of their outgoing traffic move by motortruck. The total percent of incoming and outgoing traffic was 12.1 percent.

As typical of unsolicited comment in those replies, the brief said, one aircraft manufacturer reported 90 percent of its tonnage handled by truck, because the trucks permitted a lower minimum load. Thus smaller quantities could be accumulated quicker by truck than by rail.

Another aircraft manufacturer reported 50 percent of its tonnage handled by truck, with 100 trucks a day moving in and out. Both of these firms expected decided increases during the last half year of shipments handled by truck.

A survey made by a leading truck-trailer manufacturer recently of 455 motor carriers disclosed that the amount of their defense business ran anywhere from 10 percent of their volume to 95 percent of their volume. That cannot be exact, because in common-carrier traffic particularly, one never knows, for instance, when a bit of material passes through their hands, some may go into defense and some may not, and of course, that was not segregated.

Manufacturers' excise taxes were originally imposed as emergency taxes on articles deemed to be luxuries, or at least dispensable conveniences. Automotive products are clearly necessities today, because of the very use to which they are put. This is particularly true of equipment, parts, tires, fuel, and so forth, for truck transportation.

As I indicated before, trucks, in special State taxes on license tags and gasoline, more than pay their share of road construction and maintenance cost. Chairman Eastman of the Interstate Commerce Commission in his study as Federal Coordinator of Transportation on Public Aids to Transportation found that, without crediting motor-vehicle operators with Federal excise taxes paid, or special motor-vehicle taxes diverted by the States to nonhighway purposes, these same operators overpaid their share of highway costs by $501,138,000 between the years 1921 and 1937. This annual overpayment showed a steady increase, reaching its peak in 1937, when it amounted to $110,772,000.

Mr. Eastman found the trucks more than paid their share of highway costs, by as much as $287 per vehicle per year on the largest for-hire vehicles.

The act of June 25, 1940, increased excise taxes on tires by 11.1 percent, on tubes by 12½ percent, on truck chassis by 25 percent, on parts by 25 percent, and on lubricating oil by 12½ percent. In addition, one-half cent was added to the Federal excise tax on gasoline, or an increase of 50 percent for defense purposes.

The bill before this committee, as it comes from the House of Representatives, doubles the already increased rate of excise taxes on equipment, tires and tubes and parts—and I refer to truck equipment. In addition, a 5 percent tax is placed on trailers and semitrailers, not in effect before. This is an impost placed on one form of transportation not visited on all others.

As I indicated before, earnings from 1938 on have been very slim. They were slim in 1936 and slim in 1937. Class I motor carriers had an operating ratio of 97.26 percent in 1938 and 95.14 percent in 1939. Chairman Eastman, of the Interstate Commerce Commission, in a concurring opinion in MC–F–1108, Keeshin Freight Lines, Inc.—Issuance of Notes, decided by the Commission on February 3, 1940, held that prosperous conditions in the motor-carrier industry required an operating ratio of 90 percent. In recent months, with rising costs, carriers who formerly netted 5 percent on their gross revenue have seen their percentage shrink in half.

These increased excise taxes will still further shrink this revenue to the vanishing point, particularly if this Committee should go further and recommend an excise tax on the gasoline used.

Specific figures, however, speak probably more eloquently than I am able to. One truck line operating on the Atlantic coast, and which keeps close account of the mileage and gasoline consumption of its trucks, indicates that its vehicles average slightly in excess of 114,000 miles per year—that is the intercity vehicles—with a gasoline consumption of 4.2 miles to the gallon. This mileage, which applies to their interstate over-the-road trucks only, is not unusually high. At this rate, each road truck would consume 27,143 gallons of gasoline per year. An increase of 1 cent per gallon in the gasoline levy would cost this company $271.43 per truck per year.

Another company, also operating in the Atlantic coastal area, but with a shorter operating radius than the line just referred to, has an average gasoline consumption for all of its vehicles, both over-the-road and the lighter and more economical pick-up trucks, of 8,000 gallons per year. The heaviest over-the-road trucks, in contrast, consume over 19,000 gallons each annually. An increase of 1 cent in this tax would mean an increased annual cost to each truck of $190.

Another operation, operating in Missouri and nearby States, has an annual per-vehicle consumption of over 12,000 gallons.

Those figures I have given are just typical. We could pick them across the country in varying mileages, but they are all high.

Quite to the point, also, is the fact that this increase in operating costs could not be passed on down the line, eventually to be paid by the ultimate consumer, as is the tax, for instance, on cigarettes. It is easy enough to say, "Why not have the rates increased?" but that is not easily done in an industry whose rates are regulated as a public utility.

We cannot very well, under our tariff rules, issue a freight tariff to a man and say we burned 17 or 17½ gallons and the tax will be so much and that is included and distributed to the shippers.

The CHAIRMAN. Your industry would rather have the $5 use tax on the automobile——

Mr. LAWRENCE. That would be a fraction of what the increase would be if the gasoline tax were increased 1 cent.

The CHAIRMAN. Than the 1-cent-per-gallon increase on gasoline?

Mr. LAWRENCE. Yes; I might mention right here that our industry is a little different than what most people base price theories on. A man manufactures shoes, or a lot of other commodities that just run through a production line, and if he doubles his production the chances, are his unit profit, say it is 10 cents a unit, is going to increase on the double production when he ships those shoes, but on transportation it is much different. Take for instance in Senator Vandenberg's city of Detroit in his State; Detroit is typical of troubles that a transporting agency has in getting a balanced movement for freight in-bound and out-bound, so much moves on its own wheels, whereas the trucks that the clothing people use moved in, and the parts go on their own wheels. That has been the bugbear of transportation.

I was speaking of defense. We have movements out of Akron, to one of these eastern airplane plants. It is overnight service. Trucks leave at 8 or 9 o'clock at night, and deliver early the next morning at the airplane plant. They want parts quickly. They thought it was splendid business. That truck operator, by dint of effort, built up a return business from this eastern city that pretty well balanced his load. His rates are based on 62½ percent load factor. He has got to get at least that on the round trip, whereas if he gets five or six extra loads at night and he has nothing to go back he is losing money on every load he handles.

The same thing with camps in the Southwest. Where you had towns of 5,000 people before, with a balanced situation worked out after months and years of effort, they have suddenly 30,000 or 40,000 people in this territory and everything is moving in. While you may say this upsurge of traffic is helpful in increasing the growth of

business, it cuts the margin of profit, because the traffic gets unbalanced and the operating ratio goes up. It is different from the manufacturing business in that respect. So the only out we have is to get an increase in rates, and anyone familiar with public-utility rates knows it is quite easy to get rates decreased before a public commission, but it is another problem to get them increased. It is long drawn out and they are broke by the time their rates are increased.

Now we appeared before this committee before. I might mention before concluding that we have this problem, too, that the size of a unit is restricted, naturally, and properly so, by State law, that we cannot just hook on something more when we have an increased load. We have got to put another man on the truck. Our labor actually runs about 50 percent of our gross operating dollar. We have more labor to pay, we have more loaders. In lots of States we have to break the load into two loads, with almost 50 percent increase in cost. So the increased volume does not convert itself into increased profit. In other words, the margin on the unit gets smaller and smaller as it grows up in times like these.

We have appeared before this committee before with our problems, and have not failed to receive sympathetic consideration. We are quite confident that again we will receive the same degree of consideration and we hope accord with our ideas. Once again we wish to reiterate that we are entirely in sympathy with the national-defense program, cost what it may. But we urge that you refrain from taking a chance on crippling transportation on which, in the event of hostilities, the success of our military and naval operations must, in the last analysis depend.

Senator VANDENBERG. As the bill now stands, then, the only thing apparently that you complain against is the new excise taxes?

Mr. LAWRENCE. That is so; they are practically doubled, as I recall, Senator. Of course, we have always over our head the threat of the gasoline tax. We are thinking about that also.

Senator VANDENBERG. Do you want to substitute the general sales tax for the excise tax?

Mr. LAWRENCE. In the record before the House committee, in the extension of my remarks in the House hearings, we pointed out we felt it was a fairer proposition not to visit those larger taxes on a selected few.

Senator BARKLEY. Do you think, with the experience we have had in excise taxes, that we can pass a general sales tax in a few minutes?

Senator VANDENBERG. Let me follow up Senator Barkley's suggestion. We have established the principle of a general manufacturers' sales tax. Let us say it is 3 percent this year; if your problem next year requires additional revenue you confront the very simple expedient of increasing your rate. You do not have to write your law all over again. It is an advantage instead of a disadvantage.

Senator BARKLEY. That is being done in this bill. That is what this bill is, to increase excise taxes.

Mr. LAWRENCE. I guess we were unfortunate enough to be selected as the first. It is just a continual increase.

The CHAIRMAN. Are there any other questions?

Senator GUFFEY. Mr. Lawrence, how much does this tax cost the trucking industry?

Mr. LAWRENCE. If you take the whole country the cost is very great. I tried to take segments and pointed out specific trucks. There is a lot of question about the average consumption, because there is no proper detail on the trucks of this country. The Public Roads Administration is commencing this year, for the first time, to make a detailed inventory of trucks. They leave the factory, they are rebuilt, remodeled, reengined sometimes, so it is difficult to ascertain that. Many statisticians claim if you take the trucks from the little truck used by the grocery store up to the large road truck, the average is about 1,200 gallons. My own guess, taking the average, would nearer be 1,600 to 1,800 gallons a year.

Senator GUFFEY. That is the industry as a whole. I am trying to figure how much revenue the Government is going to lose if you carry out your wish. What proposition do you have to raise the money for the Government?

Mr. LAWRENCE. Senator, I am not a tax expert. The Treasury estimates are in on the excise taxes, I understand. We are just pointing out that we feel it is just coming back to the same old well all the time.

Last year we had, without complaint in the whole industry, an increase of half a cent on gasoline, but it is beginning to pinch now, coming back and back again.

Senator GUFFEY. What tax do you propose in favor of this excise tax?

Mr. LAWRENCE. I am not a tax expert.

Senator GUFFEY. Would you favor the joint return; that cuts off $300,000,000?

Mr. LAWRENCE. I am not familiar enough with that, sir.

Senator GUFFEY. All right.

The CHAIRMAN. All right, Mr. Lawrence. Thank you, sir.

The next two witnesses are Mr. Vernor and Mr. Riley, who are listed here. Now, I presume you gentlemen wish to come around, both of you.

STATEMENTS OF JAMES VERNOR, DETROIT, MICH., AND JOHN J. RILEY, WASHINGTON, D. C., REPRESENTING AMERICAN BOTTLERS OF CARBONATED BEVERAGES

The CHAIRMAN. You are Mr. Vernor?

Mr. VERNOR. Yes, sir.

The CHAIRMAN. And this is Mr. Riley?

Mr. RILEY. Yes, sir.

The CHAIRMAN. Will you state your name and whom you represent, Mr. Vernor?

Mr. VERNOR. My name is James Vernor, Detroit, Mich., appearing for the carbonated beverage industry and representing its association.

The CHAIRMAN. And Mr. Riley is John J. Riley?

Mr. RILEY. John J. Riley, secretary of the same association.

The CHAIRMAN. The same association?

Mr. RILEY. Yes, sir.

The CHAIRMAN. You gentlemen have a written brief?

Mr. RILEY. We have submitted a statement, Senator. I think it is in that folder that the clerk is passing out.

The CHAIRMAN. Do you wish to present the brief for the record, or do you wish to present the substance of it orally?

Mr. VERNOR. I would like to make a few statements, Senator, and then I would like Mr. Riley to present a summary of the brief.

The CHAIRMAN. You may do so.

Mr. VERNOR. First, I would like to assert the position of the industry that we have every desire to share our just share of this burden that we know we must have. I realize the position you are in in raising the tax burden. We do not care to sidestep anything. Any equitable tax we certainly will do our share in, but we consider the tax as proposed in the House bill a very inequitable tax.

This business is somewhat different than some of you gentlemen that buy any soft drinks in hotels may imagine. Eighty-five percent of our business has a 5-cent roof, and certainly it cannot be classed as a luxury with 85 percent with a 5-cent roof. We have a 5-cent roof price on 85 percent of our production. It is an absolute impossibility to maintain production and increase that 5-cent roof. The profits in the industry depend entirely on the net profit per case, and depend more on volume than anything else. If anything is done in the nature of disturbing the 5-cent roof, thereby destroying the volume, naturally the industry is in trouble.

I would just like to present one more picture of this to the Senators, and that is the set-up of the industry itself. That is shown in this chart that I believe we have given you with the brief.

There is, I believe, a wrong impression on the type of the industry; that is, that it is made up of plants that are making considerable money and are large plants. That is very erroneous. We have approximately 6,309 bottling plants in the industry.

The CHAIRMAN. What number, Mr. Vernor?

Mr. VERNOR. 6,309. Sixty-four percent of those plants produce less than 25,000 cases per year, and on any basis of profit that you might give them per case they could not earn over $2,500 or $3,000 to save themselves in any way they tried. In other words, it is an industry of small business rather than of large business. Twenty-seven percent of them produce between 25,000 cases and 100,000 cases per year. So that 91 percent of them produce less than 100,000 cases per year, which, in my estimation at least, could not make the highest net earnings, on any of those 91 percent, over $10,000 or $12,000, a year on their invested capital. I am only bringing that out to bring out the type of the industry and the fact that 91 percent of the industry are small businesses and only 9 percent are what you might call fairly large concerns.

Now we have prepared the brief that has been submitted, and Mr. Riley has a summary of that brief. At this time I would like Mr. Riley to give you that summary.

The CHAIRMAN. Very well, Mr. Riley.

Senator BARKLEY. Let me ask you before you begin: I notice in the chart here you have got different kinds of drink, and among them is sauerkraut juice. Do you regard that as a soft drink?

Mr. VERNOR. No; we do not.

Senator BARKLEY. That is more of a table drink.

Mr. VERNOR. That will be brought out, Senator, in the summary.

Senator BARKLEY. I just happened to see that. I wondered if you cataloged that among the drinks like Coca-Cola, grape juice, and the like.

Mr. RILEY. I might say, Senator, there are a lot of things there that we do not put in the identical category of soft drinks, but they are drinks sold through the same sources, and to some extent are on a competitive status with a soft drink.

Senator BARKLEY. "Hearts Delight," is that a soda-fountain drink?

Mr. RILEY. That is a canned drink that, with the possible exception of some greater quantity of fruit juice used and the lack of carbonation, is identical with many drinks that are put in bottles by the bottlers.

Senator BARKLEY. Go ahead.

Mr. RILEY. As Mr. Vernor has said, we are speaking on behalf of the soft-drink industry. As we interpret the provisions of section 551 relative to the proposed tax on soft drinks, they may be briefly summarized as follows:

On bottled carbonated beverages (up to 33-ounce bottles) the tax proposed is one-sixth cent per bottle if bottled to retail at not more than 10 cents.

One-third cent per bottle if bottled to retail at more than 10 cents and not more than 20 cents.

One-half cent per bottle if bottled to retail at more than 20 cents per bottle.

On bottled carbonated beverages (bottles over 33 fluid ounces) 6 percent of the price for which sold.

Then there is a tax on finished and fountain sirups of the kind used for making carbonated beverages sold otherwise than in bottles, a tax of 6 cents per gallon, and on carbonic gas sold for similar use, a tax of 4 cents per pound.

These two latter taxes, of course, are intended to apply to those sirups and carbonic gas sold for fountain use, not for bottle use, the bottle being taxed on the per bottle basis.

Two observations on the provisions of section 551 are: First, the definition of taxable "soft drink" is such that its practical effect is to exclude a wide variety of noncarbonated soft drinks manufactured and sold in closed containers as well as by the glass by numerous manufacturers, soft-drink stands and fountains. The definition subjects to the tax on finished drinks only the types of soft drinks which are carbonated—that is, those impregnated with carbonic gas, and commonly known as carbonated beverages, soda water, or pop. The effectiveness of the definition in excluding from the proposed tax all soft drinks but those which are carbonated seems to make the provision more correctly referred to as a "carbonated beverage tax," rather than a general soft-drink tax.

Now, the tax on sirups and gas for fountain use does not change this situation, as only sirups of the kind used for carbonated drinks, or gas sold for use in carbonated drinks are taxed.

The second is: Inasmuch as between 80 and 90 percent of bottled carbonated beverages are sold at retail in the common types of 5-cent bottles, with the greater proportion of the remainder in 10-cent bottles of less than 33 ounces, the first bracket applying a rate of one-sixth cent per bottle seems to be the only one here requiring consideration. The other rate brackets applicable to bottles have no great importance, from the standpoint of this brief discussion, because they are mostly of lesser application due to the smaller quantities that are sold. That one-sixth-cent rate means a tax of 4 cents on each case of 24 of the 5-cent bottles, or 2 cents on each 12-bottle case of the 10-cent bottles up to 33 ounces.

Our statement outlines these basic features of the proposed tax on carbonated beverages which make it objectionable in this way:

First, such a tax takes the form of an added special tax on earnings of the carbonated beverage bottler, where ordinary earnings exceed the tax, or is a capital levy where such earnings are less than the amount of the tax.

Second, it is discriminatory and seriously complicates competitive conditions, because it not only selects one item from the numerous foods items carried by every grocery in the country for taxation, but also limits such selection to a segment of the soft-drink industry itself.

Third, it is basically unsound in relation to the industry.

Fourth, because of the effect of this tax upon the bottlers' earnings taxable under the income-tax provisions of the bill, and these other factors, the net revenue yield from the industry may be expected to be substantially less than that estimated.

The tax on carbonated beverages appears as one planned for absorption by the bottler, or the retailer, or both. In any event that would be its practical effect because of the very nature of the industry, which, for the vast bulk of its product, operates under the 5-cent roof that Mr. Vernor has spoken of, and which experience has shown we must keep if we expect to keep the business alive.

Senator VANDENBERG. Let me ask you at that point. In the World War you faced an extra tax. In some instances was an effort made to pass the tax on? Was the 5-cent roof raised?

Mr. RILEY. It had a very serious effect. That was one of the reasons the tax was taken off.

Senator VANDENBERG. That is what I was going to ask.

Mr. RILEY. It was a different type of tax, but that was the effect of it.

Senator VANDENBERG. A retail tax?

Mr. RILEY. It was a tax on the bottle. It had a very serious effect in the increased price to the consumer.

Senator BARKLEY. What was the tax?

Mr. RILEY. It was 10 percent of the bottler's price.

Mr. VERNOR. When they raised that price to 10 cents it cut the volume exactly in two. The volume went right in two.

Senator VANDENBERG. How about 1932, when you had approximately the same tax that is proposed now? What did you do? Did you try to raise the retail price?

Mr. RILEY. The retail price was not raised, but we suffered the same things that we rather anticipate in this bill.

Senator VANDENBERG. What did you suffer?

Mr. RILEY. We suffered a cut in the profits, a large portion of the earnings of the bottler, for one thing. In other words, that was a tax on earnings in addition to this ordinary income tax.

Senator VANDENBERG. So you have now the experience at both ends of the line to prove, first, that you cannot lift the roof; and second, that you cannot absorb it?

Mr. RILEY. That is right.

The CHAIRMAN. When was the sirup tax imposed?

Mr. RILEY. That was put in two different bills, Senator. The first was in 1921 and the last one in 1932.

The CHAIRMAN. In 1932?

Mr. RILEY. Yes.

Senator BARKLEY. Let me ask you: The ordinary drink that costs 5 cents a bottle to the public, to the consumer, produces a gross of $1.20 a case to the retail distributor; is that right?

Mr. RILEY. If he sells it for a nickel a bottle straight; that is true.

Senator BARKLEY. If he sells it for a nickel a bottle for 24 bottles—what does he pay for the 24 bottles?

Mr. RILEY. His price may vary according to the different drinks, but the common price is between 70 and 80 cents.

Senator BARKLEY. Well, we will take Pepsi-Cola or Coca-Cola. What is the price on those?

Mr. RILEY. I think the price on those is 80 cents.

Senator BARKLEY. So he gets 60 cents profit?

Mr. RILEY. No; 40 cents, Senator.

Senator BARKLEY. Yes, 40 cents. And the tax would be 4 cents on that case. One-sixth of a cent per bottle, that is 4 cents. So that after paying the tax he will still have 36 cents. Of course, that is not net profit.

Mr. RILEY. This tax is not on the retailer; this tax is on the bottler.

Senator BARKLEY. That is true. If that is passed on it has got to go on through the retailer.

Mr. RILEY. The retailer will not take it.

Senator BARKLEY. Suppose it is passed on to the retailer; suppose he did pay this tax to the bottler, who has paid it in the first instance, that is 4 cents a case. Suppose the retailer pays it. He would pay 84 cents instead of 80 cents, unless the bottler pyramided the tax and charged him more than 84 cents a case, which I do not suppose any bottler would do. Do you say the 4 cents cannot be absorbed out of the 40 cents?

Mr. RILEY. My knowledge, in saying it could not be absorbed, sir, is rather limited, because I am not familiar with the problems of the retail grocer. The grocer who is familiar with the problem says right at this moment this 40 cents is not sufficient to cover the ordinary costs of maintaining his stock, to cover his movement costs which, in the case of the 5-cent bottle, means the same movement that he may incur with a 25-cent or 30-cent article, plus refrigeration and cooling costs, plus the cost of accounting for the deposits that he must get on the bottles, plus the cost of handling the empty bottles and sorting them when they come back. That is his argument.

Senator BARKLEY. Yes. He has made that argument to you?

Mr. RILEY. Yes.

Senator BARKLEY. And you are making that argument to us?

Mr. RILEY. This tax is not on the retailer.

Senator BARKLEY. You are claiming that the retailer cannot absorb it.

Mr. RILEY. That is in our brief, Senator.

Senator BARKLEY. You are telling us what the retailer has told you. I wonder whether it would be entirely out of the ordinary procedure if somebody knows whether he can absorb it, not simply hearsay, who would come here and tell us that?

Mr. RILEY. Well, of course, I am telling you what is common knowledge in the trade.

Senator BARKLEY. I am not trying to multiply witnesses, but I am trying to get at the facts.

Mr. RILEY. It is a matter of such common knowledge in this industry that everyone in the industry knows it. I am sure Mr. Vernor can explain to you some of the difficulties in retailing, because he is an actual bottler of soft drinks. He can tell you what their attitude is.

Senator BARKLEY. It is your position that the bottler cannot pass it on to the retailer?

Mr. RILEY. That the retailer will not accept it, and the bottler cannot accept it. Furthermore, since the retailer has so many means of avoiding it, not only under the bill, but under the competitive conditions——

Senator BARKLEY (interposing). If they all paid this tax, which amounts to 4 cents a case, one-sixth cent on a bottle, if they all paid it then they are all on the same basis.

Mr. RILEY. All who, Senator?

Senator BARKLEY. All of the bottlers. If they all paid it, which of course they will, and if they all passed it on to the retailer, which they may do in the wholesale price that they get, instead of 80 cents we will say they get 84 cents, that would only mean 4 cents a case to the retailer.

Mr. RILEY. That would be an ideal solution, Senator, but it never would work out that way.

Senator BARKLEY. Why not?

Mr. RILEY. Because that has been the experience of the industry. It will not work out that way. We have some bottlers who are making more than four cents a case. In the past they absorbed the tax, and they will do it again. There is a vast number of the industry who are not making four cents a case and they cannot absorb it. If they do they will go out of business.

Senator BARKLEY. If all the bottlers pay the 4 cents a case tax and they pass it on to the retailer, it is a simple matter of adding the 4 cents to the 80 cents, or 60 cents or 70 cents, whatever it is that they have already paid. That might be hard on the retailer, because the retailer might not be able to charge one-sixth of a cent on the bottle when he sells it to Dick, Tom, and Harry. But the question I am trying to find out is—and I am simply trying to get the facts, because I do not know—whether out of the difference between the wholesale price or the bottler's price to the retailer plus the 4 cents a case the retailer can afford to deal in the drink and make a reasonable profit.

Mr. RILEY. I do not believe he can. From what knowledge I have of the industry, and from what information we have, his net per case, after all of the costs I have referred to are incurred, is just a couple of cents.

Senator BARKLEY. If he pays 80 cents a case and sells it for $1.20, his gross profit is 50 percent. How much of that 50 percent would he have to knock off in order to get to his net profit?

Mr. RILEY. He would have to knock off all except a very small part, perhaps a very small percentage, a case.

Senator BARKLEY. You mean the retailer who is selling bottled drinks is charging enough overhead for all bottled drinks so he can get the profit out of everything else he sells?

Mr. RILEY. I do not say that is true, but it is one of the retailers' contentions that it costs at least a cent a bottle to put out soft drinks. There is 24 cents out of the 40 cents right there.

Senator WALSH. Is there some breakage?

Mr. RILEY. There is plenty of breakage; yes. He must stand the cost of the deposit that he has paid on the bottles broken.

Senator BARKLEY. Take the little automatic—maybe they are not automatic—distributing boxes, or whatever you call it, out in front of a garage or in front of a gasoline station, where you go up and either take a bottle out of an ice-cooled compartment or take it out of an electrically cooled compartment, do you think that it is an average cost of doing business for that particular concern to be out 24 cents a case for distribution?

Mr. RILEY. I do not know what it is, and that amount of cost may not apply in such instances for distribution, because there is less labor charge. But that is only a portion of the movement costs I have mentioned.

Senator BARKLEY. Go ahead.

Mr. RILEY. Of course, on the question of discrimination, the condition that that seems likely to create in the industry and competition resulting from other items for the consumer's nickel, it will bring the retailer to concentrate, we feel, upon these competitive items. And because of his own interests, as I have been speaking of here, in maintaining his own profit, the net effect of this proposal is to put this tax directly on the bottler. That has been the experience, and that seems to be the intention, and was the expressed intention apparently in the Ways and Means Committee, to at least have it absorbed either by the bottler or by the retailer. Our contention is you cannot pass it on to the retailer; that the bottler has to absorb it in some way or another.

Now, as to whether or not this could be absorbed—Mr. Vernor has already shown you that this is an industry of small businesses. We have some large plants, good large plants, but they are just a minute portion of the industry.

We also have plants that make a fair margin of profit. This has been broken down in the chart. Out of the 6,309 plants there are almost 700 plants that are losing money. There are 1,594 plants that have a margin that is not greater than the tax here proposed, 4 cents a case. We have 1,700 plants that have a margin between 5 and 9 cents a case, and then a balance of 2,304 plants on a margin of over 9 cents a case.

Senator WALSH. Is the number of small plants increasing or decreasing?

Mr. RILEY. The number of plants in the industry, Senator, has been relatively stable in the last 4 or 5 years. I could not say definitely just as to that condition.

So that applying this 4-cents-a-case tax to the one-third of the bottlers of the country who are making 4 cents or less, it either takes all of their profit or appropriates part of their capital.

For almost another one-third the tax would take from 45 percent up to 80 percent of their earnings per case. The remainder would be, of course, affected in a lesser degree, but the tax would still take a very substantial proportion of their earnings. This would be particularly serious in the case of those bottlers who, notwithstanding the higher margin per case, have a low sales volume and consequently small income. In other words, there are some of those in the top bracket of earnings per case but which are very small plants.

This tax would, of course, have to be paid in addition to the taxes on net income which they pay in common with all other citizens.

And as I have previously stated, carbonated beverages are the only type of soft drinks in closed containers, that is in bottles, cans, or kegs, which are subject to the proposed tax.

The unfair competitive situation with which the industry is faced, even if it could absorb the tax, seems apparent when we realize the great variety of soft drinks sold in cans, in bottles, or dispensed from bulk by the glass, but differing essentially from the bottled carbonated drinks only in that they lack that characteristic which makes the latter taxable, which seems to put them in that class, and that is carbonation.

To these must be added the numerous types of undiluted fruit juices, concentrated juices, soft-drink powders and sirups, all sold in competition with the carbonated drinks. These untaxed canned and bottled drinks and powders are illustrated in the photograph, which you have in the folder, but the photograph does not illustrate the untaxed drinks of the thousands of corner drink stands and fountains, untaxed because they are not carbonated, and because they use no taxable sirups of the kind used in making the carbonated drinks. Under the bill, these other drinks are thus being endowed with a competitive profit margin, amounting to the tax the carbonated beverage bottler must pay, which they can use to further entrench their position as his competitor in the soft-drink market.

It also seems obvious that those manufacturers of the other items in competition for the nickels of the consumer, such as the popular types of 5-cent candies and other confections, chewing gum, packaged cookies, ice cream cones, and other 5-cent frozen items, will be in the field with this competitive tax margin as an added advantage if any such tax on carbonated beverages is enacted.

Even among the bottlers themselves we have a serious competitive situation. Some of these are outlined in rather detailed form in the statement, but I do want to mention one which I do feel is the most serious, and that is that the proposed tax would result in the concentration of the bottled soft-drink business into the hands of these bottlers who have attained a position of financial strength, and the elimination of many of the weaker members of the industry.

The chart classification shows those bottlers enjoying a profit margin per case of over 9 cents, and while numerous, as I said before, that total includes plants that are small, in small communities with limited sales volume, and must be eliminated from it. We figure there are about one-third, or somewhat less than one-third of the plants in the industry making perhaps fair total earnings that would be able to absorb this tax.

Should any such absorption become an actuality, all bottlers would be obliged to do likewise, regardless of their low margin per case or the limitation upon their annual earnings, or be at hopeless disadvantage in pricing their products to the retailers. A large proportion of them would eventually be bankrupt by this attempt to keep their business intact through the competitive necessity of absorbing a tax equalling the major portion or all of their earnings, or actually in excess of such earnings.

Adding to this competitive situation, if the tax is enacted, of course we could speak to some extent of the bottlers constantly increasing costs. I am not going to take up your time on that, but I do want to point out particularly our problem, our inability to change the size of our package. With one-third of the bottler's total investment in bottles and cases, you do not have the ease of changing the size of the package. To pass the added cost and added taxes on to the consumer is an absolute impossibility as far as our package is concerned.

I think it is important that I call your attention to the item of tax costs. The bottler has borne, and is bearing, his share of increasing Government costs, particularly in the way of State and local license and privilege taxes of various kinds and amounts, to which other business is not always subjected, and also by income taxes.

The additional taxes to be levied under other provisions of H. R. 5417 will add to these costs. For example, bottler's costs of flavoring extracts will be increased by the proposed alcohol tax increase, and his cost of operation will be increased by the proposed new taxes, or higher rates of tax on automobiles, trucks, parts and accessories, tires and tubes, mechanical coolers and refrigerating apparatus, electric signs and electrical appliances, business machines, telegraph, telephone, transportation, radio and outdoor advertising, and the use of motor vehicles. A total of $5,000,000 is believed to be a fair estimate of the total of such added costs to the industry.

This total added to the amount of the proposed tax on bottled sales, plus such further decrease in industry income as may result from the competitive situations engendered by the tax proposal, will substantially reduce the taxable income of the industry as a whole, and, of course, the income taxes computed on such income.

The obstacles to economy in the administration of soft drink taxes in the past and the difficulties of collection seem certain to be repeated under this bill, and must also be considered in this determination of the net results from a revenue standpoint.

For example, the tax of 6 cents per gallon on fountain syrups and 4 cents per pound on carbonic gas for fountain use will invite competitive adjustments, which will make it easily evaded or impossible to administer.

Senator CONNALLY. How much tax do you advocate on soft drinks?

Mr. RILEY. Senator, we do not advocate any tax on soft drinks. We believe it is an entirely impossible tax.

Just as examples; I have three or four but I will mention two. Take flavor, either fruit flavor or artificial flavor, or soft-drink powders—they can be mixed in bulk without a sirup and carbonated and the tax on sirup avoided because there is no sirup used at all, if our interpretation of this bill is correct.

One more example: Chocolate sirup is used in carbonated chocolate sodas, but also in chocolate milk shakes and on ice-cream sundaes. Its taxable status can readily be a matter of endless controversy, because who is to say, or who can say, whether such use makes it of the kind used for making carbonated drinks?

In this connection we must also point out that the proposed tax will fall from 2 to 3 times as heavily on the carbonated beverage bottler as it will on the carbonated beverage portion of soda fountain soft drink sales. As an example, if a bottler sells 120 bottles, on which we will assume there is the price of 80 cents, his tax is 20 cents and his ratio of tax is 5 percent. The same 120 drinks can be exactly the same drink sold by the soda-fountain proprietor for $6 and his tax is 8 cents, and the rate is 1⅓ percent.

Now, we believe it is important that consideration also be given to the characterizations given similar taxes on soft drinks in the past in the reports of the Committee on Ways and Means, the Senate Committee on Finance, and also by the Treasury. In those reports similar taxes, or taxes having a similar effect, at least on the industry, are called in the reports unwise and unjust; they must be paid out of capital and to that extent it constitutes a capital levy; very difficult to administer; widely evaded; administrative nuisance and adversely affecting business; are not great revenue producers; not highly productive; ill-defined and uncertain; widely evaded and evasion cannot be stopped without the employment of a larger number of agents and measures more drastic than the potential importance of these taxes would justify.

On this last statement from the reports I may also call attention to the fact, which I do not think was brought out clearly in the brief, that this tax on finished bottled carbonated drinks and on the fountain sirups, and on the carbonic gas involves, as I said, the 6,300 bottlers; it involves, we estimate, 125,000 fountains, and we have no means of knowing how many dealers sell carbonic gas who will have to pay the tax. So as a minimum you have a total of 131,300 taxpayers from whom to collect revenue, from whom you will have to get the returns and audit them each month.

Gentlemen, I am going to conclude with just a statement which summarizes our brief, and that is that the industry does not argue that its products can be substituted for the meat, potatoes, and flour on which armies are fed. But it does submit it is as manifestly unreasonable to select carbonated beverages from the grocer's stock for taxation as it would be to levy an excise tax on any one of his other items of vegetable juices; fruit juices; frozen desserts; ices and ice cream; dessert, ice cream, and beverage powders and gelatins; sirups; spices; ketchups, prepared mustards, sauces and salad dressings; preserves; fruit butters; jams; jellies; pickles; confectionery and candies; nuts and nut butters; chewing gum; chocolate and other

sirups; prepared foods for dogs, cats, and other pets; tea, coffee, and cocoa.

Senator CONNALLY. How about cigarette and plug tobacco?

Mr. RILEY. I am sorry, we are talking no position on those. I am not familiar with them.

Senator CONNALLY. We do tax those.

Mr. RILEY. We have taken the position that it is unfair and unreasonable to tax any one particular commodity selected from a group when it is in competition with other commodities.

Senator CONNALLY. Then you favor repealing the cigarette tax, the cigar tax and tobacco tax?

Mr. RILEY. I would not want to put our association on record to that extent, Senator. At least the principle of general taxation is the one thing we stand on.

Senator CONNALLY. How about gasoline? You tax gasoline. Why should not soda fountains pay a little tax, and the bottlers? I am just exploring this subject.

Mr. RILEY. Yes. We agree we will have to pay more taxes, we readily agree we will have to pay more taxes, if you will just let me conclude this statement.

Senator CONNALLY. Pardon me.

Mr. RILEY. The soft-drink bottler contends it is most unjust to levy this tax which, due to the factors previously outlined, will have the effect of a special supertax upon his earnings, when he pays the same taxes on income and profits to the Federal Government as the drink-stand proprietor, the canner or the preserver, the ice-cream manufacturer, the chewing-gum manufacturer, the confectionery manufacturer, the dog-food manufacturer, or the manufacturer of any of these other grocery items. The bottler is ready and willing to bear his full share of the Nation's tax burden at this critical time by such increase in taxes of general application as Congress may deem necessary to distribute that burden equitably and in recognition of the equal interest all industries and all taxpayers have in it.

Senator CONNALLY. What is his share?

Mr. RILEY. Beg pardon?

Senator CONNALLY. What is his share?

Mr. RILEY. Any increase in income taxes that is shared equally by all citizens who have the same vital interests that he has in this Government and in its support.

Of course, if there must be a tax on product sales, the soft drink bottler urges that it should be a general tax, levied upon a base sufficiently broad to distribute the burden with the least hardship by taxing all or substantially all commodity sales at the same rate, thus giving this and each other industry a chance of holding its own in the competitive field, producing the maximum revenue, and being the least disruptive of this and other industries in a similar position.

Senator CONNALLY. Would you advocate repealing the beer tax, the whisky tax, and wine tax? They have to pay an income tax, too. You need not answer if you do not want to; that is all right.

Mr. RILEY. I would say this, Senator, however, that we have been concentrating our attention particularly on food items into which we think the soft-drink product falls, because it is on the grocer's shelf with other hundreds of commodities, and soft drinks have been picked out as the one item for special taxation.

Senator CONNALLY. We are helping your business now by taxing beer. That makes the man pay more for beer. The tax is to your advantage, it seems to me, instead of disadvantage.

Mr. RILEY. That is a matter of opinion with which I would not agree.

Senator CONNALLY. Let me ask you this: Do you prefer this one-sixteenth of a cent, I believe it is, on a bottle to be paid by the bottler or would you prefer a 1-cent tax to be paid by the purchaser?

Mr. RILEY. We think both are equally vicious and equally harmful on the industry.

The CHAIRMAN. Are there any further questions?

Senator CONNALLY. That is all I have.

The CHAIRMAN. Thank you.

(The statement submitted is as follows:)

STATEMENT ON BEHALF OF THE AMERICAN BOTTLERS OF CARBONATED BEVERAGES BEFORE THE COMMITTEE ON FINANCE OF THE UNITED STATES SENATE

TAX POSITION OF THE BOTTLED-SOFT-DRINK INDUSTRY

The bottled-carbonated-beverage industry, in a statement before the Committee on Ways and Means of the House of Representatives at the hearings preliminary to the drafting of H. R. 5417 by the American Bottlers of Carbonated Beverages, has presented its general views in opposition to special excise taxation of soft drinks.

In that statement the men and women engaged in the bottled-carbonated-beverage industry indicated their sincere desire to bear their full share of the tax burden required for national defense, but urged that fairness and recognition of the equal interest of all industries and all consumers in the preservation of the American way of life required such burden to be distributed by an equitable system of general taxation—whether it be in the form of increased taxes on income, a general sales tax, or a general manufacturer's tax.

The industry desires to reassert this position before the Senate Finance Committee, and to make apparent the facts upon which such opposition is based, to the end that such facts may demonstrate its entire propriety under our American principles of justice and equality and that by so doing this committee will be aided in finding a proper solution to the revenue problem.

THE SOFT-DRINK TAXES IN H. R. 5417

At the conclusion of lengthy deliberations by the Committee on Ways and Means the proposal to levy an excise tax on soft drinks was incorporated in H. R. 5417 (pt. V, New excise taxes, sec. 551—Soft drinks) in a substantially modified form (1).[1]

As passed by the House, section 551 proposes the following tax:

1. On bottled carbonated beverages (up to 33-ounce bottles), section 3402–b–1–A:

⅛ cent per bottle if bottled to retail at not more than 10 cents.
⅓ cent per bottle if bottled to retail at more than 10 cents and not more than 20 cents.
½ cent per bottle if bottled to retail at more than 20 cents per bottle.

2. On bottled carbonated beverages (bottles over 33 fluid ounces), section 3402–b–1–B: 6 per centum of the price for which sold.

3. On finished syrups of the kind used for making carbonated beverages sold otherwise than in bottles (such as at fountains), a tax of 6 cents per gallon (sec. 3402–c–1); and on carbonic gas sold for similar use, a tax of 4 cents per pound (sec. 3402–d–1).

It should be pointed out that there is no great significance in the one-third-cent and one-half-cent per bottle brackets just mentioned, nor the 6 percent rate on exceptionally large bottles because about 90 percent of bottled carbo-

[1] For notes see supplement to this statement.

nated beverages are sold at retail in 5-cent bottles and on almost all of the balance in the "quart" classification the usual price is 10 cents. That remainder sold in bottles over 33 fluid ounces, or for more than 10 cents, consists of only an extremely small portion of the industry's production.

For purposes of discussion we may therefore consider the vital point to be the one-sixth-cent per bottle tax proposal, which represents a per case tax of 4 cents on each case of 24 small (5-cent) bottles.

It is particularly vital to note here that, because of the diversified nature of the soft-drink industry the definition of soft drinks in the bill (sec. 3402–a–1) causes the proposal to lose its identity as a tax on soft drinks, and to become a special tax on carbonated beverages or soda water. It also is the only tax on a food product (if we except wines) in the bill.

Of equal importance is the fact that, due to characteristics of the industry differentiating it from most others (2), the provision cannot have the expected effect of an excise tax, but becomes a special tax on either the capital or the income of the bottler, as will be outlined more fully later. Obviously, any such result will bear heavily upon this industry of small businesses, more than two-thirds of the units of which have maximum gross sales of less than $20,000 per year (3).

The adoption of a tax rate of one-sixth cent per bottle by the Committee on Ways and Means appears to represent wholehearted recognition of the disastrous results certain to follow a rate of tax which would necessitate an increase in the 5-cent retail price for approximately 90 percent of America's bottled soft-drink consumption.

The apparent theory of the provision, as approved by the House of Representatives, therefore, is to levy a tax to be absorbed by the bottler or by the retailer of carbonated beverages without resorting to a price increase to the ultimate consumer (4).

THERE IS A SERIOUS FLAW IN ANY SUCH "ABSORPTION" THEORY

The fallacy of any such theory is demonstrated by an explanation of the economic basis upon which the bottled carbonated beverage industry must operate (2).

1. *The customary nickel price to the consumer for the bulk of the industry's products constitutes a "roof," which experience shows may not be exceeded without disastrous results upon the volume of sales*

This was clearly demonstrated before the Committee on Ways and Means, based upon the recent experience of the industry in States where an increase in retail price to 6 cents was necessitated by the levying of a 1-cent-per-bottle tax, such as that contained in the original Treasury recommendation.

That it is a well-established economic fact, so far as the soft-drink industry is concerned, is also apparent from the harmful effects of Federal taxes under the Revenue Act of 1918 on soft-drink consumption, concerning which testimony was given at that time as a basis for their repeal.

2. *The profit margin of the retail outlets, upon which the carbonted beverage bottler depends almost entirely as the means of getting his product to the consumer, cannot be decreased*

As an incident to the handling of bottled soft drinks the retailer incurs all of the costs involved in the maintenance of his usual stock, plus those specific costs applicable to this particular product (such as costs of cooling and refrigeration), plus a substantially heavier movement cost per dollar of sales due to low value per unit sale, and the costs of handling the returnable bottles and accounting for the bottle deposits which are typical of soft-drink sales.

Evidence already exists to indicate dissatisfaction among soft-drink retailers with current margin on soft drinks, prior to any further reduction through a shifting of the proposed tax. Grocery stores are a major retail outlet for bottled soft drinks. In a resolution adopted by the National Association of Retail Grocers of the United States, in convention in Kansas City, Mo., on June 19–22, 1939, the grocers alleged insufficiency of current margin on bottled soft drinks to cover the costs of handling empty bottles.

3. *Solvency in the bottled-soft-drink industry, as in every other industry, means that the bottler must maintain a margin of profit on his operations, but such margin requires control of costs (5) to a degree not understood outside the industry*

Examples of some of the more important and current of these cost problems will be helpful:

Sugar is an important factor among ingredient and material costs (*6*). Inasmuch as the quantity of sugar used in a case of bottled carbonated beverages varies from a minimum of 1½ pounds per case to as much as 3 pounds per case or more, depending upon the type of drink and the size of bottle, it is readily realized that an increase of a fraction of a cent per pound in sugar cost may mean the difference between a profit and a loss to the thousands of plants in the industry operating on an extremely narrow margin of earnings per case.

This is particularly true in the smaller plants, where sugar is purchased from local wholesalers in relatively small quantities. Since August 1, 1940, the wholesale price of sugar has increased 85 cents or more per 100 pounds, which means a cost increase of from 1¼ to 2½ cents per case (*7*).

Increased use of fruit juices in bottled carbonated beverages is one of the major developments of the past decade. Because of the higher cost of ingredients and greater possibility of spoilage, this has required investment in special equipment and rigid cost control to keep the consumer's price of the drink within the 5-cent "roof."

For example, surveys by the California-Arizona growers show that during the 1938–39 season approximately 82 percent of the juices processed from navel and Valencia oranges went into beverage bases for the bottled-soft-drink industry, using over 77,000 tons of oranges. Over three-fourths of that quantity was for carbonated-beverage bottlers. Florida-orange tonnage for similar use, while not as large, is reported to have quadrupled in the last 3 years. Over 5,000 tons of grapefruit is diverted annually to the uses of the bottled-carbonated-beverage industry by one growers' association in the Southwest, contributing much to relieve the surplus problem in fresh-fruit sales channels. Only two out of many manufacturers of flavors for the bottler's product report the use of about 75,000 gallons of grape juice annually in such beverage bases. Complete reports would show these examples to represent but a portion of the amount of surplus fruit crop that is used in the manufacture and bottling of carbonated drinks.

The added cost of the proposed tax will be a serious handicap to the bottler in his efforts to make and sell the juice-type drink in the 5-cent market. This may have a most serious effect upon the continued development of that type of drink right down the line from the bottler to the flavor manufacturer, to the fruit processor, and to the fruit grower.

Labor costs involved in the bottling, selling, and distribution of carbonated beverages amount to from 30 to 40 percent of dollar value of sales, so that the steady increase in such costs which bottlers have experienced during the past few years has created numerous problems for them in their effort to keep out of the red.

The average wage scale of labor in the beverage industry, as reported by the Department of Labor, is the highest among the food industries listed (*8*).

An important factor in consideration of this cost item is the attention the industry has given to maintenance of substantially level employment throughout the year, even though two-thirds of its annual production and sales occurs during the warmer period of less than 6 months. This means, in the great majority of instances, that the bottler operates his plant at a loss during much of the remainder of the year and depends upon the compensating increase in sales volume during the summer to bring sales for the entire year sufficiently above total costs to produce a reasonable return on his investment (*9*).

The degree of dependence upon the temperature and the weather for profitable operations is one of the major hazards of the industry.

Selling, delivery, and service are important items of cost to the soft-drink bottler. Increased sales come only through large costs for labor, equipment, and overhead in maintaining that constant sales and service operation, direct to the retailer, which is essential to make soft drinks easily available to the consumer when he wants them, where he wants them, and how he wants them.

This requirement has largely outmoded mass distribution through wholesalers. It has made soft-drink bottling an industry of 6,300 local plants serving the 2,899 communities in which they are located (*10*). It has given to sales and service costs an importance fully equal to plant and ingredient costs, from the standpoint of control and of effect on earnings.

Changing trends in consumer purchasing have contributed to rising costs. The increased purchase of carbonated beverages for home consumption, which has affected a substantial change in the soft-drink market in the past few years, requires the added expense of cartons. A doubling of the investment in bottles has not been unusual because of the delay in their return by home consumers to the retail outlet and the greater bottle losses. While sales volume has been increased, these factors result in a smaller margin per case.

New developments in plant equipment to offset these rising costs, at least in part, and to insure sanitary operation and purity of the products have required heavy investment by the industry (*9*) and consequently increased maintenance and overhead costs. At the insistence of the industry, the practices of bottling on foot-operated machines, and of washing bottles by hand, have been relegated to the past. Today the medium-sized plant ordinarily means an investment of about $100,000 for sanitary and efficient operation and to provide for normal growth.

4. Tax costs are particularly important

All of the taxes now imposed on other kinds of business for local, State, and Federal purposes are being paid by the soft-drink industry.

In addition, the bottlers are paying, in many States, license and privilege taxes of varying kinds and amounts, to which other business is not always subjected. Because of these special State and local licenses, it can fairly be said that in relation to investment, business volume, and earnings, the bottlers of soft drinks are already subject to a degree of taxation which is fully equal to, or in excess of, the taxes laid on many other kinds of business. The industry has borne, and is bearing, its share of increasing State and Federal governmental costs. Because of the vital importance of maintaining the 5-cent "roof price" for the product, these rising tax costs have not been passed on to the consumer.

The additional taxes to be levied under other provisions of H. R. 5417 will create special problems for the industry.

For example, alcohol used in making the flavoring extracts for soft drinks is an important item of cost. At the present time the tax on such alcohol is 1,600 percent of the cost of the alcohol, and represents a tax cost of approximately 1.2 cents per case of the finished soft drink. The increase of $1 per proof gallon provided in this bill will increase this tax cost by one-sixth.

Other bottlers' costs of operation will be affected by the proposed new taxes, or higher rates of tax, on automobiles, trucks, parts and accessories, tires and tubes, mechanical coolers and refrigerating apparatus, electric signs and electrical appliances, business machines, telephone, telegraph, transportation, radio and outdoor advertising, and the use of motor vehicles.

A total of $5,000,000 is believed to be a fair estimate of such added costs to the industry under H. R. 5417.

5. The ability of the soft-drink bottler to meet competition and remain in business therefore depends upon withstanding the "squeeze" exerted on his margin of profit by the force of his costs of manufacture and distribution from below, and by the inflexibility of the retail "roof price" and the dealer's margin from above

Some owners of bottling plants, because of careful control of costs, a fortunate combination of volume and plant capacity, and successful merchandising, have been more successful than others in withstanding this "squeeze," with the result that earnings in the industry vary widely—some produce a higher rate of earnings than others, while many are losing money in their efforts to become established.

Based upon a recent survey of 1940 operations, it is estimated the bottling plants in the industry fell into the following profit margin classifications:

Per case margin (or loss)	Number of plants	Percentage
Loss over 4 cents per case	284	4.5
Loss 4 cents or less	409	6.5
Profit:		
0 to 4 cents	1,594	25.3
5 to 9 cents	1,718	27.2
Over 9 cents	2,304	36.5

It is apparent from the foregoing summary of margin per case in the bottling industry that such a tax would constitute a capital levy upon those bottlers who are losing money or are earning less than 4 cents per case. Over one-third of the industry is in this position. It would be a very heavy special income or profits tax upon bottlers earning as much as 9 cents per case, and its absorption without immediately serious effect upon survival could be accomplished only by that proportion of the industry now earning more than 9 cents per case. The proposal therefore presents a serious threat to the preservation of the industry and to the continuance of employment for many thousands of workers during the critical period which the Nation is facing.

6. *Concentration of bottled soft-drink business*

One result of the proposed tax would be the concentration of the bottled soft drink business into the hands of those bottlers who have attained a position of financial strength, and the elimination of many of the weaker members of the industry.

The above classification of bottlers enjoying a profit margin per case of over 9 cents includes numerous plants in small communities with limited sales volume, and relatively low total earnings per year. It is estimated, therefore, that the larger and financially stronger bottlers whose margin per case may permit absorption of the 4 cents per case tax, by relinquishing a substantial portion of their earnings to that purpose, operate less than one-third of the plants in the industry.

Should any such absorption become an actuality, all bottlers would be obliged to do likewise, regardless of their low margin per case or the limitation upon their annual earnings, or be at a hopeless disadvantage in pricing their products to the retailers. A large proportion of them would eventually be bankrupt by this attempt to keep their businesses intact through the competitive necessity of absorbing a tax equaling the major portion or all of their earnings, or actually in excess of such earnings.

In the end the strong would become stronger, the weak become weaker, and the livelihood and investment of thousands of taxpayers in the industry would be utterly destroyed.

In addition, those members of the industry producing 5-cent drinks and having an investment of million sof dollars in bottles which must be used may find themselves in a precarious competitive position due to this provision of the House bill which taxes the 24-bottle case of small 5-cent bottles at 4 cents per case, but taxes the 12-bottle case of large 10-cent bottles at 2 cents per case. This incongruity is further emphasized by the provision taxing 36-ounce bottles at 6 percent, amounting to between 4 and 5 cents per case, depending upon the selling price to the dealer, even though its retail price is 10 cents (the same as the 32-ounce bottle).

The trade generally considers each large bottle, which usually sells at 10 cents, as the equivalent of 2 of the smaller 5-cent bottles. Sold in 12-bottle cases (compared with 24-bottle cases of the smaller sizes), the retail selling price per case is generally the same, which is also ture of the price per case to the retailer.

Such a situation seems certain to produce extreme inequities.

It must be remembered, also, that the greater number of plants in the bottled-soft-drink industry have no franchise connections with sirup- or flavor-base manufacturers. Most of them purchase their basic raw materials in the open market, compound their own flavoring sirups as the preliminary to actual combination of such flavored sirups with carbonated water. Each such bottler is the flavoring-sirup manufacturer and the bottler combined.

There may be, in the minds of some, an assumption that the flavor and sirup manufacturers may be in a position to absorb a part of the proposed tax, which seems doubtful. But even if that were true, the bill makes no provision of this sort, and the franchised bottlers are in no position to demand modification of existing contracts with flavor and sirup manufacturers to that end. Even if this absorption were possible and occurred voluntarily, it is clear that the large group of bottlers above referred to, who make their own flavoring sirups, would be unable to obtain any tax-cost advantage by such a course, and that they would, therefore, be subjected to a terrific handicap under which many of them would be unable to survive.

The nature of the proposed tax, therefore, is such that it can have no relation to profit margins or volume of profit. As previously stated, the more prosperous bottlers, a relatively small group, may be able to absorb the proposed tax without serious effect on solvency, although for this group it would constitute a heavy special tax on profits—in addition to the taxes they pay on income in common with all other individual or corporate taxpayers.

For the rank and file of the soft-drink bottlers the tax would amount to confiscation of all or a large proportion of the profits, and it would throw a substantial number of them into the loss column—thus actually becoming a capital levy.

THE HOUSE BILL CREATES OTHER INSURMOUNTABLE OBSTACLES

It is most important to realize in considering the carbonated-beverage tax provisions of H. R. 5417 that there are many basic economic factors which differentiate such proposal from other excises listed and which create serious obstacles to the fulfillment of its purposes.

The more vital of these will be outlined:

1. *The retailer has many avenues of escape from any attempt to require him to absorb any proportion of the proposed tax, and he will resist it successfully, with serious effect upon the carbonated-beverage industry*

He may limit his soft-drink stocks to those numerous types of noncarbonated canned and bottled drinks (usually made from a combination of juices, artificial flavors, or other flavoring materials, with fruit acid, sugar, and water), which, excepting for carbonation, are substantially the same as this industry's products, and which are untaxed under the House bill.

He may endeavor to influence customers to purchase untaxed beverage sirups, packaged beverage powders, beverage flavors, and concentrated fruit juices for mixing of soft drinks and mixers at home (*11*).

He may direct his selling efforts to items sharply competitive with carbonated beverages and which are untaxed, or relatively so, such as the numerous popular types of 5-cent candies and other confections, chewing gum, packaged cookies, ice-cream cones and other 5-cent frozen items, and many others.

If he feels compelled to sell carbonated beverages notwithstanding the tax, he may decide to stock only the larger size bottles (such as quarts) selling for 10 cents, because his gross selling price per case is the same but the tax cost to him is only half of that on the smaller bottles.

In any event retailers would tend to concentrate their sales efforts on the fastest moving items. The introduction of new brands and the sale of local brands not supported by costly advertising would alike be handicapped.

As a result of these obvious and natural dealer reactions the final impact of the taxes would be most severe upon the independent bottlers—that is, upon those who would not have the sales promotional support of Nation-wide advertising and other methods of sustaining consumer interest. Thus there would be the same tendency toward concentration of the industry through elimination of the weaker bottlers as would ensue if the more prosperous bottlers absorbed the tax. In this case the weaker bottlers would suffer from a decline of dealer interest in handling their products with a consequent drying up of their sales outlets, rather than from direct expropriation of their profits.

But when a concern is being put out of business, the precise nature of the destructive forces is of less importance than the cold fact that the sheriff is taking over.

2. Other potential competitive problems presented by the "soft drink" tax provision of part I of title V of the House bill are numerous and of vital importance

For example, in those few instances since 1917, when excise taxes have been levied on "soft drinks," not only have there been included such products as carbonated beverages and carbonated waters but also the other types of soft drinks—specifically designated as fruit juices (unfermented), fruit juices (with sugar added), imitation fruit juices, grape juice, mineral waters (natural and artificial), still drinks (meaning noncarbonated), and other table waters (natural and artificial) (*12*).

In the provision here being considered bottled carbonated beverages and carbonated waters have been made subjects of the proposed tax to the exclusion of all of these other types of soft drinks, thus providing the basis for severe competitive problems, disruption of the industry, and demonstrating the utter ineffectiveness of such a tax as a revenue means.

Still drinks—meaning those which are substantially identical in every feature with carbonated drinks with the exception that they are not impregnated with carbonic gas, and do not effervesce—are an important competitor with carbonated beverages in the soft-drink field.

Such drinks are produced by soft-drink manufacturers in bottles; by the canners in cans (*13*); by dairies in bottles (*14*); mixed by the corner drink stand in bulk and dispensed by the glass; and by the soda fountain.

With a cost differential (or profit margin) equivalent to the amount of the proposed tax, the Government will have put the bottled carbonated beverage manufacturer in a competitive position which will be disastrous to him. Competitors selling the bottled or canned noncarbonated drinks may readily influence the retail outlets to give preference to their products on account of their lower cost and greater profit margin because not burdened with the "soft drink" tax.

Noncarbonated drinks dispensed from bulk or by direct mixing of flavoring materials (not syrups) with sugar and water in the glass by drink stands and fountains will likewise operate tax free in competition with the same flavor of drinks in bottles which are taxed solely because they "fizz."

Very low carbonation is a desirable characteristic of some types of drinks (such as some bottled orange drinks, root beer, and others). It seems ironic that one bottler would bear the burden of a special heavy tax on his earnings because he has developed a market for a bottled orangeade with just sufficient carbonation to give it a perceptible tang, while a competitor bottler, canner, dairy, corner drink stand, or fountain proprietor can avoid that burden merely by selling the same product without carbonation.

Fruit juices (with or without added sugar) are an important feature of the soft-drink market, and particularly since they are being sold in 5-cent cans. Iced in the same coolers, vended through the same types of vending machines, and distributed at ball games and similar places by the same hawkers in competition with the carbonated types of drinks (often of the same flavor) in bottles, the proposed tax on the latter seems most unjustified, unfair, and without reason.

This is especially true since the product is developed as a competitive item for sale as a soft drink, in soft drink outlets, and often sold from the same delivery vehicle from which the bottled drinks are sold to the retailer (*15*).

The soda fountain or drink stand where drinks are dispensed in bulk is, of course a major competitor of the bottled carbonated beverage manufacturer.

Such an outlet is the manufacturer of the product it sells, and to that extent is comparable to the bottler. But it sells direct to the consumer at the full retail price, whereas the carbonated-beverage bottler sells to the retailer at wholesale. The benefit of this income differential, plus many cost advantages coming from absence of investment in expensive machinery, delivery equipment, the heavy losses incident to the use of bottles, and from less expense for labor, give the fountain and soft-drink stand a decided advantage over the bottler in earnings per dollar of sales.

Notwithstanding these competitive advantages enjoyed by them, under the provisions of the House bill all soft drinks sold by them excepting those in which carbonated water is used are excluded from the definition of taxable "soft drinks."

This means that all fountain drinks made by mixing water and sugar with lemon juice, orange juice, grape juice, or with any of the variety of artificial flavors, or soft-drink powders—so long as carbonated water is not used—are not in the taxable class.

It is true, of course, that under the provisions of the bill when carbonated drinks are dispensed at such fountains the sirups used are taxed at 6 cents per gallon, but even in that event it is a prerequisite to taxability that a sirup must have existed in the preliminary operation. With carbonating equipment installed in every soda fountain it is conceivable that the sirup tax is subject to easy avoidance by mixing the flavor, sugar, water, or other ingredients in bulk and then carbonating it for dispensing by the glass, or by mixing the flavoring ingredient in the glass and adding sugar and carbonated water.

A further competitive complication is added by the fact that the same finished sirup is commonly used by the fountain or stand for a given flavor of drink in carbonated or noncarbonated form, and for other purposes. Chocolate sirup, for example, is used for preparing chocolate sodas (carbonated), but it may also be used for making chocolate milk shakes, or in chocolate ice-cream sundaes. A question of interpretation immediately arises whether or not this is identified as a sirup "of the kind used in * * * mixing" carbonated drinks because of its use in chocolate sodas, or whether its other (and perhaps more prevalent) uses determine its classification and nontaxable nature.

Carbonic gas tax at the rate of 4 cents per pound is proposed to be levied on that "sold by the manufacturer * * * or by a dealer * * * to any person who sells soft drinks otherwise than in bottles." The tax does not apply to gas made and used by the fountain proprietor. Past experience of the industry shows that gas generating units have been installed to escape such a tax. A saving in cost of 4 cents per pound on carbonic gas may be an inducement to revive this practice, or result in widespread bootlegging of gas for fountain use by irresponsible persons purchasing it from the manufacturers tax-free.

Further, the bottler of the carbonated drinks also faces a serious competitive situation because of gross disproportion between the tax levied on him under the bill and that proposed for competitive fountains and stands, even assuming that the 6 cents per gallon on finished syrups, and 4 cents per pound on carbonic gas, is collectible and paid on all such syrups and gas used by such fountains and stands for the carbonated drinks they sell.

Using a common type of soft-drink syrup, for example, 1 gallon will make an average of 5 cases (120 bottles) of the finished drink, on which the bottler's tax under the bill would be 20 cents. Yet the fountain on 120 glasses of the same drink will pay but 8 cents (6 cents on 1 gallon of syrup, and 2 cents on ½ pound of carbonic gas used).

With a maximum selling price of 80 cents per case by the bottler, his tax is 5 percent of his $4 sale, while the selling price of the same quantity of the same drink by the fountain proprietor is $6 and the tax is 1.33 percent of his selling price.

The competitive advantage of such a disparity in production and tax costs, plus the ability of dispensers by the glass to recoup any such increased cost on the retail sales by a minor investment in smaller glasses, which the bottler cannot do to his bottles, makes the inequities and impracticability of the provision of the House bill most apparent.

This also offers a comparison of the 1.33-percent ratio of the tax on fountain-dispensed carbonated drinks with the position of the carbonated beverage manufacturer who sells his product in tanks (for example) to stands for dispensing by the glass in competition with fountains, and on which the 6-percent rate of tax is applicable under section 3402–b–1–B.

EXPERIENCE ARGUES AGAINST THE "SOFT-DRINK" TAX

The same compelling reasons expressed by the Committee on Ways and Means, the Committee on Finance, and the Treasury as basis for early repeal of previous similar taxes on soft drinks (*16*), enacted as features of emergency Federal Revenue programs, lend full force and vigor to the carbonated beverage industry's opposition to the "soft-drink" tax proposal in H. R. 5417:

1. "* * * It is unwise and unjust, in addition to the income and war-profits taxes, to impose a heavy gross-sales tax upon products out of which the income and profits of a business are made. Such taxes should not ordinarily be imposed at heavy rates unless it is unequivocally intended that they are to be fully and invariably paid by the ultimate consumer" (S. Rept. No. 103, 65th Cong. 1st sess. August 4, 1917).

"* * * The tax in most instances cannot be paid out of the profits in the industry and must be paid out of the capital, and to that extent constitutes a capital levy * * *" (H. Rept. No. 170, 68th Cong., 1st sess., February 11, 1924).

The renewed proposal to tax soft drinks justly bears such characterization. It cannot be passed on to the consumer or to the retailer. It must be added to the bottler's cost of placing his product on the market, appropriating in the guise of an excise tax the whole or a major portion of the earnings of his business as a super-tax in addition to the taxes he pays on such earnings in common with all other citizens. There is nothing in the nature of the product or its relation to defense operations that can possibly warrant such singling it out for special exorbitant taxation on gross sales or profit.

2. "This tax has proved very difficult to administer and is widely evaded" (S. Rept. No. 276, 67th Cong., 1st sess., September 26, 1921).

"* * * An administrative nuisance and is adversely affecting business * * *" (S. Rept. No. 558, 73d Cong., 2d sess., March 28, 1934).

"* * * difficulty has arisen in attempting to establish the present-day definition of finished or fountain syrup, fruit juices, and still drinks, in view of the fact that the beverage industry has developed many new products and practices * * * (p. 77, annual report of the Secretary of the Treasury for fiscal year ended June 30, 1932).

The controversial aspects of any attempt to levy an excise tax on soft drinks are intensified by the immense range of items which properly belong in this category and by the peculiar characteristics of the soft-drink trade.

Some effort appears to have been made to minimize this difficulty by excluding, through arbitrary definition of a soft drink, many types of soft drinks and closely allied competitive products from the tax proposal. The situation thus created by the present tax proposal warrants a conclusion which is sustained by all previous experience; namely, that a general tax on all soft drinks by whomever produced or sold, is impossible of effective administration, while a tax of narrow scope, characterized by greater ease of levy and collection, becomes a grossly discriminatory imposition upon a portion of those taxpayers engaged in the soft-drink industry.

3. "As a considerable portion of the soft drinks sold are compounded at the soda fountain, and not reached under existing law, the taxes levied under existing law are not great revenue producers * * *" (H. Rept. No. 767, 65th Cong., 2d sess., September 3, 1918).

"These taxes are not highly productive * * *; they are ill defined and uncertain; they are vexatious and expensive to the dealers who pay them; and I am informed by those in charge of their administration that they are widely evaded and that such evasion cannot be stopped without the employment of a larger number of agents and measures more drastic than the potential importance of these taxes would justify" (p. 43, Annual Report of the Secretary of the Treasury for the fiscal year ended June 30, 1920).

"Difficult to enforce, relatively unproductive, and unnecessarily vexatious * * *" (statement of Secretary of the Treasury, p. 11, Internal Revenue hearings before the Committee on Finance, U. S. Senate, 67th Cong., 1st sess).

"This tax is a burdensome one and one of the most difficult to collect. The difficulty and cost of administration in collecting the taxes imposed by those sections, the inconvenience caused by these taxes to taxpayers, and the burden which these taxes place upon the industries affected justify their repeal * * *" (H. Rept. No. 179, 68th Cong., 1st sess., February 11, 1924).

The present proposal invites this same critical comment.

There has been a marked tendency to overestimate the direct revenue to be obtained from a tax of this kind (*17*), but with the problems confronting the industry today in its efforts to avoid the disastrous results of any increase in the 5-cent price of its products to the consumer (notwithstanding rising costs of materials, labor, overhead, and taxes), the effect upon ultimate revenue to the Government from the bottled carbonated beverage industry cannot be overlooked.

Those bottlers now operating profitably are paying all taxes levied on business or income. With inevitable taxes on income at rates considerably higher than heretofore known, insofar as the industry continues to produce income, there will be a considerable loss of revenue under these taxes which must be offset against the anticipated yield of the soft-drink tax.

This condition may reasonably be expected to reduce the net additional tax yield from the bottled carbonated beverage industry to no more than half of that now anticipated. Nothing is said here of the added administrative costs of such taxes, but they are likely to be substantial and thus to reduce still further the realized return from this tax.

IN CONCLUSION

1. The result of the soft-drink tax proposed in H. R. 5417 will be to disrupt the bottled carbonated beverage market and concentrate the business into the hands of the financially stronger companies. The consequence will be the closing of many plants through sheer inability to pay the tax out of earnings or to meet competition if they do not.

Were the industry one in which such condition would affect a few large plants in widely separated parts of the country, and which were susceptible to use in the manufacture of other products, the result might not be so serious.

But most bottlers have no other business, their plants are not adaptable to products other than soft drinks, and as an industry in which small plants predominate, located in 2,899 cities and towns in every State, the unemployment, decline in State and local tax revenues, and the general effect upon their withdrawal from community business life, would be widely felt.

2. The industry does not argue that its products can be substituted for the meat, potatoes, and flour on which armies are fed. But it does submit it is as manifestly unreasonable to select carbonated beverages from the grocer's stock for taxation, as it would be to levy an excise tax on any one of his other items of vegetable juices; fruit juices; frozen desserts; ices and ice cream; dessert, ice cream, and beverage powders and gelatins; syrups; spices; ketchups, prepared mustards, sauces, and salad dressings; preserves; fruit butters; jams; jellies; pickles; confectionery and candies; nuts and nut butters; chewing gum; chocolate and other syrups; prepared foods for dogs, cats, and other pets; tea, coffee, and cocoa.

The soft-drink bottler contends it is most unjust to levy this tax which, due to the factors previously outlined, will have the effect of a special supertax upon his earnings, when he pays the same taxes on income and profits to the Federal Government as the drink-stand proprietor, the canner, or the preserver, the ice-cream manufacturer, the chewing-gum manufacturer, the confectionery manufacturer, the dog-food manufacturer, or the manufacturer of any of these other grocery items. He is ready and willing to bear his full share of the Nation's tax burden at this critical time by such increase in taxes of general application as Congress may deem necessary to distribute that burden equitably and in recognition of the equal interest all industries and all taxpayers have in it.

The bottler realizes that increased taxes on income are inevitable, and has no objection to accepting his pro rata increase, and any accompanying hardships, in common with all other citizens.

If, in the solution of the problem, there must be a tax on product sales, the soft-drink bottler urges that it should be a general tax, levied upon a base sufficiently broad to distribute the burden with the least hardship by taxing all or substantially all commodity sales at the same rate, thus giving this and each other industry a chance of holding its own in the competitive field, producing the maximum revenue, and being the least disruptive of this and other industries in similar position.

Respectfully submitted.

AMERICAN BOTTLERS OF CARBONATED BEVERAGES.

NOTES SUPPLEMENTING STATEMENT ON BEHALF OF THE AMERICAN BOTTLERS OF CARBONATED BEVERAGES

(1) At the presentation of the industry's views before the Committee on Ways and Means there was available, as basis of discussion, only a vague proposal submitted by the Treasury to levy a tax on soft drinks of "1 cent a bottle and equivalents."

This proposal was obviously too indefinite and uncertain to permit of specific interpretation, but its general import was clear to those citizens engaged in the soft-drink industry.

On the basis of retail sales it involved the levying of a special excise tax of 20 percent on a simple, harmless, and wholesome food product, sold for 5 cents and depending upon the children and the wage-earners of the nation for its market. On the basis of the bottler's average selling price to the retailer the proposed tax amounted to a rate approximating 33⅓ percent.

In dealing with this proposal it was demonstrated:

1. That neither the bottler nor the retailer of soft drinks could absorb such a tax, as it exceeded their margin of profit many times over.

2. That the "passing on" of the tax to the consumer, by increasing his cost of soft drinks from 5 cents to 6 cents, would have serious effect upon sales volume of the entire industry in competition with other tax-free items devoted to the same market.

3. That a special excise tax on soft drinks is based either upon the false premise that a 5-cent drink is a luxury to the child or the wage earner who are its principal consumers, or upon the false assumption that the bottled soft-drink industry as a whole is an unusually profitable industry, because of which it is an unusually harsh, unproductive, and costly form of taxation.

4. That such a discriminatory tax would be especially disastrous to thousands of bottlers who do not have the support of extensive, Nation-wide advertising, and similar promotional efforts, and would tend toward concentration of the bottled soft-drink business into the larger and financially stronger companies, such as those selling under nationally known brands.

(2) Characteristics of the bottled carbonated beverage industry:

The principal economic characteristics of the industry should be briefly sketched, because they are often misunderstood.

1. Carbonated beverages and other soft drinks are recognized as wholesome food products. They are, of course, nonalcoholic, and are not customarily put in the same classification as alcoholic drinks either from the regulatory or the competitive standpoint

Aside from the well-known characteristics of those drinks comprising fruit and berry juices, and extractives, herbs, or spices, the sugar content of soft drinks contributes definite food, refreshment, and energy values, and in the case of effervescent drinks the carbonation is recognized as contributing tonic and healthful properties. Their manufacture, labeling, and sale are subject to all State and Federal food laws and regulations, the same as other food products. They take their place on the grocer's shelf, or on the lunch counter, among other foods competing for consumer acceptance.

Over 90 percent of the total output sells at the standard price of 5 cents per bottle. While there is no agreement as to what is meant by the term "luxury," it is certainly a misuse of the term to speak of a 5-cent luxury. There is no better evidence of the wholesome nature of soft drinks than the provision usually made for an ample supply to be available at post exchanges, at Civilian Conservation Corps camps and Army posts. They are similarly stocked in quantity on naval vessels.

2. The bottled carbonated beverage industry includes about 6,300 bottling plants in the United States at the present time

These plants vary in size from small concerns having an annual output of only a few thousand cases to a few very large plants in metropolitan areas producing a million cases or more. The industry provides employment for over 80,000 employees and owners.

The shipping of bottled soft drinks of the soda water or carbonated types from one plant to the national market is virtually nonexistent at the present time. An analysis of the census report will show that the ratio of bottled soft-drink production in each State to total production in the country is substantially the same as the ratio of the population of each State to United States population. This is an indication that the industry is primarily a local business, filling local needs from local plants and, naturally, employing local labor, paying local taxes, and otherwise participating in the general economic life of the community.

With the exception of a comparatively small number, all of these plants are locally owned. The majority of plants in number purchase their basic materials on the open market, compound their flavoring materials and finished sirups in their own way, and sell their bottled drinks under their own brands. The other plants operate in somewhat similar manner, the principal distinction being that their basic flavoring materials are purchased from a central source under contract, or territorial franchise, and the finished drink sold exclusively within that territory under the trade-mark controlled by the flavor manufacturer. In this latter group, of course, are those plants producing the nationally known brands; but the territorial rights to which brand, together with the plant and equipment, are owned locally.

3. The consumer market for bottled carbonated beverages is preponderantly among children and among wage earners in the low-income groups

In addition to those outlets serving soft drinks at fountains, the bottled drinks are distributed through virtually every type of retail outlet, a substantial portion being sold the same as other groceries for home use at meals and as refreshment.

It is a recognized fact in the soft-drink industry that carbonated drinks (such as club soda, ginger ale, lemon soda, etc.) have been declining in volume used as mixers. Those used for that purpose are estimated to be not more than 5 percent of the industry's production at the present time.

Outlets making retail sales of bottled soft drinks are estimated at over 1,000,000.

The number of fountains and soft-drink stands making soft-drink sirups, such as those taxable under H. R. 5417, and from whom the sirup tax would be collectible, and dispensing the finished drinks made therefrom, are estimated at over 100,000. In 1939 the Census of Manufactures reported the following numbers of eating and refreshment places where fountains are common: Restaurants, cafeterias, lunch rooms, 99,068; lunch counters and stands, 62,073; soft drink, juice, ice cream stands, 8,051; drug stores with fountains, 39,452; total, 208,644.

(3) Upon the basis of available data, the 6,309 plants comprising the bottled soft-drink industry are divided into the following classifications:

Estimated sales volume per year	Estimated gross sales value	Number of plants	Percent of total
25,000 cases or less	$18,750 or less	4,025	64
25,000 to 100,000 cases	$18,750 to $75,000	1,714	27
100,000 to 250,000 cases	$75,000 to $187,500	382	6
Over 250,000 cases	$187,500 or more	188	3

Just as an illustration of the comparative size of soft-drink plants, compared with candy and chewing gum. For 1939 confectionery manufacturers' production value averaged $238,000 per plant (1,252 plants, value $297,761,813); chewing-gum production averaged $2,250,000 per plant (27 plants, value $60,783,246); bottled soft-drink production averaged $81,200 per plant (4,504 plants reporting, value $365,779,000). Preliminary report, Bureau of the Census, Census of Manufactures, 1939; Value of Products and Value Added by Manufacture, issued December 29, 1940.

Even this average does not sufficiently emphasize the small size of most plants, as its computation does not include figures from about 1,900 plants, presumably because annual production did not total $5,000, which is the minimum covered by the census reports.

Preliminary report (April 5, 1941), Bureau of the Census, Census of Manufactures, 1939; nonalcoholic beverages shows total cases bottled beverages produced 479,055,717, value of production $358,232,407. Average, 74.8 cents per case.

(4) This motive was made clear in the following Washington dispatch (Trenton, N. J., Evening Times, July 1, 1941):

"As one means of raising the remaining money, the committee today looked for a way to tax soft drinks without increasing their retail prices.

"The Treasury proposed that such beverages be taxed 1 cent a bottle, but some legislators said that in States which already had tried such levies, it was found that they seriously impaired the sale of the products.

" 'What we are trying to do,' one member said, 'is to tax soft drinks as much as possible without forcing the retailer to increase his price.' "

Commenting on the provisions of H. R. 5417 as reported by the Committee on Ways and Means, of which he is a member, Mr. Treadway (Massachusetts) made the following comment in the House of Representatives (Wednesday, July 30, 1941, Congressional Record, No. 139, p. 6626):

"In the case of soft drinks the Treasury recommended a rate of 1 cent per bottle. The committee, however, took into consideration the fact that such a tax might cripple the industry since its sales depended upon a 5-cent price. Instead of adopting the Treasury proposal, the committee fixed a rate of one-sixth of a cent per bottle, which of course is equivalent to 4 cents per case. So far as I am informed, the bottling industry will not be able to absorb this tax due to its small margin of profit. I feel that the tax should be eliminated, or at least further reduced."

Commenting upon the same action by the committee, of which he also is a member, Mr. Dingell (Michigan) stated in the House (Friday, August 1, 1941, Cong. Rec., No. 141, p. 6782):

"As to the attitude of your humble servant, I have favored the elimination of this tax in its entirety, especially so since I have been in entire accord with the elimination of the tax proposal with regard to candy."

(5) Costs, for example, involve the following items:

Material:
- Sugar.
- Extracts, acid, color.
- Sirups.
- Carbonic gas.
- Crowns.
- Labels, foil, paste.
- Cartons and glass (when package is sold).

Factory labor and overhead:
- Factory labor.
- Rent.
- Building repair and maintenance, building depreciation.
- Insurance.

Depreciation:
- Machinery and equipment.
- Light and power.
- Water.
- Fuel.
- Machinery repairs.
- Factory supplies.
- Bottle breakage in plant.
- Taxes (manufacturing proportion).
- General factory expense.

Selling expense:
- Sales, salaries, and commissions.
- Traveling expense.
- Sales-car expense.
- Advertising.
- Depreciation on coolers loaned to trade.
- Samples, premium deals, etc.
- Telephone and telegraph.
- Taxes (selling proportion).
- General selling expense.

Delivery expense:
- Drivers' wages.
- Gas, oil, grease.
- Truck repairs.
- Truck insurance.
- Truck tires.
- Truck depreciation.
- Truck licenses.
- Truck general expense.
- Garage rent.
- Paint and repair—cases.
- Depreciation—cases.
- Freight out.
- Freight empties in.
- Taxes (delivery proportion).
- General delivery expense.

Administrative expense:
- Salaries and wages.
- Traveling expenses.
- Stationery and office supplies.
- Postage.
- Insurance and bond premiums.
- Dues and subscriptions.
- Legal and accounting fees.
- Depreciation—furniture and fixtures.
- Taxes (administrative proportion).
- Miscellaneous general expense.

Bottle and case loss with the trade:
Other expense:
Interest.
Discounts and allowances.
Bad debts charged off.

(6) The Department of Commerce reports the soft-drink industry was the fourth largest user of sugar products of the United States refiners in 1939, using a total of 567,473,543 pounds, of which 464,884,942 pounds were used in the manufacture of bottled soft drinks, the major portion of which was cane sugar.

According to a preliminary report of the Bureau of the Census, soft-drink bottling plants used approximately 22,250,000 pounds of beet sugar during 1939, 5,675,683 pounds of corn sugar, and 7,425,196 pounds of corn sirup. These represent substantial increases in the use of these agricultural products in 1939 over quantities previously reported for 1937.

(7) See Weekly Statistical Sugar Trade Journal, published by Willett & Gray, Inc., New York City. Issue of August 1, 1940 (p. 275), quotes prices that date of $4.15 and $4.35 per 100 pounds. Issue of July 31, 1941 (p. 277), quotes current price of 5.20 per 100 pounds.

(8) Note rate of labor costs in beverage industries in comparison to other food industries: Average hourly earnings—All manufacturing, 68.3 cents; food and kindred products, 64.1 cents (baking, 64.4 cents; butter, 49.8 cents; canning and preserving, 51 cents; confectionery, 49.8 cents; flour, 60.8 cents; ice cream, 65.8 cents; slaughtering and meat packing, 68 cents; beet sugar, 56.2 cents; cane-sugar refining, 65.8 cents; beverages, 88.7 cents). (Employment and pay rolls, December 1940, U. S. Department of Labor, Division of Employment Statistics.)

(9) The bottled soft-drink industry is reported to have invested $24,122,464 in new items of plant and equipment in 1939.

Preliminary report (April 24, 1941), Bureau of the Census, Census of Manufactures; Expenditures for Plant and Equipment, by Industry Groups and by Industries, 1939.

(10) Bottling plants in the soft-drink industry are distributed in 2,899 cities and towns of various sizes, as follows:

	Plants
Population less than 2,000	684
Population between 2,000 and 5,000	991
Population between 5,000 and 25,000	1,890
Population between 25,000 and 50,000	683
Population over 50,000	2,081

Census figures show the plants in the soft-drink bottling industry are located primarily as the means of supplying that particular area. In the eight States showing highest bottled soft-drink production (California, Georgia, Illinois, New York, North Carolina, Ohio, Pennsylvania, and Texas) the 1,648 plants included in the census report (1937) show total production valued at approximately $125,000,000, or 45 percent of the total, while those same States have 44 percent of the total population of the United States.

(11) The Successful Grocer magazine, May 1941, under the heading "Kool-Aid soft drinks," refers to the soft-drink powder sold in competition with the bottled drinks as the "Nationally advertised soft-drink powder," stating: "Kool-Aid's current advertising campaign embraces more than 815,000,000 sales messages in 18 national magazines and 3,019 local newspapers."

(12) See sections 313–315, Revenue Act of 1917; sections 628–630, Revenue Act of 1918; section 602, Revenue Act of 1921; section 615, Revenue Act of 1932.

(13) Concerning this type of drink the Western Canner and Packer magazine (1940 Yearbook and Statistical Number) states (p. 121):

"Aside from the pineapple and citrus juices there are a wide variety of other juices packed in the West. Fruit nectars make up the largest proportion of these. Deciduous fruits, particularly apricots, peaches, and pears, are used in making nectars. They are not strictly fruit juices, according to United States Food and Drug Administration rulings, because they include sugar and water with the juice and pulp of the fruit. However, under the classification of nectars of similar names they have been competing with other fruit juices. * * *

In the same issue (p. 119), concerning "Canned fruit juices":

"The phenomenal increase in canned-juice production is not a new story, but a brief résumé of available data gives a factual picture of the development of this

industry in the past decade. In 1929 the total United States canned fruit juice pack (all varieties) was 205,000 cases. A new record was set in 1939 with an estimated output of almost 24,000,000 cases."

The Food Field Reporter of August 4, 1941 (p. 3), comments on the sale of juice drinks:

"Canned juices have proved so popular that the individual style can, about 6 ounces, has been developed. Introduced in the Southern States, this 6-ounce can of fruit juice is a popular item at soda fountains, gas stations, and other soft-drink outlets."

(*14*) The Milk Dealer magazine for February 1941 (p. 75) comments upon the advantages accruing to dairies selling bottled orangeade in competition with bottlers of carbonated beverages as follows:

"That the trend is to fruit beverages is clearly evidenced by the tremendous growth in recent years of the canned fruit-juice industries. From a pack of 153,000 cases a year to nearly 24,000,000 cases a year, in 9 years' time, is little short of phenomenal—proof enough that the American public is 'fruit-juice conscious.'

"With orangeade bases of the better manufacturers today more adaptable to home delivery than ever, the milk dealer still has an advantage over the carbonated-beverage bottler in cutting a wide swath into potential fruit beverage sales. Delivery to the home from dairy retail routes is an advantage any bottler of carbonated beverages would enjoy having. Crowell-Collier's survey showed that 50 percent of all beverages are consumed in the home.

"As home sales are almost always quart sales, the consumer's cost per drink is less than that for many of the nationally known carbonated beverages which must be purchased at a store and carried home. Thus a high quality fruit beverage can be offered to the consumer by the milk dealer at a low cost per drink and with the added convenience of home delivery. Of considerable importance to milk dealers, too, is the fact that quart sales are more profitable than sales from individual bottles."

(*15*) That the soft-drink market is of considerable importance to the canners of juice drinks is indicated by the Southwest Banker magazine, May 1940 (p. 17), in which comment on canned grapefruit juice includes the statement:

"The idea of undiluted chilled juice in the soft-drink outlets 'clicked' immediately, and a new Texas industry got away to a grand start."

and (p. 14):

"One of the innovations of Texas grapefruit canners was the popularizing of a small can selling at cafes, cold-drink places, stores, etc., at popular prices to compete with the usual run of drinks."

(*16*) See exhibit I, accompanying statement on behalf of American Bottlers of Carbonated Beverages (p. 870, hearings before the Committee on Ways and Means, House of Representatives, 77th Cong., 1st sess., revenue revision of 1941) outlining the basis of levying prior taxes on soft-drink products under the various revenue acts, committee and Treasury comments on such taxes and reasons for their change or repeal, including a digest of the various acts showing products taxed, rates, collections, and effective and repeal dates.

(*17*) *Estimated yield and revenue realized*

[In millions of dollars]

Revenue act	Under House bill	Under Senate bill	Revenue realized [1]
Act of 1917	20	11	3.9
Act of 1918	47	(2)	32.2
Act of 1921	14	12	5.9
Act of 1932	10	7	4.8

[1] For details see exhibit I referred to in note 16.
[2] No estimate.

(See Hearings Before the Committee on Ways and Means, 77th Cong., 1st sess., on Revenue Revision of 1941, vol. 1, pp. 854–880, covering statements on behalf of soft-drink industry.)

Senator DANAHER. I have here a statement which was unanimously adopted by the Connecticut Manufacturers of Carbonated Beverages, Inc., which I would like to have incorporated in the record.

The CHAIRMAN. That may be done.

(The statement referred to is as follows:)

CONNECTICUT MANUFACTURERS OF CARBONATED BEVERAGES, INC.,
Waterbury, Conn.

Hon JOHN A. DANAHER,
United States Senator, Senate Office Building,
Washington, D. C.

DEAR SENATOR DANAHER: The Ways and Means Committee of the House of Representatives has at present under consideration a proposal submitted by the Treasury Department, of a 1 cent tax per bottle on carbonated beverages, and the bottlers of the State of Connecticut, in conjunction with the members of our industry in the other 47 States of the Union, feel that we must most strenuously object to such a tax as unjust, discriminatory, out of proportion, ruinous to our whole industry, uneconomical, and unprofitable to the Government.

Such a tax would be unjust because, with the exception of the small proportion of manufacturers and bottlers of the few nationally advertised specialty drinks, the great majority of the members of the carbonated-beverage industry own and operate small and medium-sized bottling plants which yield them an income barely large enough for a decent existence. The necessary replacement of worn-out and antiquated machinery, lost and broken bottles and cases, eliminated any surplus profit earned.

In spite of the constantly increasing wages of our employees the price of our product to the consumer has not been raised and the members of our industry would therefore be unable to absorb the proposed tax of 1 cent per bottle, which tax would have to be passed on to the ultimate consumers who are to the greatest extent children and people of medium and small incomes.

The proposed tax is discriminatory because our products have been recognized and classified by the Government authorities as important food products which although not a necessity of life provide the consumer nevertheless with important vitamins, and due to the sugar contents, carbon dioxide, and other ingredients are a substantial aid to the health and well-being of the consumer. They are, therefore, not a luxury as indicated by the proposed tax and should not be singled out from other food products for such a heavy tax burden.

The proposed tax is out of proportion because the biggest proportion of our product is sold for a nickel and a 1-cent tax per bottle would represent 20 percent of the selling price, which rate is considerably higher than that imposed on other products.

The proposed tax would prove ruinous to our industry, because the necessary increased selling price would greatly decrease the consumption of our product and thereby put quite a number of bottling plants, especially the smaller ones, out of business and a great number of employees, especially older men, out of employment. This would also make the proposed tax uneconomical. The Treasury Department figures on a yearly income of $132,500,000 from this tax, but this amount will be greatly reduced by greatly decreased consumption, and other tax sources will be affected by reduced incomes and profits, loss of business, and employment. A similar tax imposed by a few of the States has proved such tax to be uneconomical and unprofitable and expensive to collect and with the exception of one State such a tax on carbonated beverages has been repealed.

Now, the Connecticut manufacturers of carbonated beverages, as well as the members of our industry in the other States of the Union fully realize the wisdom and importance of the defense program as inaugurated by our Government and fully approve thereof. We also realize the necessity of our Government to raise the funds necessary for the execution of such program by taxation and otherwise, and we declare our willingness to fully contribute our just and equal share of the necessary funds, but we must strenously object to be singled out from other food products for such unequitable and unfair tax burden as proposed by the Treasury Department and we appeal to you as one of our Connecticut Representatives in Congress to use all the influence at your disposal to prevent the adoption of aforesaid tax, and if there must be a tax on production sales, to work and vote for a general tax levied on a base sufficiently broad and dis-

tributing the burdens equally by taxing all or substantially all commodity sales at the same rate, thus giving each industry a chance of holding its own, producing the necessary revenue, and bringing the least disruption of this and other industrise in similar practice.

The above statement was approved and adopted unanimously at a meeting of the bottlers of the State of Connecticut held at the Hotel Garde, New Haven, on the 13th day of May 1941.

Most sincerely yours,

THE CONNECTICUT MANUFACTURERS OF CARBONATED BEVERAGES, INC.,
(Signed) OSCAR SILVERMAN, *President.*
(Signed) C. F. G. SCHIRMER, *Secretary.*

The CHAIRMAN. The committee will recess until 2 o'clock.

(Whereupon, at the hour of 12:40 p. m., the committee recessed until 2 p. m. of the same day.)

AFTERNOON SESSION

(The hearing was resumed at 2 p. m., pursuant to recess.)

The CHAIRMAN. The first witness is Mr. Abram F. Myers of the Allied States Association of Motion Picture Distributors.

Mr. MYERS. That is an error; that should be Allied State Association of Motion Picture Exhibitors.

The CHAIRMAN. Exhibitors. All right, sir, you may proceed.

STATEMENT OF ABRAM F. MYERS, WASHINGTON, D. C., REPRESENTING ALLIED STATE ASSOCIATION OF MOTION PICTURE EXHIBITORS

Mr. MYERS. That is an association of independent motion-picture theater owners located in various parts of the United States. The bill as it stands reduces the exemption from payment of admission taxes from 20 cents to 9 cents.

The CHAIRMAN. To 9 cents?

Mr. MYERS. Yes. Our association representing the independent theater owners, did not oppose a general reduction in the exemptions on admissions. In fact, before the House committee we urged that the exemption, so far as it relates to adult admissions, be entirely abolished. Nine cents seems like an arbitrary figure. I never heard of a 9-cent admission, and I can only assume that it was arrived at for purposes of somewhat enabling theaters to continue to charge low admission for children without the payment of a tax. It creates a problem because I am afraid there will be, and my associates are afraid there will be, a tendency in some competitive spots to reduce these 10-cent admissions to 9 cents to evade the payment of the tax and create thereby an unhealthy competitive situation; and so we would suggest to the committee that it reconsider that exemption as it applies to adult admissions, and we hope that the committee will see its way clear to abolish the exemption altogether, so far as it relates to such admissions.

The theater owners I represent also bespeak the consideration of the committee in regard to the more or less standardized 10-cent children's admissions. Children are defined in the Revenue Act as persons under 12, and that standardized admission means that parents are

accustomed to giving the children a dime for the motion-picture show and the imposition of a penny tax means the breaking of another nickel which may not sound like a terrible burden but which actually parents are sometimes reluctant to pay, and in some cases cannot afford. We feel that coupling these two changes together, abolishing the exemption as regards adult admissions and exempting the children's 10-cent admissions, taken together, will not mean any loss of revenue but, on the contrary, will protect the revenue which the bill is designed to raise. That is true, we believe, because in its present form inevitably the children's admissions will go down to 9 cents, and the Government will realize no tax.

We also bespeak the attention of the committee to the definition of coin-operated machines as defined in the act. That definition was rather skillfully drawn to embrace just two categories of coin-operated machines; namely, the so-called pinball machines and the slot machines, which are strictly gambling machines, although the general language refers to entertainment and amusement devices, and it expressly excludes bona fide machines.

Senator GUFFEY. Isn't that what you get out of the slot machine, a little entertainment?

Mr. MYERS. A little experience, I think, because I have heard the percentage being as high as 90 and 10 against the player. There has come into the field in recent times, in the form of coin-operated machines, something known as the movie juke box. It gives a motion-picture program on a screen projected in pretty much the same way that pictures are projected in the theater. Of course, the screen is not so large. That affords competition to the theater, and presumably those who use those machines, patronize those machines, do not go to a motion-picture exhibition and, therefore, do not pay an admission tax. We think that the competition is unfair, because the legitimate motion-picture industry has set up a sort of self-censorship and observes pretty much high standards of decency in its productions. These other productions are practically dedicated to the barroom trade and do not serve any such standard, and we think, possibly selfishly, they should be included in the category of taxed coin-operated machines.

Finally, and here again, while I may be speaking for the protection of our industry, there is also the question of revenue involved. There are a great many so-called free-money movie shows being given in various parts of the country. I might say to Senator La Follette I had a newspaper from Medford which I read, and 3 of the enterprises advertised in that paper offered free movie shows. Well, obviously such patrons do not pay an admission tax. I do not suggest that should be included in the admission tax, but I do think the committee and its staff might give consideration to some form of tax on the amount of compensation received by the man who owns or leases the equipment and who actually gives the show, because it has worked in this fashion. The merchants in a town, or a particular merchant, will engage the owner or lessee of some of this equipment to give a free show in the town to attract people, or will give it in his store to attract customers. Of course, he pays for this show, which is ordinarily given on a 16-millimeter film. I assume that is within the reach of the taxing power.

That is all I have to suggest. The suggestions have been reduced to specific language in the form of a memorandum; and, with the permission of the committee, I would like to file that.

The CHAIRMAN. It may be filed.

(The memorandum referred to is as follows:)

STATEMENT ON REVENUE BILL, H. R. 5417

The following suggestions, relating to the admission tax, are submitted in behalf of Allied States Association of Motion Picture Exhibitors (pt. IV, sec. 541, as introduced in the House):

1. As passed by the House, the bill provides for an admission tax at the rate of 1 cent for each 10 cents or fraction of the amount paid for any admission down to and including 10 cents.

The effect of this is to lower the exemption from the admission tax from 20 cents to 9 cents.

The exhibitors have not opposed reduction of the exemption because they recognize that the Government must increase its revenue.

They feel strongly, however, that the exemption of 9-cent adult admissions is arbitrary and unworkable and may result in some cases in the reduction of adult 10-cent admissions to 9 cents in order to avoid the tax. Also, we have received word that a few drive-in theaters have lowered their admissions to 5 cents, and these should not go untaxed.

We therefore suggest that the Congress abolish altogether the exemption on adult admissions. This can be accomplished by striking from the provision the following words:

"Except that in case the amount paid for admission is less than 10 cents, no tax shall be imposed."

This amendment will not affect the special provision in reference to municipal officers, children, and soldiers, sailors, etc., in uniform.

2. The exhibitors also would like to see children's 10-cent admissions exempted from the tax.

Apparently it was in deference to children's admissions that the House fixed the exemption at 9 cents.

Children's admissions in the neighborhood and small-town theaters are more or less stabilized at 10 cents. Under the bill these will be subject to a 1-cent tax, making the admission 11 cents. This will mean the breaking of another nickel which parents are often unable to afford. Therefore, under the bill, the theaters will have to absorb a penny and cut the admissions to 9 cents, and the Government will derive no revenue therefrom.

Therefore, little or no loss to the Government would be involved in exempting children's 10-cent admissions. On the contrary, coupling such an amendment with the total abolition of the exemption on adult admissions would protect the revenue.

The exemption would apply only to children under 12 years of age.

This suggestion can be made effective by inserting in lieu of the language to be stricken under our first proposal, the following:

"Except that in the case of admissions of children under 12 years of age of 10 cents or less, no tax shall be imposed"—

and by striking from the parentheses in the most succeeding sentnce the words "children under 12 years of age."

3. The debate in the House of Representatives casts doubt on whether the definition of coin-operated amusement and gaming devices (pt. IX, sec. 3267, House committee print) is broad enough to include coin-operated motion-picture machines.

These machines, mostly located in taverns, barrooms, and resorts, exhibit motion pictures on a small screen and are, strictly speaking, motion-picture shows.

They not only compete with theaters, but compete unfairly, since the legitimate-motion-picture industry, through the Breen Board in Hollywood, censors its own pictures and observes standards of decency.

This new juke-box industry observes no such standards, and its films are obviously dedicated to the barroom trade.

The movie juke boxes are no more bona fide vending machines than are the pinball and slot machines specifically described in the bill.

The legitimate exhibitors feel strongly that these juke boxes should be subject to an amusement tax.

Accordingly, they suggest that the first category in the definition should be described as follows:

"(1) So-called pin ball, motion picture, and other similar amusement machines, operated by means of the insertion of a coin, token, or similar object."

4. Finally, the exhibitors feel that to round out the system of amusement taxes and to protect the revenue, the bill should include a provision for taxing free motion-picture exhibitions.

The free shows are operated in this manner:

An itinerant exhibitor owning or leasing a projecting machine, sound apparatus, and some film (usually quite old) will arrange with the merchants in a town, or with an individual merchant, to give a free show as an advertising device to attract people into the town or into a particular store, tavern, or eating place.

These free shows compete directly and seriously with the theaters and tend to cut attendance thereat and consequently to reduce the Government's yield from the admission tax.

The exhibitors suggest that a tax of 10 percent be imposed on the amount of the compensation received by such itinerant exhibitors for staking such exhibitions. This could be accomplished by inserting at an appropriate place, possibly in the section relating to cabarets, roof gardens, etc. (pt. IV, sec. 542, House print), the following:

"Every person owning or leasing motion-picture equipment who shall exhibit motion pictures publicly for or on account of others, at which exhibition no admission fee is charged, shall pay a tax equal to 10 percent of the total amount received for the giving of such exhibition from the person for whom or on whose account the exhibition was held."

Senator LA FOLLETTE. May I ask this question: What has been the tendency of movie attendance? Is it climbing or static or what?

Mr. MYERS. Beginning last winter there was a very decided falling off, and that continues to the present time, and I think from the inquiries I have made in the various parts of the country that it is due in part to the dislocation of people moving from one place to another to take jobs; working on shifts has a great deal to do with it; and also, with more money in their pockets, the people can afford other types of entertainment denied them a long time, and of course, even during the depression, everyone could afford a movie. However, we are hopeful that will pick up with the new pictures coming out in the fall.

The CHAIRMAN. Very well, Mr. Myers. Thank you very much.

STATEMENT OF MRS. JOAN DAVID, WASHINGTON, D. C., REPRESENTING THE NATIONAL LEAGUE OF WOMEN SHOPPERS

Senator GEORGE. Give your name, please, to the stenographer. You may have a seat, if you so desire.

Mrs. DAVID. My name is Joan David, and I am speaking for the National League of Women Shoppers. This group is a national consumers' organization, with branches from coast to coast.

The purposes and activities of our organization have always been directed toward improving the American standard of living. We have worked chiefly to raise wage standards through the use of our buying power, and our efforts have expanded to include attempts to keep down the rising cost of living, since this now seems the major danger to American living standards.

We are interested in the tax bill now before Congress because we realize the effect it will have on the health and welfare of America's millions of low-income families. We realize that the enormous cost of defense has to be paid for out of taxes. But we are alarmed at the

trend of the tax discussion so far. The bill, as it now stands, does not, in our opinion, follow the principle laid down by President Roosevelt when he said:

> It is our duty to see that the burden is equitably distributed according to ability to pay so that a few do not gain from the sacrifices of the many.

On the contrary, under this bill the consumer, through commodity taxes, and the low-income groups, through lowered income-tax exemptions, will bear the greater part of the defense program.

It is misleading to talk about the "90 percent of our people who don't pay taxes." This group is already paying heavy taxes, mostly hidden consumer taxes. The Temporary National Economic Committee, in its Monograph No. 3, entitled "Who Pays the Taxes," shows that the group earning less than $500 a year in 1938–39 paid 22 percent of its total income in taxes. The income group earning from $500 to $3,000 a year paid about 18 percent in taxes. And the group earning between $3,000 and $10,000 paid out about 17.5 percent.

Altogether, the groups earning less than $3,000 a year paid 59.5 percent of all taxes. This disproportionate burden on the groups least able to pay increased throughout the past decade. In 1930, about 60 percent of Federal taxes came from income and corporate taxes and about 40 percent from consumer taxes. By 1940 the figures had been reversed, with consumers paying over 60 percent of the total.

The League of Women Shoppers agrees on the necessity for the raising of revenue for the defense program, and we believe that everyone should participate in the sacrifices necessary for this effort. We do not believe, however, that the poor, millions of whom are already living below the danger line, should be required to pay more until our present tax structure has been adjusted so as to strike at those best able to pay.

We are not tax experts in any sense of the word. But we have studied the situation enough to bring before you certain recommendations which we believe are in the interests of the great majority of the people of our country and in the interests of the defense program.

1. *On the excess-profits tax.*—We see that in the last war excess profits were taxed on the basis of invested capital only. This tax raised 2½ billion dollars in 1918. In spite of this, nearly 18,000 new millionaires paid income taxes in 1918.

Today corporations can figure their normal profits either as 8 percent of their invested capital or as 95 percent of the average profit they made from 1936–39. This allows companies which were making large profits during those years to continue to make such enormous profits indefinitely and never pay any excess-profits tax.

We believe that Congress should follow the example of the last war and tax on the basis of invested capital only. If 2½ billion dollars was raised then, surely far more than that could be expected now. A strong excess-profits tax should be the heart of any good tax bill.

We agree with Federal Reserve Board Chairman Marriner Eccles, when he said:

> The first source of defense revenue should be the corporation tax and excess-profits tax, because, generally speaking, corporations are the greatest beneficiaries, directly and indirectly, from defense expenditures.

And yet, according to the Treasury Department, "the law we call an excess-profits tax does not tax excess profits at all." We wish to urge this committee to investigate thoroughly all possibilities of making the excess-profits tax one of the big sources of revenue for the defense program.

2. We approve, as a step in the right direction, the 6-percent surtax on corporate income. We would like to have the committee investigate the possibility of raising this surtax, since there seems to be some evidence of the ability of the corporations to pay more, on the basis of profits they are now making.

3. We believe that the income from all Government securities, issued in the past or present, should be taxed. We approve the fact that the Government issues no more tax-exempt bonds, but we believe that those issued in the past should be taxed, since their interest makes up a large part of the income of many wealthy persons, as well as banks and corporations, who could and should be paying taxes on them.

4. We know that the Government loses considerable revenue each year through tax evasion. We urge this committee to give special attention to methods of plugging up all loopholes which permit tax evasion.

We were very interested in Secretary Morgenthau's proposal of a simplified income-tax form. While this was apparently designed for the small-income groups, we believe that such a simplified form for all incomes could be devised. This would remove present possibilities of manipulation which so often end in tax evasion. We urge the committee to carefully consider this proposal.

5. We urge a single tax with a rising rate to cover any transfer of wealth—either by gift, inheritance, or insurance. A wealthy man today can give $40,000 to his heirs, leave another $40,000 worth of insurance, and still another $40,000 in his will, before incurring any taxes whatever.

We agree with President Roosevelt's statement that—

> The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals of the American people.

We believe, with Mr. Eccles, that a total of $40,000 should be the maximum untaxed transfer of wealth.

6. We urge the committee to investigate the income taxes in the higher brackets. While the rates on these incomes seem high at first glance, we must consider the actual money incomes left to those individuals after all taxes have been paid.

For example, if a man with a million-dollar income paid his full tax down to the last penny, he would still have, roughly, $250,000 left.

This is equivalent to the combined incomes of more than 200 average families. It seems reasonable that some part of such an amount should also be taxed if defense sacrifices are to be widely spread.

Lastly, and particularly significant in view of the recent deluge of adverse comment, we urge that the committee restore the proposed joint tax return requirement.

One of the best-known methods of avoiding the payment of full tax rates is the filing of separate returns by wealthy husbands and

wives. We believe that such families should be required to file a single joint tax return. We feel that exemption might be made for families making less than $5,000, because of the added household expenses when the wife is working. We do not believe that such a law would in any way affect the independence or rights of women. We don't anticipate any broken families. We believe that most married women who live on and enjoy a joint income are willing to contribute to the necessities of the defense effort on the basis of that joint income.

Let me repeat that the League of Women Shoppers realizes the urgency of increased taxation in this time of emergency. We are, however, firmly convinced that a decent standard of living for our citizens is one of the most vital factors in national defense.

Our objection to this tax bill as it now stands is that it does not consider this real problem—the danger of further lowering American living standards. We grant that at some future time such drastic action may become necessary. But we believe that at present there is no valid reason for Congress to impose heavy taxes on low-income groups and consumers while all the possibilities we have outlined for shifting the tax burden to those able to pay remain unexploited.

We wish to urge this committee to investigate all the possibilities for increased revenue which we have briefly outlined. Unless this is done, the heavy, unfair, and, at present, unnecessary sacrifices imposed on the low-income groups will be inevitably reflected in the health of the people—and will constitute a major blow to the ability of the Nation to defend itself.

We are grateful to this committee for granting us the opportunity to present our views on this bill.

The CHAIRMAN. Thank you very much.

Senator DANAHER. What is the League of Women Shoppers, Mrs. David?

Mrs. DAVID. Well, it is a group of women, well-educated, many of them business and professional women. I would guess in reference to joint tax returns, that 90 percent of them are married. Most of us are people with a little time to spare. We meet together in discussion groups. The group itself divides into several committees: Education, labor, housing—mostly public-interest affairs.

Senator DANAHER. Is this league incorporated?

Mrs. DAVID. Yes.

Senator DANAHER. Where is it incorporated?

Mrs. DAVID. I believe in New York; that is where the national headquarters are.

Senator DANAHER. How many members are in the league?

Mrs. DAVID. I don't know the national membership; there are over 400 members in Washington. The league has branches in 10 States and the District of Columbia.

Senator DANAHER. Does it have an executive committee?

Mrs. DAVID. Yes.

Senator DANAHER. Who selects that?

Mrs. DAVID. They are voted on by representatives of the various branches of the league.

Senator DANAHER. And did the executive committee participate in the preparation of this statement?

Mrs. DAVID. The executive committee, as I understand it—through representatives from that committee known as the emergency committee—prepared and provided the statement and it was then sent to each of the branches and approved by them.

Senator DANAHER. And how were you selected to come here?

Mrs. DAVID. The statement was to be presented by a member from New York who was unable to get down for the occasion and I guess I happened to be the one member in Washington who was able to come here.

Senator TAFT. Who are the officers of the league?

Mrs. DAVID. I have a letterhead here that shows the names of the officers.

The officers are honorary president, Aline Davis Hays; president, Sophia Ames Boyer; vice presidents, Mrs. Sherwood Anderson, Nina P. Collier, Fannie Cook, Marion Hathway, and Lillian Hellman; secretary, Iris Winsor; and treasurer, Freda Sternberg.

The sponsors are Mary C. Baker, Mrs. William A. Douglas, Dorothy Canfield Fisher, Lucile Webster Gleason, Inez Hays Irwin, Freda Kirchwey, Dorothy Parker, Cornelia Bryce Pinchot, Mrs. Carl Sandburg, Gale Sondergaard, Mrs. Stephen S. Wise, and Mary E. Woolley.

Senator TAFT. Who made that study as to the relative tax burdens to which you referred?

Mrs. DAVID. I think most of that was derived from a report by the T. N. E. C. I wasn't present at the drafting of the report, but, as I understand it, most of the figures were secured from that report.

Senator LA FOLLETTE. They have a monograph on that, a study of it?

Mrs. DAVID. It is called Who Pays the Taxes.

The CHAIRMAN. Any further questions?

(No response.)

STATEMENT OF JAMES F. STILES, JR., NORTH CHICAGO, ILL., VICE PRESIDENT AND TREASURER, ABBOTT LABORATORIES

The CHAIRMAN. Mr. Stiles, you are the vice president and treasurer of Abbott Laboratories?

Mr. STILES. Yes.

The CHAIRMAN. You wish to address yourself to the question of——

Mr. STILES. The normal tax and excess-profits tax of corporations.

The CHAIRMAN. All right, Mr. Stiles, we will be glad to hear you. You can be seated or stand.

Mr. STILES. I have been seated, Senator; I will stand, and confine my remarks to this little paper. I think the clerk has submitted copies of it to all the members, and we can read it together.

I welcome the opportunity to appear before this committee to express my appreciation of your action in amending the second Revenue Act of 1940 by the passage of H. R. 3531 last March, known as the special relief bill. Your cooperation in the preparation of that amendment was, in my opinion, one of the most constructive acts of your committee, and its retention is without doubt most essential to the existence of hundreds of growing companies all over this country.

I am convinced that, while it is necessary for Congress to levy and for all of us to pay all the taxes that can be raised, it is not your intention to tax normal profits of any company as excess profits, when it is possible to determine what are excess profits.

For this reason I am appearing on behalf of my company and many other companies similarly situated to present a problem which I hope will receive your earnest attention. I also wish to propose a solution which I believe is simple, equitable, and necessary.

The problem is how to determine fairly the normal profits of a growing corporation. Under the present law, as amended last March, a formula was adopted which recognizes normal growth during the base period. But there is no recognition in the law of the fact that normal, reasonable growth may and should continue after the base period.

Every growing organization today must, through constant research and development work, discover better means of making new and more useful consumer goods, which must be sold for less money if it expects to keep on growing. Such companies form the backbone of our normal peacetime economy. Their discoveries during the past have made, and in time to come will continue to make, our country outstanding in the world in that respect.

If such growth companies by reason of their research are able to contribute to the economic welfare of our Nation, and in so doing increase not only their profit but their pay roll, then I believe you will agree with me that at least that increase in profit which bears the same relationship to their pay roll as their normal profit bore to their pay roll during the base period is and can be justly called normal profits.

I therefore submit to you for your consideration the following simple formula for determining normal profits of a growing company:

Determine the average ratio during the base period of pay roll (subject to social-security taxes) to net profit (net income after deduction of normal tax, or to the profit before normal tax depending on how the law is finally written) and use such ratio to determine the base credit for normal profits in each subsequent year, for example—

Gentlemen, you have all the formula there in front of you and I really see no reason for going into these figures. I would ask, however, that they be copied in the record.

The CHAIRMAN. Yes; that will be done.

(The table referred to follows:)

Year	Pay roll subject to social-security tax	Net profit after normal tax	Profit before normal tax
1936	$1,000,000	$600,000	$705,882
1937	1,500,000	900,000	1,058,823
1938	1,400,000	800,000	987,654
1939	2,100,000	1,200,000	1,481,481
Total	6,000,000	[1] 3,500,000	[2] 4,233,840
	Example of application for current year		
1941	$3,275,000	$2,500,000	[3] $3,289,473
Less pay roll on defense contracts or subcontracts	275,000		
	3,000,000		
Base credit for current year		[4] 1,750,000	[5] 2,116,920
Amount subject to excess-profit tax		750,000	1,172,553

[1] Which is 58.33⅓ percent of pay roll, column 1.
[2] Which is 70.564 percent of pay roll, column 1.
[3] Figures used are based on 24 percent. Normal tax.
[4] 58⅓ percent of column 1. ($3,000,000.)
[5] 70.564 percent of pay roll column 1. ($3,000,000.)

If the ratio of pay roll subject to social-security tax, during the base period, is used as a yardstick for the current year, then when you deduct pay roll used on defense contracts, or subcontracts, you automatically make all profit on such contracts subject to the excess-profits tax.

Mr. STILES. Now, the $3,500,000 net profit after normal tax is 58 and a fraction percent of pay roll subject to social-security tax, whereas profit before normal tax is $4,233,840 or 70.654 percent. The example for the current year assumes pay roll is $3,275,000. The net profit after normal tax, $2,500,000, and profit before normal tax, $3,289,473.

I have suggested that you take out the amount of pay roll paid on defense projects and apply to that balance of $3,000,000 the ratios sustained during the base period.

Senator CONNALLY. Why do you adopt that standard pay roll subject to social-security tax?

Mr. STILES. Because, sir, after applying various ways of arriving at a formula, I found that by the use of pay roll, subject to social-security tax, a taxpayer cannot inflate his excess-profits credit through the payment of large salaries to officers or a restricted group of high-paid employees, and reports showing pay roll, subject to social-security tax, are already on file both in the Treasury Department and the taxpayers' records giving the necessary information.

In presenting this formula for determining normal profits in a growing company, I desire to make very clear the following:

(1) It is not offered as a substitute for any of the present methods but as an additional provision or yardstick.

(2) It is not offered as a panacea for all difficulties nor do I presume to say it is the only method. It is a simple, logical, and fair one. In fact, its very simplicity makes it a desirable alternative both from the standpoint of the taxpayer and the Treasury Department.

(3) I do believe its adoption will definitely encourage those companies, whose pay roll in the lower brackets expands as they grow, to keep on growing—and thus they will pay more normal tax plus

excess-profits tax if their net profit, after normal tax or profit before tax, depending on how the law is written, increases faster than their pay roll.

(4) If adopted as an additional alternative, I believe it will very definitely be an incentive to cooperation in increasing employment, stimulate research and development work, and thereby strengthen our national industrial relationships.

(5) Its simplicity makes it easily understood and at the same time it can be applied to thousands of organizations which operated at a profit during the base period, each one of which might have a different relationship between pay roll (subject to social-security tax) and net profits (after normal tax), depending on many factors peculiar to their own business.

(6) I believe that growing organizations will play a vital part in the economic readjustment which must take place after the defense spending is discontinued. The knowledge they acquire by continuous research and development work, as well as the steady employment and normal profits which will arise by new discoveries, will not only help to pay the defense bill but put us in a position as a Nation to meet competition in the new world relationships which will arise after this conflict is over. Certainly we need, Senator, not and must not stop all present development and postpone all progress until the emergency is over.

Senator CONNALLY. Nobody proposes to do that that I have heard.

Mr. STILES. All this formula does is to use the average earnings method with pay roll (up to $3,000 annual salary per employee) as a common denominator. It says to everyone of us:

> If you are a growing corporation, if your nondefense business and your profits increase, and if at the same time your pay roll increases in the same proportion, then your growth is normal, the kind we wish to permit and encourage, and your profits will correspondingly be considered normal.

It does not interfere with the defense program but it does encourage industries to keep on growing and to find new ways to replace materials now needed for defense. It rewards them for putting men to work—which will be the real problem when the defense spending stops.

The success, nay even the preservation, of our entire economic system will depend on what we can and will do after this great struggle is over.

I have suggested that "this option should not apply to any part of a corporation's profits arising directly out of defense contracts or subcontracts." In making this suggestion I had no thought of profiting by increased employment due directly to defense spending.

The idea that capital alone makes profit is fundamentally wrong. Only when capital employs human effort or when it is loaned to an enterprise which employs human effort is economic value created and profits accrue to the investor. Therefore, pay roll, the basis for compensating the producer of economic wealth, related to the net value of what he creates (profits) is to my way of thinking a practical, simple yardstick for measuring normal profits.

When you consider placing increased tax burden on well-managed growing corporations, I urge you to weigh carefully these simple facts.

While the corporation is in fact a legal entity, it is in reality an American institution. It has fundamentally two major functions—

(*a*) To provide the mechanism by which economic wealth is created and distributed.

(*b*) To redistribute the economic purchasing power in the form of wages and dividends.

Every tax placed upon a corporation must interfere with these functions. A well-managed growing corporation bears the same relationship to the economic welfare of its customers, employees, and stockholders, as the hospital does to the physical welfare of the community, and churches and schools to our spiritual and mental development. Therefore, when taxes become the major burden on the institution which creates national wealth and income, we not only restrict but penalize the production of the very thing we must have for taxes.

Such a burden slows down progress and may even break down the internal mechanisms which are necessary for their continuation.

I do not contend that the Government should not tax corporations in time of emergency to the very limit of their ability to pay. But a normal tax of 25 to 30 percent plus a penalty tax up to 50 percent is beyond the safety point unless the application of such tax is based upon some relation to or measure of the normal functions of the corporation.

I realize we are in a period of great international difficulty; a period when every citizen of our beloved country should be willing to make many personal sacrifices; a period when our every act should promote cooperation, create confidence, and inspire courage. It takes all three of these elements to operate successfully a growing business during normal times.

I realize that to meet this defense program, you must of necessity raise sums of money far greater than any one of us, as individuals, can comprehend. Under our present tax laws you are depending on private enterprise to provide a large portion of this sum. It is essential, therefore, that private enterprise must continue to remain in a position where it can create and distribute an ever-increasing amount of economic wealth and national income. I urge you, therefore, in preparing the final draft of this measure to give serious consideration to the necessity of providing a yardstick, which will permit growing organizations to keep on growing.

Finally, gentlemen, as citizens, we must rest this matter in your hands with confidence that you and all members of Congress, as business directors of our country, will be exemplary in all matters of appropriation for nondefense activities; allowing economy to be your watchword, and always remembering that every dollar of needless expenditure raises our outstanding indebtedness, increases the need for more taxes, and may be the spark which will start an economic conflagration. Thus, by your example, you will encourage our free enterprises to continue their progress in raising our economic standard of living. Let our Government establish a defense which in every sense of the word will defend our American way of life, and together we will build a Nation where no foreign "ism" will ever arise, and by the benefit of constructive, or may I say, incentive legislation confidence will be created and courage will inspire every heart.

Mr. STILES. That is correct, Senator. If you will refer to the third paragraph on the first page, I tried to cover that in stating that the problem is how to determine fairly, normal profit. Under the present law amended last March, a formula was adopted which recognizes normal growth during the base period, but there is no recognition in the present law that normal, reasonable growth may and should continue after the base period.

The CHAIRMAN. That is right. You are undoubtedly putting your hands on the evil in the excess-profits tax. It doesn't make any difference whether we agree with you or not as to this particular matter, but if you are going to stop progress and growth, the result will soon become evident. It is on the same theory as the tax on estates. If you continue to tax estates we won't be getting anything from the estate tax in 25 years. You have to have some reason in the law.

As I interpret your formula, it is intended as a relief to those, what you might call, rapidly growing or developing companies not covered fully under the growth formula, which the Treasury did work out in the second bill in 1940.

Mr. STILES. Senator, you have said it better than I could.

The CHAIRMAN. Of course, the problem in all excess-profits tax is first, to determine what are excess profits. If you are going to do it arbitrarily, you haven't gotten anything but simply a legislative statement which might have no relation to the fact of what is or is not excess profits. That is the problem and, in any true excess profits, it would have to be worked out with respect to every business. That is your concept, isn't it?

Mr. STILES. Yes.

The CHAIRMAN. And since you cannot work it out, specially for every business, you have cases that are most unjustly dealt with under most any general formula you have for determining the normal tax as distinguished from the excess profits; and I personally think that there is much in your suggestion here, if it could be worked out and practically applied, because you don't propose to change any rates in the bill; you are not concerned with that?

Mr. STILES. No, sir. We are paying just what you gentlemen decide. I am not objecting to anything. I am merely trying to suggest a simple formula for arriving at a fair basis for tax.

The CHAIRMAN. But suggesting a possible way of relieving that particular class of corporations who have not been as much helped as others.

Mr. STILES. Yes; you might be interested in knowing that I have received over 4,000 unsolicited letters, all urging that I present this thought to this committee and to the Ways and Means Committee. It has taken much of my time answering those letters. I have brought them down here; I didn't want to introduce personal letters before the committee, but they are here available.

The CHAIRMAN. Thank you.

Senator CONNALLY. Are you selling any of your pharmaceutical products to the Army?

Mr. STILES. Yes.

Senator CONNALLY. You sold more this year than last year?

Mr. STILES. Yes.

Senator CONNALLY. You sell to veterans' hospitals?

Mr. STILES. Yes.

Senator CONNALLY. And you have been doing that for a good many years?

Mr. STILES. Yes.

Senator CONNALLY. You have been selling the Army a good deal more this year than last, have you not?

Mr. STILES. I wish we could sell them more, but, in some way or other, they only use a few of our products. I wish I knew how to sell them more, but, up to the present time, we have not sold them so much. We specialize in antiseptics, anesthetics, and hypnotics——

Senator CONNALLY (interposing). Hypnotics?

Mr. STILES. Yes.

Senator CONNALLY. You have been trying to practice that here today.

Mr. STILES. You are very complimentary to me here today. I wish I were able to do as well as you can.

Senator DANAHER. Does your company produce Abbott's Bitters?

Mr. STILES. No. We have nothing bitter about our company.

Senator DANAHER. Not even experience?

Mr. STILES. No; it has been a real pleasure to be here. I enjoyed coming here very much.

Senator TAFT. Couldn't we accomplish something of the same sort by adjusting the base period every 2 years?

Mr. STILES. You might be able to accomplish very much in that manner. Your action on the Davidson suggestion, which you adopted last March, was most constructive, and I am absolutely sincere when I say that. Senator Vandenberg knows that I complimented members of the Treasury Department for what they did in that matter. However, it still leaves a ceiling over any future progress. I have had various people say, "Why hire any more fellows; why build or add to a plant?" referring to the fact that, if they do, the increase in earnings will all go in taxation.

Senator CONNALLY. Not all.

Mr. STILES. Well, I just told you, 95 percent in our case for the first 6 months of this year.

Senator CONNALLY. That is because you are in the higher brackets and making so much.

Mr. STILES. That is very complimentary; you are very kind to me.

Senator CONNALLY. Those are excess profits.

Mr. STILES. Well, we will be in the higher brackets under the pending legislation.

The CHAIRMAN. Thank you.

STATEMENT OF RALPH HETZEL, JR., WASHINGTON, D. C., REPRESENTING THE CONGRESS OF INDUSTRIAL ORGANIZATIONS

The CHAIRMAN. Do you wish to file the brief for the record, or read parts of it?

Mr. HETZEL. I would like to read portions of it.

The CHAIRMAN. You may put the whole brief in.

Mr. HETZEL. I know that President Murray would have liked to have been here representing the C. I. O., but his doctor has required him to rest.

I thank you, gentlemen.

Senator CONNALLY. What does your company manufacture—make?

Mr. STILES. Pharmaceutical supplies.

Senator CONNALLY. A general line?

Mr. STILES. Yes.

Senator CONNALLY. During the past 4 years, this base period, has your business increased?

Mr. STILES. Steadily That is the reason we appreciate your action in amending the Second Revenue Act of 1940.

Senator CONNALLY. If you should choose the base period of the 4 years, as set out in the bill of last year, you would get a very good allowance, would you not?

Mr. STILES. Senator, may I give you an example of the first 6 months? Our taxes were 95 percent of our increasing earnings in the first 6 months of 1941 as compared with the first 6 months of 1940. Under the present revenue act, 95 percent of our increased earnings are represented in taxes.

Senator CONNALLY. How much increase was that; what percentage of increase? You made a very large increase in profit over the same period?

Mr. STILES. I think our profits show an increase in 1941 over 1940.

Senator CONNALLY. That is right. How much?

Mr. STILES. They increased approximately in the same proportion of our sales, or about 15 percent. Isn't that true? May I ask my associate?

Senator CONNALLY. Yes.

Mr. STILES. About 15 percent.

Senator CONNALLY. Of course, the emergency, the increased business due to the boom had nothing to do with it.

Mr. STILES. I should say it had something indirectly to do with it.

Senator CONNALLY. Just because you don't make cranks or bullets does not mean you have not shared in the demand for goods. There is no question but what you have been helped by this thing.

Mr. STILES. There is no question about that.

Senator CONNALLY. These Army camps are located all over the country and every merchant, within reach of them, derives some beenfit as a result. He is helped; everyone is. Your company made 15 percent more, you say in 1941 over 1940.

Mr. STILES. But we have done that every year for the past 8 years. We have steadily increased from 15 to 17 percent.

Senator CONNALLY. Then you are all the more able to pay some taxes.

Mr. STILES. I am not complaining about the tax; I am trying to suggest a constructive method of applying it.

Senator CONNALLY. But you state you feel you should not penalize a growing and prosperous business.

Mr. STILES. Well, do you think we should?

Senator CONNALLY. Well, how about one that is not growing and so prosperous?

Mr. STILES. Do you think we should penalize one that is?

Senator CONNALLY. You are not being penalized. If you pay your taxes, that is not penalizing you. We have to carry out this program and to procure the money to do it, we have to collect taxes.

Mr. STILES. I am not talking about the amount of taxes. I am trying to talk about the method of allocating them.

Senator CONNALLY. You are calling this 15-percent increase a normal increase? It is not normal because it is 15 percent more than you have ever made in your life.

Mr. STILES. We are growing, the same as we have been; that is all.

Senator CONNALLY. Yes; you are growing because you have opportunity here for your ingenuity and your salesmanship.

Senator TAFT. And other companies have been going down because they didn't have that ability for success in their business.

Mr. STILES. We are working hard; our business is growing as a result of it.

Senator CONNALLY. I understand, from the energy you have displayed here, how you did it.

Senator LA FOLLETTE. How would this alternative method affect higher incomes?

Mr. STILES. How would it affect them?

Senator LA FOLLETTE. Yes.

Mr. STILES. It would have no affect on higher incomes nor would the total amount of higher incomes affect the base credit of any corporation which would benefit by this formula. That is one of the reasons for suggesting pay roll subject to social-security tax (the first $3,000 paid any employee during a taxable year) as the common denominator between the base period and the current year.

Senator LA FOLLETTE. Take your own company and apply this alternative you suggested; would you pay more or less tax?

Mr. STILES. If we employed more people in the lower bracket, we would pay less tax.

Senator LA FOLLETTE. Suppose this thing went into effect now, and you took advantage of this alternative method; how would it affect the total amount of taxes the Abbott Co. pays to the Treasury; would it increase or decrease that amount?

Mr. STILES. Frankly, I should say it would have a decreasing effect. I haven't applied this formula to our current earnings, so I cannot tell you exactly.

Senator LA FOLLETTE. What effect would it ultimately have on revenue?

Mr. STILES. I believe it will stimulate increased employment and activities in business.

Senator LA FOLLETTE. But we may not be able to wait for that. What effect would it have if we let it be applied to this calendar year? Would it be more or less money for the treasury?

Mr. STILES. I can't even hazard a guess.

Mr. Stam is probably better able to say that than I would be.

The CHAIRMAN. What you are suggesting is really a relief measure, a specific relief proposal for rapidly developing growing companies.

Mr. STILES. Yes; other than those developed as a result of defense spending.

The CHAIRMAN. Yes; you exempted those. In the supplement of the second Revenue Act of 1940, to which you referred, we did try to work out the growth formula, which does help. It is a relief measure in some situations.

Senator BARKLEY. Will you state for the record your position with the C. I. O.?

Mr. HETZEL. I am director of the economic division, C. I. O. headquarters.

Mr. Chairman, we recognize the pressing difficulties before the committee and the spirit in which we come here is to be constructive and helpful.

The new tax bill, as passed by the House of Representatives, fails to meet labor's specifications for sound taxation in many respects. As President Murray pointed out in testimony before the Ways and Means Committee, the present tax system, to say nothing of State and local taxation, rests with undue heaviness upon the wage earners, farmers, and other working people. Thus, the already heavy burden resting upon the low-income consumers would be increased, not lightened.

The effect of this tax bill upon the general character of the Federal tax system can be seen in part by the fact that the current tax bill adds a tax system composed of less than three-fourths of ability-to-pay taxes and more than one-fourth consumption taxes to a Federal tax system which was already composed of 54-percent-consumption taxes and 46 percent ability to pay.

Therefore, though the percentage of ability-to-pay taxes in the whole Federal structure will be improved by this bill, the weight of taxation upon consumption has substantially increased. Where this tax on consumption rests on wage earners' income, it means more wage cuts and less wages than before.

The C. I. O. proposals.—President Murray in his testimony before the House Ways and Means Committee set forward three principles to improve the Federal tax system. They were:

1. Repeal of all excise and sales taxes which bear upon working people's incomes, those incomes below $2,500 for married couples and $1,000 for single persons. No additional sales taxes or excise taxes should be enacted.
2. Income-tax exemptions should be returned to $2,500 and $1,000 and no income taxes should be laid below that level.
3. All new tax income should at this time be collected from increased taxes on high individual incomes, estates, and growing corporation profits. These include taxes on excess profits, undivided profits, tax-exempt securities, and inheritances.

On the basis of these proposals, the C. I. O. is emphatically opposed to the suggestions that personal income-tax exemptions must be lowered and that more extensive excise taxes be imposed.

We urge that the committee restore the mandatory joint return. The inclusion of this measure would close one of the most serious loopholes in the progressive income-tax structure.

Senator CONNALLY. In other words, you favor the proposition that if a man is working and his wife is also working, both of them earning income, that on that they be permitted to file surplus returns; is that it?

Mr. HETZEL. As in the House bill, or as suggested by the President, with some allowance for earned income.

Senator CONNALLY. You want the earned income exempted but not the other? Now I ask you if you favor putting them in a joint return and paying on that one where a man works and his wife also works?

Mr. HETZEL. We would be perfectly willing to accept the position of the Treasury on that.

Senator BARKLEY. In the case suggested by Senator Connally where both husband and wife are working and earning income and are required to make a joint return by which they would pay more taxes than the two separately would pay, that likewise reduces their compensation for work to that extent, does it not?

Mr. HETZEL. As I understand it, yes; to a certain degree. However, the report of the House committee said it would not on joint incomes below $4,000 and if the general income exemption suggested in this memorandum would apply that exemption would be substantially higher and I don't believe that cutting into incomes in those levels would be very serious, even though it is earned income.

As this paragraph says, the inclusion of the measure would close one of the most serious loopholes in the income tax structure. After all, the most extensive use and abuse of the returns has been in the highest brackets. So far as I know, it has not been a serious matter in the lower brackets. It would collect revenue, as the committee well knows, in the higher-income brackets and among persons who can well afford to pay. To allow this bill to be passed without this provision will be a shocking defeat for an effective tax policy.

It is the sincere contention of the C. I. O. that whatever additional revenues may be necessary can be collected on the ability-to-pay basis from higher taxes on the large individual incomes, estates, and extensive corporation profits.

Sales and excise taxes.—The House bill fails to improve the Federal sales or excise-tax situation. As a matter of fact, it adds a number of new taxes which will bear upon working people, such as the $5 tax on every automobile, additional taxes on tires and tubes, matches, soft drinks, and such.

The C. I. O. urges the reduction, rather than the extension of Federal sales taxes. It is well known that sales taxes bear with unequal heaviness upon the low-income groups. As President Murray's testimony pointed out to the House committee, in the last 10 years the burden of Federal taxation upon the working people has grown heavier in size and proportion. It is a shocking record. In 1930, for example, approximately 68 percent of all Federal tax income was raised by taxes on individual income, corporations, inheritance, and gifts, while about 32 percent came from consumption taxes, excise or sales. In 1940 the percent of taxes coming from the income, corporation, and other progressive taxes fell to 46.3 percent, while taxes bearing primarily on consumption, that is, sales and wage taxes, rose 53.7 percent.

Senator BARKLEY. Do you include in that figure the social-security figures?

Mr. HETZEL. Yes.

Senator BARKLEY. Ought that really to be figured? Of course, it is true just as a matter of naked taxation but whatever taxes are levied for social security are levied for the benefit of the workers, and is it really exactly accurate to draw that comparison when considering the subject without attempting to take that fact into consideration?

Mr. HETZEL. The basis of the comparison was the general effect of the tax system upon the income of the low-income groups. Now, as

you know, our position relative to the social-security tax is that an increasingly larger portion of it should come from general revenue.

Senator CONNALLY. More like a pension.

Mr. HETZEL. The point is, it should come from general revenue.

Senator CONNALLY. That is what I said—a pension.

Mr. HETZEL. *Personal income taxes.*—President Murray has taken the position that the C. I. O. will support the most effective possible progressive personal income-tax system. This, in our view, means an income tax which begins not lower than the 1939 exemptions of $1,000 and $2,500. A sound individual income tax is so devised as to be fully and clearly progressive; the effect is both economically sound and just to individuals.

We have proposed the bottom limits of $1,000 for single persons and $2,500 for families because we believe that these annual incomes are an absolute minimum for the decent livelihood of American working people. The budget of the Heller committee for research in social economics showed that in March 1941 a family of 5 in San Francisco required $2,211 as a minimum for health and decency, and that is a very minimum budget. Between the time this budget was priced and June 15 cost of living as a whole has gone up 2.9 percent and food 6.5 percent. These figures are for the city of San Francisco. The cost of living for the country as a whole has advanced even more.

Taxes which strike below these levels of income are, in substance, cuts in the standard of living. For wage earners they mean real wage cuts.

It is labor's sincere belief that a great disservice is done to defense by cutting the standard of living of those who income is already inadequate to furnish them with their basic needs.

Consumption cuts.—The argument is now being made that taxes which bear upon the consumption of wage earners and low-income groups are necessary in order to prevent inflation. This argument is the basis for proposals to spread the income tax to lower income groups and to lay extensive sales taxes, or purchase taxes, as they have been euphemistically called.

It would not be suitable here to engage in an extensive discussion of the inflationary situation. I think it is necessary to say, however, that proposed taxes upon low-income groups would not in the present situation do a great deal to prevent the price rises now imminent. The major effect of such taxation would be to reduce the standard of living, to cut the purchase of materials that are still available in sufficient supply, and to induce resentment among the working people of the country.

According to the latest available C. I. O. estimate, unemployment remains at 6,305,000 for June. It is highly improbable that such unemployment will be reduced by more than one and one-half million during the next year. That is optimistic. If national income is frozen by placing extensive curbs on consumer purchasing power, this and even greater amounts of unemployment will become a permanent feature of the economy, even in a period of enormous defense expenditures. Already Mr. Leon Henderson has suggested that the so-called priorities unemployment, against which the C. I. O. has warned for some time, may cause additional unemployment of at least 2,000,000.

Senator CONNALLY. The morning papers say unemployment was reduced 300,000 during the month.

Senator BARKLEY. What portion of the figure 6,300,000 that you estimate will be still unemployed is made up of unemployables?

Mr. HETZEL. The basis of our calculation doesn't include unemployables in that unemployment. That is, this calculation is made up by subtracting the number of employed from the total working force of people who can work.

Senator BARKLEY. Are there any accurate, dependable figures as to the number of unemployables in the country?

Mr. HETZEL. I don't know of any figures on that; there are some census figures, the details of which I do not know.

Senator BARKLEY. We all know there are a lot of people out of work who cannot work and who could not work before the depression started, and who never can work. They are either ill or crippled or for some reason are unemployed, and in all these estimates of people out of work I have wondered for a long time how many of the number are made up of unemployables for one unfortunate reason or another who couldn't get a job if there was nobody out of work. You have no exact figures. I confess I do not know.

Mr. HETZEL. I doubt if accurate figures could be made on that. A man may be unemployable in certain circumstances. That is, if you give him only 10 days to learn a job or harden himself, he will not be able to work. In another circumstance, if you give him 60 days he may be able to do the job. Again, if an employer will take a man over 45 he is employable; otherwise not.

Senator BARKLEY. The number, of course, is flexible but it would be helpful if there was some way we could find out how many people are not working and how many of them cannot work.

Mr. HETZEL. We have tried to get the Federal Government to make a decent, dependable, continuing classification of unemployment. We would be very glad to get out of the field in a minute if they would do so.

Senator GERRY. Do your figures of unemployed contemplate those completely unemployed?

Mr. HETZEL. Completely unemployed. Our employment figures are those taken from the Department of Labor statistics. As I recall, they require that a person work a specific number of days a week during a specific period to be considered employed.

Senator VANDENBERG. It is a fact that the abrupt curtailment is already causing widespread unemployment and threatening more of it, is it not?

Mr. HETZEL. That is true. We are very much alarmed indeed. We think it a scandal of a major nature that when we are trying to utilize our manpower to the fullest, men are to be put out of work. Automobile workers of the number of 200,000, and other——

Senator VANDENBERG. Workers or refrigerators, washers——

Mr. HETZEL. Yes. Workers in the refrigeration, washing-machine industry, and those engaged in the manufacture of aluminum products, and a great many others—I could go on with a very long list.

Senator VANDENBERG. I suppose the State of Michigan is as much benefited from defense contracts as any State in the Union, and yet in spite of that it is on the verge of a major economic crisis because of the too abrupt and unsound curtailing of priorities and such.

Mr. HETZEL. We agree with you.

Senator VANDENBERG. If this goes on, priorities and curtailment will do more damage to the United States than Mr. Hitler will do the rest of his life.

The CHAIRMAN. We hope.

Senator VANDENBERG. We hope.

Senator BARKLEY. Let me ask you this: If it be true that it is necessary to inaugurate certain priorities in order to get materials for national defense, assuming that must come first, what is the remedy, what can be done to absorb the unemployment that would result by the exercise of these priorities, whether abrupt or curtailed?

Mr. HETZEL. Well, I think that in the past 12 months there has been the most serious and fundamental failure on the part of the persons responsible for production of essential commodities, such as steel and aluminum, and that the only way to meet the necessity of providing a sufficient flow of those materials for the kind of production we are going to have to get our defense materials out and employ our people, requires planning that is far beyond their ability or desire. We have proposed, through President Murray and through our various unions in each of these commodities, what we consider to be concrete, effective plans to speed up the production, in steel and aluminum, for example. The general proposal was for an industry council to be set up in each industry where industry and labor jointly concerned wuld be jointly charged with the responsibility of seeing that the job was done.

Senator BARKLEY. That doesn't answer my question. Let us take the automobile industry in Michigan, about which it has been decided, or at least an effort is being made to curtail production because steel, aluminum, or other materials necessary to make automobiles are needed in making guns, tanks, and airplanes, and things of that sort. Now, let us suppose that is necessary and, of course, you cannot help what has gone on in the past, we are looking now into the future, and granted that somebody in the steel and aluminum business was not very farsighted in preparing for the supply of steel that we might need; and it now turns out that we now have this need. Now, granting that, we face a situation where if it is necessary to curtail production to develop more material, what is the concrete plan by which the man thrown out of his job in the automobile, refrigerator, or any other industry is to be placed in some other job or industry, because that is the only way I know of they can continue to work? What is the concrete situation under which that is to be done?

Mr. HETZEL. Several of our unions, Senator, have made concrete proposals relative to this problem. However, we stick to the basic principle they ought to expand steel, but, specifically, for example, we believe that the cut in the production in the automobile industry can be so leveled out that it is related to the increase in the production of the new plants now in Michigan. If they cut automobiles 50 percent, there will be an hiatus for a considerable period of time during which many men will be unemployed during the transition. If their jobs can be held together until spring, the problem will not be nearly so acute.

Senator BARKLEY. You mean the dislocation ought to be staggered so that workers from one industry which is being curtailed will be

able to take their place in another defense industry as they are relieved?

Mr. HETZEL. That has been done already in Buffalo with the cooperation of the O. P. M. where the Chevrolet plant is shutting down. It requires 6 months to shift to defense work and the men who are to be shifted to this defense work are being prepared to be put into their new jobs. Another proposal is to give them a dismissal pay or subsistence wage. Other proposals are to give the men who have experience seniority. There are other proposals which have to be explored jointly with the industry. It is a joint problem, it seems to me.

Senator BARKLEY. I agree with you. It would have no direct bearing on the question of taxation, but it is an important matter which cannot be ignored.

Senator VANDENBERG. May I just comment in response to your question, Senator Barkley, to this extent? The complaint, as it comes to me, in the seriously affected areas in the Middle West is not against the curtailment per se, but against the abruptness with which major curtailments are made and the summary fashion in which priorities are suddenly precipitated. It takes a little time to integrate a nondefense employment over into a defense operation, but there is no time allowed for the transition. Our people are suddenly confronted with these major restrictions; it is just more than they can assimilate. I completely agree with the witness. My theory is that the domestic dislocation will do our total defense effort severe harm. Now, the effort, it seems to me, ought to be to cushion these curtailments instead of so summarily precipitating them in situations where they cannot be assimilated.

The CHAIRMAN. You gentlemen have discussed this matter interestingly. Will you proceed, Mr. Hetzel?

Senator BARKLEY. I move that ought to be referred to Mr. Knudsen who knows more about that. He comes from Michigan.

Senator VANDENBERG. Well, he is more or less an outsider on it.

Mr. HETZEL. The price rises, outside of the rises in farm products with which the committee is familiar, have come from causes not based in the rising purchasing power of the low-income groups. Important among these causes are:

1. Shortages of specific essential materials, specialized equipment, and transportation.
2. Monopoly control of prices.
3. Price speculation and excessive accumulation of inventories.
4. Unplanned public purchasing.

The more serious field where supply of material will be unable to meet the demand is that in so-called consumer durable goods; that is, of course, automobiles, radios, washing machines, refrigerators, and so on. These shortages are most serious. First, they provide a most serious hindrance to effective defense production. Secondly, they will be the cause of shocking economic dislocations which will smash literally thousands of businesses and throw hundreds of thousands of men out of work. And third, they will prevent the production of certain types of goods for which there will be a demand.

The existence of these shortages are really a very grave public scandal. It is shocking indeed that the men whose lack of foresight

and whose adherence to business as usual are responsible for a failure to meet these shortages are still in positions of high public office and are still responsible for defense production.

An examination of the patterns of purchasing by the low-income groups shows that only a minute part of the wage earner's budget could, at best, go to the purchase of such consumer durables. Most of the wage earner's income must be devoted to the purchase of food, clothing, and shelter. For example, the budget of the Bureau of Labor Statistics, for computing the amount of wage earner's income which goes to various products, gives food as accounting for 34 percent of the budget; clothing, 10½ percent; rent, 18 percent; fuel, electricity, and ice, 6.4 percent; house furnishings, 4.2 percent. The miscellaneous item amounts to 27 percent. In this miscellaneous item only 2.2 percent goes to automobiles out of 7.8 percent for transportation; 3.7 percent goes to medical care; 3.6 percent for household operation; 5.2 percent for recreation, and so on.

Senator BARKLEY. In your figures, 2.2 percent for automobiles, did you include the purchase of gas?

Mr. HETZEL. No; that 2.2 is solely for the purchase of the car. Gas and tires are separate.

As a matter of fact, then, the major expenditures of a wage-earner's family are in the three items of food, clothing, and rent. According to this index, they take 65 percent of the income. Possibly 5 percent of such an income would go to the so-called consumer durables and scarce materials.

Senator VANDENBERG. Well, then, if any form of a manufacturer's sales tax was to exempt food, clothing, and rent, it would substantially remove the major portion of your complaint, wouldn't it?

Mr. HETZEL. It would remove part of one item, Senator. We are still opposed to such a tax even with those items taken out.

Senator VANDENBERG. I understand that, but mathematically it would reduce by half, your protest?

Mr. HETZEL. On this aspect of the argument?

Senator VANDENBERG. Yes.

Mr. HETZEL. Yes; it would be a most serious mistake to cut wage-earners' low incomes in the hopes of cutting down wage-earners' demands for the 5 percent of consumer durable goods which they may use. Most wage earners can afford only second-hand cars at that.

Certainly no one would hold that the Nation, either from lack of materials or manpower, is not able now to produce all the food, clothing, and housing our people should have.

It seems perfectly clear that until every possible penny of tax income is taken from the upper brackets of income and from corporation profits, no penny should be withdrawn from families where it will mean less to eat or wear.

Higher income taxes.—Therefore, on behalf of the C. I. O., I urge the further increase of income taxes in the high brackets. We would urge the closing of loopholes which have made the actual payment of income tax in the high brackets sometimes as little as half of the nominal rates. And I would say, parenthetically, that as far as I know there are no actual figures on the actual rates paid in the higher income brackets. The so-called rates are only a computation of the various taxes which are levied upon such incomes theoretically,

but actually what the average man with a million dollars income pays we have no figures.

Senator CONNALLY. They are available at the Treasury. They issue a pamphlet each year that shows all that information.

Mr. HETZEL. I have never seen that.

This includes, of course, the compulsory joint return. It includes the taxation of the tax-exempt securities—certainly with special emphasis upon the taxation of all newly issued securities. It further includes the taxation of undivided business profits, since these are a form of hidden income for stockholders and owners of businesses.

Senator VANDENBERG. When you speak for taxation on all issued securities, you include those issued by municipalities, States, and subdivisions?

Mr. HETZEL. Yes.

Senator CONNALLY. Now, here are the statistics, and on page 17 is a complete table; it is all here. What you probably have in mind is because of the various deductions there is no flat figure available to you, but here is the result of the actual payments and returns. If you have never seen that, you might look at it.

Mr. HETZEL. As I recall, when we attempted to compute that from that table——

Senator CONNALLY. Then you have seen this table before?

Mr. HETZEL. Yes.

Senator CONNALLY. I thought you said you didn't have such information, didn't know this was in existence?

Mr. HETZEL What I referred to was the actual effective rate; what it was upon income of the various categories as compared to the so-called nominal income rate.

Senator BARKLEY. In other words, the amount paid after deductions is equal to a rate different from that set out in the law?

Mr. HETZEL. Yes; and much lower; the T. N. E. C. figures show that.

Senator BARKLEY. Well, it is bound to be; there is bound to be a difference between the actual payment and the normal rate on the gross income.

Senator CONNALLY. It is paid on the net; that is what the tax is paid on.

Mr. HETZEL. But there is no actual showing, as far as I know, which indicates what actually was paid last year or the year before on all incomes between, say, $100,000 and $200,000.

Senator CONNALLY. That is what this table shows exactly. That is exactly what that table shows—what you say it doesn't show.

Senator JOHNSON. Did I understand you to say that you favor taxing State and municipal tax-exempt securities?

Mr. HETZEL. Yes; we think that those tax-exempt securities are one of the means by which the persons in the higher individual income brackets and certain corporations and banks accept the real effect of the tax legislation enacted by Congress.

Then there follows a section on estate and gift taxes. The new bill increases only slightly the rates on estates and gifts.

President Murray testified that it would be socially sound to place very heavy taxes upon the transfer of fortunes. The present estate and gift taxes still allow great fortunes to be passed on from genera-

tion to generation. These great fortunes put enormous social controls into the hands of persons without public or private responsibility.

There is, therefore, still a great need for effective estate and gift taxation. Such taxes would produce very substantial revenue and would greatly improve the financial structure of the Nation's industry. As President Murray pointed out, such effective taxation could be done by the adoption of an integrated estate and gift taxation program which would lay a single set of drastically increased rates upon the whole fortune, including the estate plus all the gifts plus all transfers of wealth from it. The consolidated exemption could well be lowered to $10,000. As the tax now stands, there are exemptions which allow some $140,000 to be passed on without taxation.

Excess profits and corporation taxes.—The tax program proposed by the C. I. O. urged an effective excess-profits tax. The House bill, though it increases taxes on corporations and on excess profits, does not yet meet the specifications of a really effective excess-profits tax.

The arguments, I thought, were presented quite thoroughly by the Treasury.

In spite of the fact that most corporations in their second-quarter and first-half profit reports deducted excessive allowances for the taxes proposed in the House bill, profits for the first half of 1941 have very substantially exceeded those in the first half of 1940. For example, a tabulation of the public statements of 350 leading companies made by the National City Bank of New York shows an increase of profits after tax deductions of approximately 20 percent in the first half of this year over the first half of 1940. The average rate of profits of these companies was 12.8 percent, a most generous return.

Then there follows some specific cases.

Twenty-seven machinery companies were shown to have a profit rate of 24.2 percent in 1941; 9 automobile companies, 21.1 percent; 19 automobile equipment companies, 24 percent; 14 electrical equipment companies, 14 percent.

Twenty-three leading iron and steel manufacturing companies showed an increase of 100 percent in first-half profits of 1941 over 1940.

These profits have occurred in spite of allowances for taxes under the House tax bill, allowances which the financial journals agree are generous to a fault.

Senator VANDENBERG. That is before the new wage increases?

Mr. HETZEL. No, sir; that is the first half of 1941. They seemed to absorb the wage increases without difficulty.

Senator VANDENBERG. They seemed to absorb—you better stop there.

Mr. HETZEL. Well, I didn't say "without protest."

These facts fully justify the C. I. O.'s position that more effective excess-profits taxes are essential.

The Treasury has already pointed out to the committee, citing several examples, the extent of profits with which certain companies can make off under the House tax proposal for excess profits.

It would seem to us that in the public interest it is essential to create an effective excess-profits tax. It is necessary not only to

collect the proper revenue, but also to make effective the promise that no war millionaires should be created in this war.

In order to make the excess-profits taxes really effective, there should be established either:

1. The proposal of the C. I. O. for a tax based upon a 6-percent allowance for invested capital only and a much higher rate, say to 75 percent, or, if such cannot be accomplished, at least.

2. A strengthening of the rates in the present double standard by allowing only, say, 75 percent of normal profits and applying the rates of the C. I. O. proposal.

Conclusion.—The C. I. O. believes that now is the time to strengthen the fundamental fiscal structure of the Nation. We believe that now is the time to set up a tax program calculated to meet the Nation's needs not only in terms of revenue, but also in terms of economic stability.

We therefore urge upon the committee a tax program of the character set forth in this testimony.

Just here I want to recall to the committee two sentences in the President's budget to show that we are in substantial consonance with his view. He says:

> I suggest, therefore, a financial policy aimed at collecting progressive taxes out of the higher level of national income. I am opposed to a tax policy which restricts general consumption as long as unused capacity is available and as long as our labor can be employed.

Senator VANDENBERG. I understand the President favors the lowering of exemptions. Will you part company with him there?

Mr. HETZEL. Yes.

The CHAIRMAN. I want to call your attention to your earlier statement in the first part of your paper to the effect that under our present Federal taxing system there are 54 percent consumption taxes against 46 percent ability to pay taxes. Now, the studies that have been made, based on Treasury figures and other authentic figures, show that under the present law, before we get this bill, the total ability to pay taxes amounted to $5,077,000,000, or 67.35 percent as against consumption taxes of only $2,461,000,000, round numbers, or 32.65 percent; and even after adding Social Security taxes the ability to pay taxes in point of percentage is 57.37 as against total consumption taxes, including Social Security taxes, of 42.66.

Your figures don't agree with the figures we have been working on. Now, I think it is only fair—I haven't taken up any time to do this throughout the whole bill, but the Treasury recommended originally $400,000,000 increase out of excess-profits tax. They subsequently went up to $600,000,000 out of excess-profits tax. As a matter of fact, under the House bill, the added increase out of excess profits is $1,198,300,000, which, added to the estimated production during the whole year under the existing law, makes a total excess-profits tax of $2,224,000,000 that you are getting out of that particular class of taxes; so the House bill is considerably higher in point of dollars than anything that the Treasury recommended, and also that your corporate income taxes under this House bill as we have it here today shows an increase over existing law of $2,187,700,000, whereas your consumption taxes under this bill amount to—that is, direct consumption taxes amounting to only $514,900,000. The total increased revenue as shown by this

House bill, after the elimination of the joint return, would be $3,246,700,000, so your figures don't quite jibe with the figures we have been working on.

Mr. HETZEL. Mr. Stam and I have differed somewhat on the classifications of revenue, but I think the second set of figures is close enough so that we don't fundamentally differ; I wouldn't argue about it. With regard to the figures relating to excess-profits tax, it seems to me—I don't have the report of the House committee, but as I recall it, some six or seven hundred million dollars of the increase in excess profits is simply accounted for by the removal of that amount from the normal to the excess-profits category by changing the exemptions.

The CHAIRMAN. It is moved into that category, anyway; it takes those higher rates. It is raised from 35 to 60 percent; it is all excess profits.

Mr. HETZEL. It amounts also to a reduction of some five to six hundred million dollars of normal removed to the excess profits which, frankly, I agree is a better way to handle it, anyway.

By and large, with respect to the House bill, we thought it a pretty good bill, and it is only because we would like to see it better we have made these suggestions.

Senator CONNALLY. With respect to your recommendation for repeal of these taxes: Do you favor the repeal of the taxes on whisky, wine, beer, cigarettes, and so forth?

Mr. HETZEL. Those are borderline cases.

Senator CONNALLY. Borderline. The bulk of the money is gotten from them.

Mr. HETZEL. It is the application——

Senator CONNALLY. No. What I wanted to know is: Are you or are you not for them? Do you want to repeal those taxes or not?

Mr. HETZEL. We have taken no position in the matter.

Senator CONNALLY. I want you to take one. You say you favor the repeal of all excise and sales taxes which bear upon working people's income. Now, they bear upon working people's income. Do you favor repealing them?

Mr. HETZEL. Yes; I favor repealing them.

Senator CONNALLY. I thought you did: I just wanted to ask you.

The CHAIRMAN. Any further questions?

Senator VANDENBERG. Can you break down one further figure? On page 5 where you say that food, clothing, and rent consumes 65 percent of average income. How much is just food and clothing?

Mr. HETZEL. In the paragraph above that I have broken it down. Food, 34 percent; clothing, 10½ percent.

Senator JOHNSON. Did I understand the witness to say that in making this increase of about $600,000,000 in excess-profits tax that $500,000,000 of that was taken out of the normal tax? Is that right?

The CHAIRMAN. No. We would differ about that. He was explaining how some of it came about by transfer of the credit from the normal to excess-profits tax. That is true; it does have such an effect.

I suggested just now in my colloquy with the witness that the Treasury's final suggestion was some $600,000,000 could be raised from excess profits. I find I was in error; I believe it was some $716,000,000.

The next witness, Mr. Rowland Jones, Jr.

STATEMENT OF ROWLAND JONES, Jr., WASHINGTON, D. C., REPRESENTING THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

The CHAIRMAN. We haven't yet put any absolute limit on time. We would like to be as brief as you can. What do you propose to talk on?

Mr. JONES. Two sections of the bill: One topic, the distilled spirits tax; and the other, the retail sales tax, as contained in this bill.

The CHAIRMAN. I would like to have the committee's attention. We have witnesses scheduled through Wednesday of next week, and we have applications for some 55 more persons who desire to be heard, and that is a matter the committee ought to determine when it will close this public hearing, whether next week or run longer.

Senator CONNALLY. Why don't we limit the time rigidly and we can hear more of them; a lot of them repeat and cover the same ground.

The CHAIRMAN. That is more or less inevitable, but if we fix the final time subject to change, then we can more conveniently limit the time of the witnesses who appear.

Senator BARKLEY. Do you want to determine that time now?

The CHAIRMAN. Yes; if we might.

Senator BARKLEY. You say you have witnesses into Wednesday of next week. Personally, I feel we should close the hearing next week, but if we go into the following week, I am afraid it would take all the balance of that week.

Senator VANDENBERG. Doesn't it make some difference to the character of the people who desire to be heard? Some of them feel they have the duty of presenting their views, and it is very important to them.

Senator CONNALLY. We might classify them and let them have a spokesman for the group.

The CHAIRMAN. Some witnesses have spoken as to administrative changes in the law. The Treasury is at work on a large number of suggested administrative changes, and it is proposed to bring out a bill dealing with administrative changes in time to secure its passage and have it applied to the next tax returns. The House rigidly excluded administrative changes from the act; they are not in the act. Obviously, there are many administrative changes the Treasury would desire, and which would be recognized as desirable by the Treasury, at least it is felt they should be handled in a separate bill. If this is to be our policy, which we should now determine, we might announce it so that anyone who came down on a purely administrative change mission may know it.

Senator BARKLEY. I didn't want to leave the impression in saying that we should try to close the hearings next week that I wanted to shut off anyone, but it is getting late into the year and I think businessmen generally would like to know what taxes they are going to have to pay.

Senator GERRY. If we are really going to understand what the bill means, isn't it necessary that we give some thought to these administrative changes?

The CHAIRMAN. There might be some, but I had reference to general administrative changes not involved in this bill.

Are you to have a session tomorrow, Senator Barkley?

Senator BARKLEY. Yes; we will have a session, and it will probably require the presence of the members of the committee from 12 on. We are to take up the War Department bill and draft bill, and it is possible it may take most of the afternoon. I hope it will not, but you cannot tell.

The CHAIRMAN. We might transfer our hearing over there to the House although it is most inconvenient to try to attend a session and sit in an important hearing.

Mr. Jones, you may proceed.

Mr. JONES. My name is Rowland Jones, Jr. My address is 1163 National Press Building, Washington, D. C. I am the Washington representative of the National Association of Retail Druggists, an organization of some 27,000 independent retail druggists scattered throughout every State in the Union. In addition I represent, through affiliation with the national association, the pharmaceutical associations of the 48 States and several hundred city, county, and local groups.

In my appearance before this committee I desire to address myself only to two sections of the bill now under consideration.

Section 533, appearing on page 39 of the bill, provides an increase in the excise tax on distilled spirits from $3 to $4 per proof gallon.

Pure ethyl alcohol when used for nonbeverage purposes is subjected to this heavy tax and no exemptions are provided. We wish to point out that the tax of $4 per proof gallon provided for by this section brings the tax on pure ethyl alcohol 190 proof to $7.60 per wine gallon, the unit of measure commonly used in trade.

Senator CONNALLY. Is that what you call "absolute" alcohol?

Mr. JONES. No; absolute alcohol is theoretically 200 proof.

Senator CONNALLY. It is very hard to get; you cannot hardly buy "absolute" alcohol, can you?

Mr. JONES. Well, it is expensive and usually sold in very small bottles for scientific purposes.

The desirability of establishing a separate classification for pure ethyl alcohol in nonbeverage industrial products is recognized in every nation in the world except the United States, and a tax differential on such alcohol is now effective in every nation in the world except the United States.

Today in Canada under extreme war pressure, the tax on nonbeverage ethyl alcohol is $1.50 per proof gallon. Beverage alcohol is taxed at the rate of $7 per proof gallon. The United States during the prohibition period taxed nonbeverage alcohol at $1.10 per proof gallon, during which time beverage alcohol was taxed at the rate of $6.40 per proof gallon.

I might say that $6.40 was more of an enforcement tax than anything else.

We are advised that administration of the law in Canada is satisfactorily accomplished under a permit and bond system. A similar system was employed in the United States from 1917 until 1933, and the same can be done again today.

By requiring permits under adequate regulations for small users and requiring adequate bonds from large users of nonbeverage ethyl alcohol, with a nominal bond for the small users, diversion of such alcohol to beverage purposes can be effectively controlled. In such manner was the law enforced during the prohibition era when there existed a far greater temptation to divert to beverage purposes than exists today, because today legal, tax-paid beverage spirits can be obtained freely and easily in 45 of the States.

Through 15 district offices the Alcohol Tax Unit of the Bureau of Internal Revenue supervises and regulates the activities of more than 400,000 legal liquor taxpayers. Among these are distillers, brewers, rectifiers, wholesalers, importers, package stores, taverns, barrooms, and hotels. It seems evident, therefore, that the administrative and enforcement burden of the Alcohol Tax Unit would be but slightly increased through the addition of a new class of permittees adequately bonded and licensed under necessary regulations to use ethyl alcohol for strictly nonbeverage purposes.

Today in the majority of instances the establishment of this new class of permittee could be subjected to periodic visits by internal revenue officers as is now the common practice in the class of permittees now authorized to handle beverage-alcohol products.

It is further evident that enforcement of the liquor laws of the United States is conducted with increasing efficiency, as was indicated by the Deputy Commissioner of Internal Revenue in his testimony before the House Appropriations Committee.

Today the tax on alcohol used in essential medicinals, food products, and flavoring extracts, is exactly the same as that assessed on the same alcohol used in whisky and other alcoholic beverages. I repeat, this rate in the 1941 revenue bill is $4 per proof gallon, equal to $7.60 per wine gallon.

This excise tax was increased to $3 per proof gallon, an increase of 75 cents, in the 1940 Revenue bill, effective July 1, 1940. As a result of this increase in the excise tax, the withdrawal of tax-paid pure ethyl alcohol during the fiscal year ending June 30, 1941, declined 26½ percent, a decrease of 1,824,363 proof gallons as compared to the previous fiscal year. This decrease in withdrawals in the 12-month period represents a loss in revenue to the Treasury of $321,828. An extension of this decrease into the present fiscal year under the $4 tax proposed in this bill, leads us to expect that the revenue loss to the Treasury for this fiscal year at the $4 figure will amount to $624,467, a situation not helpful to this committee in its search for necessary revenue. The point of diminishing returns has been reached and passed for the Treasury, to the detriment of the users of nonbeverage pure ethyl alcohol.

At this point, with the permission of the committee, I offer for the record a tabulation of these figures taken from releases of July 25 and 26, 1941, of the Alcohol Tax Unit of the Bureau of Internal Revenue.

(The exhibit referred to, designated as Exhibit I, is as follows:)

EXHIBIT I.—*Figures taken from Treasury Department, Bureau of Internal Revenue, Alcohol Tax Unit*

[Releases of July 25 and 26, 1941]

Ethyl alcohol tax-paid last fiscal year as compared with the previous fiscal year and proof gallons of alcohol dumped for rectification (beverage) in like period. Difference in net nonbeverage use.

	July 1, 1940, to June 30, 1941	July 1, 1939, to June 30, 1940
	Proof gallons	*Proof gallons*
Total tax paid	27,866,524	24,344,300
Total dumped (beverage)	22,822,539	17,475,958
Net nonbeverage	5,043,985	6,868,348
At $3.00 per proof gallon	$3.00	
At $2.25 per proof gallon		$2.25
Net revenue	$15,131,955	$15,453,783

Net drop under $3 rate ..... proof gallons... 1,824,363
Net loss of revenue at $3 ..... $321,828

26½ decrease applied to 1941: 3,707,329 proof gallons at $4 = $14,829,316, or decrease under 1940 of $624,467.

Mr. JONES. It is submitted that the decrease in consumption of ethyl alcohol and the decrease in revenue is directly attributable to the increase in the tax rate, which has forced the use of substitutes wherever possible. These substitutes are not taxed and often they are inferior solvents, tending to degrade essential products and are not in the interest of public health and welfare.

It is pointed out that the administration and enforcement involved in the authorization of a new classification for nonbeverage ethyl alcohol at a lower tax rate presents no unusual or undue burden on the enforcing unit. What has been done before, can be done again by the Bureau of Internal Revenue. It has the machinery and the experience, extending over many years, in the enforcement and administrative problems involved.

The reestabishment of a separate classification for nonbeverage alcohol at a tax rate lower than that enforced upon beverage spirits is reasonable, in line with accepted practice in other countries, and gives great promise of bringing increased consumption and corresponding increase in revenue, thus reversing the present trend in this category of nonbeverage products containing alcohol.

An excise tax of $2.25 per proof gallon for nonbeverage ethyl alcohol, which we here propose, would not create an undue temptation to divert such alcohol to beverage channels.

The unlawful element now existing will probably always exist, but by and large, the vast majority of citizens and business organizations using pure ethyl alcohol for these nonbeverage purposes will comply to the letter with the law and the regulations thereunder. The experiences of the past prove this fact, in that only a small minority has ever been found in violation of the alcohol revenue laws. The lawful majority should not be penalized because of the unscrupulous minority, particularly when the penalty is not in the public interest and results in lowered total revenue receipts.

It is submitted again that a permit system with adequate regulations and, if necessary, a nominal bond for the small users of nonbeverage alcohol, together with a permit system and adequate regulations and

such bonds for the large users as are deemed necessary to protect the revenue, can be established by the Alcohol Tax Unit in an effective manner. The proponents of a separate classification of lowered tax rate for nonbeverage ethyl alcohol are certain that the establishment of such a differential will not raise any serious problems and will not be productive of a loss in revenue to the Federal Government. If the contrary is found to be true after a reasonable trial, the present system could again be easily reestablished.

With the permission of the committee, I would like to submit for the record at this point, a proposed amendment to this bill, which will provide for the differential tax which we believe to be so important.

The CHAIRMAN. You may submit it.

Mr. JONES. Amendment to H. R. 5417.

Amend title V, section 533, by inserting on page 41, after line 9, the following new subsection:

(e) *Domestic nonbeverage ethyl alcohol.*—Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

(j) Domestic nonbeverage ethyl alcohol.

(1) There shall be levied and collected on all ethyl alcohol produced in the United States and used exclusively in the manufacture of food products, flavors, flavoring extracts, medicinal preparations, and other nonbeverage products, an internal-revenue tax at the rate of $2.25 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller when withdrawn from bond.

(2) Manufacturers and all other persons using nonbeverage ethyl alcohol as herein provided for shall file application for permit, execute such bond, and keep such books and records as the Commissioner, with the approval of the Secretary, may by rules and regulations prescribe to insure that such nonbeverage ethyl alcohol purchased by them shall not be used for beverage purposes. Such books and records shall be preserved for a period of 4 years and during such period shall be open at all times during business hours for inspection by any internal-revenue officer or agent.

(3) Nonbeverage ethyl alcohol withdrawn and tax paid under the provisions of this subsection subsequently diverted to beverage purposes or used in the manufacture or production of any article intended for use as a beverage, shall be taxed as provided by section 2800 (a) (1) of the Internal Revenue Code, such tax to be paid by the person responsible for such diversion or prohibited use. It is hereby declared unlawful for any person procuring nonbeverage ethyl alcohol as herein provided for to divert or cause the same to be diverted to beverage purposes, and on conviction thereof such person shall be fined for each offense not more than $5,000 or be imprisoned for a period of not more than 5 years, or both.

(4) No refund shall be made on floor stocks of tax-paid ethyl alcohol held and intended for nonbeverage uses on the effective date of this act.

The Treasury Department up to this time has vigorously opposed the establishment of a differential between nonbeverage and beverage spirits. May I offer for the record here a copy of a communication signed by Mr. John L. Sullivan, Assistant Secretary of the Treasury (as Acting Secretary of the Treasury), addressed to the chairman of the Ways and Means Committee of the House of Representatives, setting forth the objections of the Treasury Department to this proposal?

EXHIBIT 3

Letter of John L. Sullivan, Assistant Secretary of the Treasury, to the Honorable Robert L. Doughton, Chairman of the Ways and Means Committee of the House of Representatives. In the exhibit the comments of The National Association of Retail Druggists appear after each paragragh.

MAY 21, 1941.

MY DEAR MR. CHAIRMAN: Further reference is made to your letter of February 28, 1941, requesting my comments and recommendations in respect of a bill (H. R. 3383, 77th Cong., 1st Sess.) introduced on February 17, 1941, by Mr. Kefauver and referred to your committee. The declared purpose of the bill is "To amend section 2800, chapter 26, of the Internal Revenue Code of 1939, to reduce the tax on nonbeverage ethyl alcohol used exclusively in the manufacture of medicinal preparations, flavoring extracts, flavors, and for other nonbeverage purposes."

An introductory paragraph requiring no comment.

"The Treasury Department is of the opinion that the bill ought not to be passed, and so recommends. The opinion and recommendations are based upon (1) the hazard to the revenue which the bill would create; (2) the direct loss of approximately $8,500,000 annually in revenue; (3) the magnitude and difficulty of administering such a bill as H. R. 3383, and the high cost of such administration—i. e., approximately $2,370,138 annually; and (4) the fact that the savings in tax to the manufacturers who would benefit by the bill would not, in our opinion, be passed on to the ultimate consumer for whose benefit, as related to us by those interested in the bill, the tax reduction is being sought."

For the reasons stated, the conclusion herein reached clearly indicates consideration of the question involved was based on a false premise. The truth of this assertion will be proved in the comment on each subsequent paragraph.

"There are few restrictions at present on the transportation and use of ethyl alcohol and other distilled spirits for nonbeverage purposes after they are tax-paid and withdrawn from bond. Such spirits, except brandy, are now subject to a tax of $3 per proof gallon. The brandy tax is $2.75 per proof gallon. The bill proposes a reduction of $1 per proof gallon on nonbeverage ethyl alcohol and a 75-cent reduction on all brandy. The privilege of withdrawal of distilled spirits for nonbeverage uses at a preferential tax rate would immediately make them susceptible of diversion to beverage purposes at handsome profits. Many years' experience in enforcing the liquor laws has shown that as soon as the use of distilled spirits is prohibited for beverage purposes or a preferential tax is imposed upon their use in certain products, it immediately becomes profitable to bootleggers and unscrupulous persons to divert them to unauthorized uses."

We take no issue with the first several sentences of this paragraph—assuming Congress is aware of existing tax rates. It was not the intent of H. R. 3383 to alter the status of brandy, and discussion of the tax on brandy may be eliminated in its entirety, thereby removing from further consideration no small part of this voluminous report.

But an example of the false premise on which the report is based is found in the "many years' experience" mentioned, obtained during the era of prohibition when beverage alcohol was taxed at $6.40 per proof gallon, and nonbeverage alcohol at $1.10 per gallon. Conditions have changed since that time, and today alcoholic beverages can be legally obtained in 45 States. The responsible men of industry advocating the establishment of a tax differential on nonbeverage alcohol used in certain essential products deeply resent the implication that with respect to spirits made available to them under a preferential tax "it immediately becomes profitable * * * to divert them to authorized use."

"No records are now maintained by the Bureau of Internal Revenue showing the quantity of ethyl alcohol or other distilled spirits used exclusively for nonbeverage purposes. The quantity used for this purpose can be estimated, however, by taking into consideration the quantity tax paid yearly and deducting from that the quantity used by rectifiers for blending with spirits bottled for beverage purposes. As an illustration, during the fiscal year ended June 30, 1939, 22,150,969 proof gallons of ethyl alcohol were tax paid, 17,522,484 gallons of this amount being used by rectifiers. The difference, 4,628,485 proof gallons, represents the quantity used for nonbeverage purposes. During the fiscal year ended June 30, 1940, 24,344,306 proof gallons were tax paid, 17,475,958 proof gallons used by rectifiers, and the difference, 6,868,348 proof gallons, used for nonbeverage purposes. These figures do not include the unknown quantity of distilled spirits other than alcohol used for nonbeverage purposes. A differential tax of $1 (the difference between $2, the rate specified in the bill, and $3, the present rate of tax on distilled spirits) on estimated withdrawals of 7,000,000 gallons of nonbeverage spirits annually would mean a loss of revenue of $7,000,000 per year."

The historical recital of statistics showing nonbeverage alcohol consumption merits no comment. But an additional example of conclusion reached on a false premise is evident in the last sentence of the paragraph.

Based on the Treasury's own figures for the first 9 months of this fiscal year, there will be consumed during 1941 but 4,407,486 gallons of nonbeverage alcohol. Compared with the fiscal year 1940, this represents a decrease in consumption of 2,460,862 gallons. The decrease is directly attributable to the tax of $3 per proof-gallon. Therefore, with establishment of a tax differential, it is reasonable to assume consumption of nonbeverage alcohol will again reach the 1940 level. Taxed at $2 per proof-gallon, Treasury revenue will be restored and increased over existing revenues. Only with a tax differential will consumption be restored. Therefore, the estimate of withdrawals and estimated loss of revenue is quite obviously based on erroneous premise.

"During the fiscal year 1940, 1,576,911 proof gallons of brandy were withdrawn, other than for use in the fortification of wine. During the first 8 months of the fiscal year ending June 30, 1941 (two-thirds of the fiscal year), 1,502,996 proof-gallons of brandy were withdrawn, other than for use in the fortification of wine. At this rate the withdrawals of brandy for the fiscal year 1941 will approximate 2,250,000 proof-gallons. On the basis of the anticipated 1941 withdrawals of brandy the reduction of the brandy tax will decrease the revenue by $1,687,500. This amount added to the $7,000,000 loss of revenue on nonbeverage spirits would bring the total of the revenue reduction under the bill to more than 8½ million dollars."

This entire paragraph deals with brandy. Inasmuch as a revision of H. R. 3383 eliminating the brandy question is offered as an amendment to the new revenue bill, this paragraph requires no further comment.

"The history of preferential distilled spirits taxes, and restricted withdrawal of spirits, is substantially as follows: A permit system was necessary for restricting the withdrawal and use of alcohol and other distilled spirits for nonbeverage purposes under the Food Control Act of August 10, 1917. The act of October 3, 1917, known as the Revenue Act of 1917, increased the tax on distilled spirits from $1.10 to $3.20 per proof-gallon when withdrawn for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage. The rate of tax under this act on distilled spirits when withdrawn for nonbeverage purposes was $2.20 per proof-gallon. This was followed by the act of November 21, 1918, known as the War Prohibition Act. The act of February 24, 1919, known as the Revenue Act of 1918, imposed a tax of $2.20 a proof-gallon on distilled spirits when withdrawn for nonbeverage purposes and $6.40 a proof-gallon when withdrawn for beverage purposes or for use in the manufacture of any article used or intended for use as a beverage. Under the act of November 23, 1921, an additional tax of $4.20 was imposed on all nonbeverage spirits tax paid at the $2.20 per proof-gallon rate and diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage. The act of February 26, 1926, known as the Revenue Act of 1926, imposed a tax of $2.20 a proof-gallon on distilled spirits until January 1, 1927, and from January 1, 1927, to January 1, 1928, $1.65 a proof-gallon, and on and after January 1, 1928, $1.10 a proof-gallon. Provision was made for the collection of a tax of $6.40 a proof-gallon if the spirits were diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage. These rates remained in effect until the enactment of the Liquor Taxing Act of 1934, approved January 11, 1934. The withdrawal and use of distilled spirits for nonbeverage purposes under the various statutes mentioned was controlled through a rigid permit and inspection system."

The history of preferential distilled spirits taxes is informative. Proponents of a tax differential have a complete history of taxes levied on distilled spirits, dated back to the first Congress. Thus under the provisions of H. R. 3383 no new principle is sought to be established, only a restoration of the differential. The Treasury advises how administration was carried out—"A permit system was necessary for restricting the withdrawal of and use of alcohol and other distilled spirits for nonbeverage purposes under the Food Control Act of August 10, 1917. * * * The withdrawal and use of distilled spirits for nonbeverage purposes under the various statutes mentioned was controlled through a rigid permit and inspection system." If from 1917 to 1934 differentially taxed nonbeverage alcohol "was controlled through a rigid permit and inspection system" why cannot the same be done today? Then we had prohibition; today we have legal alcoholic beverages. What then provokes the opposition of the Treasury Department?

"Under these various acts many persons who had never engaged in any business requiring the use of distilled spirits discovered that they could go into the business of manufacturing flavoring extracts, food products, medicinal and

pharmaceutical preparations, withdraw large quantities of distilled spirits, use a small portion of them legitimately and divert the remainder to beverage purposes. Such manufacturers would sell their finished product at less than cost in competition with persons who had acquired Nation-wide reputations for many years in the manufacture of such products."

Observe the statements in this paragraph pertain to conditions existing in an era long past, namely, the period of prohibition. Thus conclusions drawn from experiences obtained during that period are inapplicable to present-day conditions. The incentive to divert nonbeverage alcohol to beverage purposes no longer exists, and the matter of administration of a tax differential "through a rigid permit and inspection system" should prove a comparatively small problem.

"The statistics of the Bureau of Internal Revenue show that immediately after the preferential tax was imposed and the use of distilled spirits restricted by law and regulations to nonbeverage purposes, withdrawals for such purposes substantially increased. During the fiscal year ended June 30, 1918, 5,318,046 tax gallons of distilled spirits were withdrawn for nonbeverage purposes under the acts which became effective in August and October of that fiscal year. During the next fiscal year the withdrawals were 11,990,921 tax gallons, an increase of 125 percent. During the next fiscal year, ended June 30, 1920, which included almost 6 months of operation under the National Prohibition Act, the withdrawals were 29,087,803 tax gallons or an increase of 142 percent over the previous year. In the second fiscal year of prohibition, ended June 30, 1921, the withdrawals were 35,498,976 tax gallons, an increase of 22 percent over the previous year. It was obvious that large quantities of distilled spirits were being diverted to beverage purposes in violation of the law. The regulations were made more rigid, additional personnel was employed and more effective supervision exercised over permittees. This resulted in the disapproval of applications for permits, the disapproval of applications for renewal of permits and the revocation of permits of undesirable persons. This in turn resulted in a gradual decrease in the withdrawal of distilled spirits for nonbeverage purposes from 35,498,976 tax gallons in the fiscal year ended June 30, 1921, to 6,131,748 tax gallons for the fiscal year ended June 30, 1944. No statistical data are available showing the number of permits issued prior to the fiscal year ended June 30, 1921. The records of the Department show, however, that while the gallonage of withdrawals for nonbeverage purposes was decreasing, the number of permits gradually increased from 123,155 for the fiscal year ended June 30, 1921, to 184,649 for the fiscal year ended June 30, 1933."

This paragraph recites the history of withdrawals of nonbeverage alcohol from 1918 to 1933. It may be of some interest. But the most interesting comment on nonbeverage alcohol withdrawals is pointedly omitted. This bears repeating. During the fiscal year 1940, nonbeverage alcohol consumption amounted to 6,868,348 gallons. During the fiscal year 1941, consumption will amount to 4,407,486 gallons, a decrease of 2,460,862 gallons. The decrease in consumption is due to the high tax of $3 per gallon. Consumption will increase to the 1940 level (or more) with establishment of a tax differential.

"During the period from 1921 to 1933, inclusive, there was an enormous turnover in permits each fiscal year. This involved a large amount of detailed work. The revocation of each of these permits required extensive investigation, hearings, appeals from the action of the administrative officer in the field to the Bureau of Internal Revenue and, in many instances, appeal to the courts."

Undoubtedly the events "during the period from 1921 to 1933" are accurate as related.

"Notwithstanding that there are many problems and high costs involved in the administration of a permit system as proposed by the bill, and that even under such a system there will be diversion and frauds on the revenue, such a system is the only way to control the withdrawal and use of alcohol and other distilled spirits for nonbeverage purposes at a preferential tax rate. This system, of course, would involve the investigation of applicants for permits, the disapproval of applications of unscrupulous persons, the issuance of permits to those qualifying, the examination and approval or disapproval of formulas and processes submitted by applicants, the frequent analysis of samples of finished products to insure their nonbeverage character, the inspection of permittees for compliance with law and regulations, the investigation of cases involving diversion of alcohol to beverage purposes, the citation and revocation of permits for cause, the renewal of basic permits annually, the disapproval of renewal applications for cause, the issuance of annual withdrawal permits authorizing the producer-vendor of dis-

tilled spirits to taxpay, withdraw and deliver it to the vendee-user at the preferential tax rate, and the keeping of an extensive record system."

This paragraph is supplementary to paragraphs 6 and 9 and outlined at length administrative procedure to be followed in enforcing a tax differential. Proponents of the tax differential trust the Treasury Department will enforce and administer such a differential through "a rigid permit and inspection system."

"In determining the number of permits which may follow the passage of this bill, we must assume that the 184,049 permits in force on June 30, 1933, if increased by 5 percent, would represent a fair estimate of the number of present-day users of alcohol and other distilled spirits for nonbeverage purposes. The 5 percent increase corresponds to the increase in population during this same period. Permits would have to be issued annually pursuant to renewal applications. A corresponding number of withdrawal permits would have to be issued authorizing the permittees to withdraw a portion of their yearly quota of distilled spirits at stated intervals and authorizing the producer-vendors to taxpay, withdraw, and deliver it to the permittee-users at the preferential tax rate."

Within this paragraph one finds a most outstanding example of conclusion based on false premise. The assumption is that approximately 194,000 potential permittees will make application for use of nonbeverage alcohol. This figure is obtained by taking the total of permittees during the last days of prohibition and adding thereto an additional 5 percent to compensate for the increase in population. What the Department fails to disclose is that within the grand total of permits in force during prohibition, approximately all but 22,000 were granted to individuals, who will not now seek permits, or to such individuals or firms as are now licensed and engaged in the distilled spirits business. Therefore the estimate of 194,000 potential permittees is grossly in error, and any conclusion reached respecting administration on such an estimate is likewise erroneous.

"The present personnel of the Alcohol Tax Unit is fully occupied in enforcing the internal revenue laws relating to liquors, and since very little control is exercised at present over the use of taxpaid distilled spirits for nonbeverage purposes, the proposed legislation and a permit system incident thereto would place a gigantic task upon the Bureau of Internal Revenue and would necessitate the employment of a large force of additional pharmacists, inspectors, chemists, investigators, attorneys, clerks, and stenographers."

Issue must be taken with the statement that the establishment of a tax differential "and a permit system incident thereto would place a gigantic task upon the Bureau." It is a matter of grave doubt that an additional 25,000 permittees would materially add to the administrative burdens of the Bureau, which now supervises the activities of more than 400,000 alcoholic beverage taxpayers. The additional cost of administration is next discussed below.

"A careful study has been made of the cost of the administration of this bill which restricts the use of distilled spirits withdrawn at a preferential tax rate for nonbeverage purposes. This cost is conservatively estimated at $2,370,138 annually. This includes the salaries of pharmacists, inspectors, chemists, attorneys, investigators, clerks, and stenographers required in the 15 field districts of the Alcohol Tax Unit, and in the headquarters office of the Unit at Washington. Included in this estimate is the cost of travel, purchase, and maintenance of automobiles for use by inspectors, printing, equipment, et cetera. This cost is based on the application of the preferential tax rate to both alcohol and other distilled spirits, but its application to alcohol alone would not materially reduce the cost of administration. An appropriation of $2,370,138 would have to be made simultaneously with the passage of H. R. 3383 or any similar act to cover the cost of its enforcement."

This paragraph purports to be "a careful study" of "conservatively estimated" costs of administration of a tax differential. The total cost of $2,370,138 for an "estimated" 194,000 permittees, reveals an average administrative cost of approximately $12.20 per permittee. Thus for an accurately estimated 25,000 permittees, annual administrative cost will be approximately $305,000. It must now be evident that conclusions reached on erroneous estimates of potential permittees and costs of administration incident thereto are in themselves in evident error.

"While this bill is obviously designed to reduce the tax on nonbeverage ethyl alcohol, and perhaps on brandy too, it appears that as drafted it would have the effect of imposing a $2 tax on alcohol which is now withdrawn free of tax. Alcohol is withdrawn free of tax for denaturation; for hospital and scientific use; for use of the United States, the States, and their subdivisions; and for export. It is assumed that it is not the purpose of the bill to impose a tax on ethyl alcohol withdrawn for the purposes just above enumerated."

It was never intended the provisions of H. R. 3383 should disturb the status of tax-free alcohol. Proponents of a tax differential for nonbeverage alcohol find it difficult to understand why 6,559 permittees receive tax-free alcohol and yet present no administrative problem to the Treasury Department. Is it possible that reputable businessmen and business establishments seeking a differentially taxed alcohol present insurmountable difficulties for the Department?

"Ethyl alcohol for many years has been widely used in the manufacture of flavoring extracts, food products, medicinal and pharmaceutical preparations, and by physicians, dentists, veterinarians, druggists, and hospitals. It has been urged upon the Department that the high cost of nonbeverage alcohol products to the consumer is attributable to the tax imposed by the Government. It is appropriate, therefore, to determine what a preferential tax will actually mean to the consumer in dollars and cents. There has been some doubt that a preferential tax would benefit the consumer for the reason that most of these nonbeverage products are bought in small quantities and the decrease in cost of manufacture resulting from a reduction in the tax on the alcohol used therein would not be passed on to the consumer but would result in greater profits to the manufacturer. As an illustration, the proposed tax differential of $1 per proof gallon is equivalent to $2 per wine gallon, or 1⅛ cents per fluid ounce of absolute alcohol. The amount saved on a bottle of a particular product can be computed by multiplying the number of fluid ounces of absolute alcohol contained in the bottle (found by applying the percent of alcohol to the total number of ounces contained in the bottle) by 1⅛ cents. This is illustrated by the following table:

Size of bottle (fluid ounce)	Saving in cents and fractional cents in the tax if the percent of alcohol by volume is—				
	5 percent	10 percent	25 percent	50 percent	80 percent
1	0.078 of 1 cent	0.156 of 1 cent	0.392 of 1 cent	0.781 of 1 cent [1]	1.25 cents.[1]
2	0.156 of 1 cent	0.313 of 1 cent	0.781 of 1 cent	1.563 cents	2.5 cents.[1]
4	0.313 of 1 cent [2]	0.625 of 1 cent [2]	1.563 cents [2]	3.125 cents [1]	5 cents.[1]
8	0.625 of 1 cent [2]	1.25 cents [2]	3.125 cents [2]	6.25 cents	10 cents.
16	1.25 cents [2]	2.5 cents [2]	6.25 cents [2]	12.5 cents	20 cents.

[1] Typical bottle sizes and alcohol content of flavoring extracts.
[2] Typical bottle sizes and alcoholic content of medicinal preparations.

"For example, a saving of 1¼ cents is realized on a 16-ounce bottle of a product which contains 5 percent alcohol or a 1-ounce bottle of a product which contains 80 percent alcohol, which would mean a savings of a few cents per year to the average family. In view of the small savings per bottle, it is doubtful if the consumer would benefit by the amounts indicated. Manufacturers, distributors, and retailers would probably not pass these savings on to the consumer, and they would be the beneficiaries of the differential tax rather than the consumer."

We take no issue with the recitation of uses to which nonbeverage alcohol is put, nor do we object to the clever tabulation showing possible consumer savings. But it is felt the Department demeans its dignity in presenting the "perfect" example of inconsequential savings of 1¼ cents to consumers using: A 16-ounce bottle containing 5 percent alcohol and a 1-ounce bottle containing 80 percent alcohol.

Observe that in direct proportion, as the size of the bottle decreased, the percentage of alcohol therein contained increased. The truth of the matter is that competitive conditions in industry compel price reduction wherever and whenever possible. Today the tax burden for alcohol alone in a 16-ounce bottle of lemon or orange extract is 60.3 cents. If the tax on nonbeverage alcohol is fixed at $2 per gallon, a saving of approximately 20 cents would immediately be reflected in consumer prices. In light of the foregoing, proponents of a tax differential take deep umbrage to the direct statement that "manufacturers, distributors, and retailers would probably not pass these savings on to the consumer, and they would be the beneficiaries of the differential tax rather than the consumer." But, should this violent assumption of the Treasury come to pass, consider the effect of increased income and excess-profits taxes on the manufacturers, and then determine whether or not consumer savings will be passed along.

"H. R. 3383 proposes a differential tax on ethyl alcohol only. There are, however, hundreds of manufacturers of food products and medicines throughout the country who use distilled spirits other than alcohol, such as whisky, rum, and brandy in their products. Such manufacturers, except those using brandy on

which the basic tax is to be reduced under the bill, will no doubt advocate the application of the nonbeverage tax rate to the distilled spirits used in their products. Physicians, dentists, druggists, veterinarians, and hospitals, who also use large quantities of alcohol and other distilled spirits for nonbeverage purposes, will be the beneficiaries of the nonbeverage tax rate. In considering the legislative requirements, the administrative problems, the cost of administration and loss of revenue, we have assumed that the preferential tax rate would in the end extend to the entire nonbeverage field."

H. R. 3383 intended only to establish a tax differential on ethyl alcohol consumed in the production of necessities. The bill does not provide, and the Treasury Department has gone far afield in considering administrative problems when they "assumed that the preferential tax rate would in the end extend to the entire nonbeverage field."

"The exception contained in the parenthetical portion of the amended section appearing in line 8 on page 1 and in lines 1 to 3, inclusive, on page 2, indicates that the exception to the $3 tax rate relates to 'brandy and nonbeverage alcohol used exclusively for * * * nonbeverage purposes.' The parenthetical portion appearing on page 2, after the statement of 'the rate of $3,' in lines 5, 6, 7, and 8, states a rate of $2 on brandy, without a limitation on its use, and a rate of $2 on ethyl alcohol when used for nonbeverage purposes."

It has been pointed out several times that H. R. 3383 intended no disturbance of the status of brandy. The same is true with respect to tax-free alcohol. To eliminate continued confusion in the minds of Treasury officials, an amended or revised version of H. R. 3383 is herewith submitted for inclusion in the new revenue bill. In passing, the observation is made that H. R. 3383 was written to conform with suggestions emanating from the Treasury Department.

"The provisions of the bill in subsection (a) in respect of diversions, and in subsection (b) in respect of the procurement of spirits under permit and bond, relate only to nonbeverage ethyl alcohol. It is not provided that brandy which is taxpaid at the reduced rate shall be procured under permit or that the provision relating to diversion shall be applicable thereto. The bill is taken, therefore, as proposing an outright reduction on brandy intended for beverage purposes."

This paragraph pertaining to the taxable status of brandy requires no comment in light of representations hereinbefore made.

"The tax on distilled spirits, including ethyl alcohol and brandy, was increased by 75 cents per proof gallon as a means of increasing the revenues for national defense. There has not been a lessening of the need for such revenues since the increase."

The task of procuring funds for national defense remains. Our comment on paragraph 4 is sufficiently indicative that increased revenues to the Treasury will result from establishment of the tax differential recommended in the attached amendment, namely, a tax of $2 per proof gallon on nonbeverage ethyl alcohol.

In a parallel column we have outlined an answer to the allegations of the Treasury. We sincerely believe that the position of the Treasury as evidenced by the letter of the Assistant Secretary does not present the true picture. We outline our reasons for this statement in the paragraph-by-paragraph answer here submitted.

The National Association of Retail Druggists deeply resents the implication in the Treasury Department's letter that retail druggists generally will become bootleggers and divert a lower-taxed alcohol into beverage channels if a differential nonbeverage alcohol tax is established. In this connection we have only to cite the record of retail druggists in the United States in the handling of narcotic drugs. Retail druggists are the only legitimate retail dealers in narcotic drugs under the Harrison narcotic law. Although the possible profit which might be derived from the diversion of narcotic drugs into unlawful channels is far higher than that which might be obtained by the diversion of lower-taxed alcohol into beverage uses, we learn from the Bureau of Narcotics of the Treasury Department itself, that last year, out of some 58,000 retail druggists in the United

States, only 17 were found guilty of violations of the law and the regulations in a degree serious enough to warrant their citation to their respective State boards of pharmacy for revocation of their status as registered pharmacists.

We are proud of this record and we submit that in the face of it the fears of the Treasury Department in this regard have little reasonable basis.

The tax on pure ethyl alcohol for nonbeverage use is a direct tax on products absolutely essential in the diagnosis, treatment, prevention, and cure of disease.

This excessively high tax, which as I have indicated, amounts to $7.60 per wine gallon under the proposed bill, is a direct burden on the cost of medical care, which the Federal Government has long been interested in reducing.

Other witnesses will discuss the uses and the reasons for the use of pure ethyl alcohol in nonbeverage consumer products.

Whisky and nonbeverage ethyl alcohol should not be taxed on the same basis.

The other section of this bill upon which we wish to be heard is section 2402, appearing on page 68. It is a part of a new chapter, chapter 19, of the Internal Revenue Code, providing for new retailer excise taxes, so-called.

These new provisions were inserted in the lower House by the Ways and Means Committee at the last moment, and after the public hearings on the bill had been concluded, thus foreclosing the opportunity for those affected to be heard.

Section 2402 provides an excise tax of 10 percent of the retail price of all cosmetics and toilet preparations sold in retail stores, or used in barber shops and beauty parlors. While the Ways and Means Committee denominated this new tax an "excise" tax, we desire to brand it here for what it is—a retail sales tax. Similar sales taxes on the retail sale of furs and jewelry, including watches and clocks, are provided in this chapter.

A foray was made into this field of taxation during the first World War, but it was of short duration and was soon abandoned.

We believe this retail sales tax proposal to be the opening wedge, the foot-in-the-door, the trial balloon, which if successful will be followed shortly by a general Federal retail sales tax. This is an invasion of a new tax field which has been to a considerable degree preempted by the States, 22 of which now have retail sales tax laws.

Senator VANDENBERG. Would you feel the same way about a manufacturers' sales tax?

Mr. JONES. We have something of that in this law.

Senator VANDENBERG. How do you feel about a manufacturers' sales tax as an alternative to all these other excises to which you object?

Mr. JONES. If limited to luxuries, we would have no objection to it, but a 10-percent tax, however denominated, is a very heavy tax.

Senator VANDENBERG. I am talking about a much smaller sales tax, manufacturers' sales tax, with food and clothing exempted.

Mr. JONES. I think you may have to come to it later.

Senator VANDENBERG. Well, if later, why not now?

Mr. JONES. The National Association of Retail Druggists as a basic policy has long held the position that the sales tax is unsound in

principle because it ignores the old maxim of taxation that taxes should be levied on the people in proportion to their ability to pay.

It seems to us that this proposal involved the tapping of the last great reservoir left to the Federal Government. If the Congress in its wisdom, after due deliberation, comes to the conclusion that the fiscal position of the Treasury renders a retail sales tax absolutely essential to preserve the credit of the Government and to provide for an adequate defense of the Nation, the retail druggists of the country will do their duty gladly. But we also believe that the utilization of this last important source of revenue should be postponed as long as it is possible to do so, and in so doing preserve a last ace in the hole to meet emergencies as yet unseen.

In this connection it should be pointed out that this new retail sales tax with the provision for monthly returns on the part of the retailer, represents a gigantic administrative task for the Treasury. We estimate that the three sections of this new retailers sales tax proposal covering toilet preparations and cosmetics, jewelry and furs, will bring a minimum of 800,000 monthly returns to the Treasury Department. Compared to the administrative burden involved in this, the alcohol tax differential which we ask fades into insignificance.

This retail sales tax proposal contains no exceptions, and rightly so. We expect that the syndicate store corporations, which now monopolize at least 90 percent of the field of 10-cent merchandise, will demand an exemption for this class of goods on the ground that we should not tax the 10-cent package of face powder of the shop girl. We would be glad to see such an exemption for the low-income groups, but submit that such an exemption would simply drive the majority of consumers now purchasing the larger sizes of cosmetics and toilet preparations into the syndicate "five-and-dime" stores in order to avoid the tax, thus defeating the very purpose of the tax and at the same time diverting business from regular channels of trade.

If this retail sales tax must be enacted into law to meet the revenue needs, we have an extremely pertinent suggestion to offer.

The retail sales tax has always been considered a consumer tax. We believe that the Ways and Means Committee intended it as a consumer tax. We base this opinion on the fact that the 10-percent tax imposed on the retail price of toilet preparations far exceeds the net profit on the products taxed, and on the fact that it was so designated by members of the Ways and Means Committee on the floor of the House when this tax bill was under consideration.

No retailer can absorb a tax of this size (10 percent) on the retail sale without the necessity of handling the products so taxed at a loss, a situation not helpful to this committee in its search for revenue. But we find in this bill no provision denominating this tax as one intended to be paid by the consumers of cosmetics and toilet preparations. We believe that this committee can look with profit to the enactments of the States in this retail sales tax field.

Twenty-two States now have retail sales tax laws on their statute books. These are: Alabama, Arizona, Arkansas, California, Colorado, Illinois, Indiana, Iowa, Kansas, Michigan, Mississippi, Missouri, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Utah, Washington, West Virginia, and Wyoming.

Eight States have experimented with retail sales taxes and have abandoned them after trial. These are: Georgia, Idaho, Kentucky, Louisiana, Maryland, New Jersey, New York, and Pennsylvania.

Of the 22 States now having retail sales-tax laws, 14 States require by law that the sales tax be passed on to the consumer and collected at the time of sale, and prohibit the absorbing or the offering to absorb the tax by the retailer. These are Alabama, Arkansas, Colorado, Iowa, Kansas, Mississippi, Missouri, North Dakota, Ohio, Oklahoma, Utah, Washington, West Virginia, and Wyoming.

In addition, 5 States of the 22 having retail sales-tax laws permit the passing on of the tax to the consumer. These are Arizona, California, Michigan, North Carolina, and South Dakota.

The constitutionality of the pass-on provision in these laws has been established by the highest courts in Alabama, California, Kentucky, and Michigan.

I would like to submit for the record at this point in my testimony the language of the provisions in several State laws providing for the mandatory collection of the tax from the consumer at the time of sale, and making it unlawful for the retailer to absorb or to offer to absorb the tax.

The CHAIRMAN. You may place it in the record.

(The document referred to follows:)

EXHIBIT 4

The Ohio Sales Tax Act provides:

"SEC. 5546-3. Excepting as provided in section 5546-5 of the General Code, the tax imposed by section 5546-2 of the General Code shall be paid by the consumer of the vendor in every instance, and it shall be the duty of each vendor to collect from the consumer the full and exact amount of the tax payable in respect of each taxable sale, and to evidence the payment of the tax in each case by cancelling prepaid tax receipts, equal in face value to the amount thereof, in the manner and at the times provided in this section.

* * * * * * *

"SEC. 5546-15. Whoever being a vendor, as defined in this act, fails, neglects, or refuses to collect the full and exact tax as required by this act, or fails, neglects, or refuses to comply with the provisions of this act and the rules and regulations of the commission with respect to the cancellation of prepaid tax receipts, or excepting as expressly authorized pursuant to this act, refunds, remits, or rebates to a consumer, either directly or indirectly and by whatsoever means, all or any part of the tax levied by this act, or makes in any form of advertising, verbal or otherwise, any statements which might infer that he is absorbing the tax or paying the tax for the consumer by an adjustment of price, or at a price including the tax, or in any other manner whatsoever shall be deemed guilty of a misdemeanor and upon conviction thereof shall be fined not less than $25 nor more than $100, and upon conviction for a second or other subsequent offense, shall, if a corporation, be fined not less than $100 nor more than $500, or if any individual or a member of a partnership, firm, or association, be fined not less than $25 nor more than $100, or imprisoned in the county jail, or a workhouse, or other like penal or correctional institution not more than 60 days, or both."

Section XXVI of the Alabama Sales Tax Act provides:

"SEC. XXVI. It shall be unlawful for any person, firm, corporation, association, or copartnership engaged in or continuing within this State in the business for which a license or privilege tax is required by this act to fail or refuse to add to the sales price and collect from the purchaser the amount due by the taxpayer on account of said tax provided herein, or the amount due by said taxpayer on account of any taxes provided herein, or the amount due by said taxpayer on account of any taxes provided under this act, or who shall refund or offer to refund all or any part of the amount collected, or absorb or advertise directly or indirectly the absorption or refund of said tax or any portion of the same."

The State Sales Tax Act of the State of North Dakota provides:

"SEC. 6. Retailers shall add the tax imposed under this act, or the average equivalent thereof, to the sales price or charge and when added such taxes shall constitute a part of such price or charge, shall be a debt from consumer or user to retailer until paid, and shall be recoverable at law in the same manner as other debts.

"Agreements between competing retailers, or the adoption of appropriate rules and regulations by organizations or associations of retailers to provide uniform methods for adding such tax or the average equivalent thereof, and which do not involve price-fixing agreements otherwise unlawful, and which shall first have the approval of the commissioner, are expressly authorized and shall be held not to be in violation of any antitrust laws of this State.

"SEC. 7. *Unlawful acts.*—It shall be unlawful for any retailer to advertise or hold out or state to the public or to any consumer, directly or indirectly, that the tax or any part thereof imposed by this act will be assumed or absorbed by the retailer or that it will not be considered as an element in the price to the consumer, or, if added, that it or any part thereof will be refunded."

Section 57.3305 of the South Dakota Code, a part of the sales-tax law, provides:

"57.3305. Advertising or offering by retailer to absorb or include tax in price or refund thereof unlawful. It shall be unlawful for any retailer to advertise or hold out or state to the public or to any consumer, directly or indirectly, that the tax or any part thereof imposed by this chapter will be assumed or absorbed by the retailer or that it will not be considered as an element in the price to the consumer, or, if added, that it or any part thereof will be refunded."

The West Virginia sales-tax law provides:

"SEC. 10. *Tax paid by consumer.*—It is the intent of this article that the tax levied hereunder shall be passed on to and be paid by the consumer. The amount of the tax shall be added to the sales price and shall constitute a part of that price and be collectible as such.

"SEC. 11. *Seller may not pay tax; penalty.*—A person engaged in any business taxable hereunder shall not advertise or hold out to the public in any manner, directly or indirectly, that he will absorb all or any part of the tax, or that the tax imposed by this article is not to be considered an element in the price to the consumer. A person who violates this provision shall be guilty of a misdemeanor and upon conviction shall be punishable by a fine of not less than $50, nor more than $1,000, or imprisonment in the county jail for not exceeding 1 year, or both, in the discretion of the court."

Article 1 of the Rules and Regulations promulgated by the Commissioner of Revenues of the State of Arkansas reads as follows:

"The seller must collect the tax from the purchaser or consumer and must remit the tax to the commissioner of revenues in the manner hereinafter provided in these regulations. Failure for any reason to collect the tax from the purchaser or consumer will forfeit the seller's permit and will make the seller liable for the tax."

Section 28a of article II of the Excise Revenue Act of the State of Arizona, reads as follows:

"28a. *Unfair competition.*—No person engaged in any of the businesses classified in section 2, shall advertise or hold out to the public in any manner, directly or indirectly, that the tax herein imposed is not considered as an element in the price to the consumer. Any person violating the provisions of this section shall be guilty of a misdemeanor."

The Colorado retail sales tax law provides:

"SEC. 6. Retailers shall, as far as practicable, add the tax imposed under articles 1 to 5 of this chapter, or the average equivalent thereof, to the sales tax or charge, showing such tax as a separate and distinct item and when added, such tax shall constitute a part of the price or charge, shall be a debt from consumer or user to retailer until paid, and shall be recoverable at law in the same manner as other debts.

* * * * * * *

"SEC. 8. It shall be unlawful for any retailer to advertise or hold out or state to the public or to any consumer, directly or indirectly, that the tax or any part thereof imposed by articles 1 to 5 of this chapter will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property sold, or if added that it or any part thereof will be refunded."

The Iowa retail sales tax law provides:

"SEC. 6943.079. *Adding of tax.*—Retailers shall, as far as practicable, add the tax imposed under this division, or the average equivalent thereof, to the sales price or charge and when added such tax shall constitute a part of such price or charge, shall be a debt from consumer or user to retailer until paid, and shall be recoverable at law in the same manner as other debts.

"Agreements between competing retailers, or the adoption of appropriate rules and regulations by organizations or associations of retailers to provide uniform methods for adding such tax or the average equivalent thereof, and which do not involve price-fixing agreements otherwise unlawful, are expressly authorized and shall be held not in violation of chapter 434, or other anti-trust laws of this State. It shall be the duty of the commission to cooperate with such retailers, organizations, or associations in formulating such agreements, rules, and regulations. The commission shall have the power to adopt and promulgate rules and regulations for adding such tax, or the average equivalent thereof, by providing different methods of applying uniformly to retailers within the same general classification for the purpose of enabling such retailers to add and collect, as far as practicable, the amount of such tax.

"SEC. 6943.080. *Unlawful acts.*—It shall be unlawful for any retailer to advertise or hold out or state to the public of to any consumer, directly or indirectly, that the tax or any part thereof imposed by this division will be assumed or absorbed by the retailer or that it will not be considered as an element in the price to the consumer, or if added, that it or any part thereof will be refunded."

The regulations under the Kansas Retailers' Sales Tax Act provide as follows:

"Article 11. *Tax to be passed on.*—The retailer is required to pass on to the consumer or user the full amount of the tax imposed by this act, or an amount equal as nearly as possible or practicable to the average equivalent thereof.

"Article 12. *Unlawful advertising.*—The law provides that it shall be a misdemeanor, subject to fine or imprisonment or both, 'to advertise or hold out, or state to the public, or to any consumer, directly or indirectly, that the tax, or any part thereof, imposed by this act will be assumed or absorbed by the retailer, or that it will not be considered as an element in the price of the consumer, or if added, that it, or any part thereof, will be refunded.'"

Chapter 155, Laws of 1936 of the State of Mississippi, provides as follows:

"SEC. 3. It shall be unlawful for any person, firm, or corporation who is engaging or continuing within this State in the business of selling any tangible property and who is liable for a privilege tax assessed and levied by section 2c of chapter 119, Laws of Mississippi, 1934, to fail or refuse to add to the sale price and collect the amount due by him on account of said tax provided in section 1 hereof or to add or collect more than the amount fixed by section 1 of this act on account of said tax.

"SEC. 4. Any person, firm, or corporation violating sections 1 or 3 of the provisions of this act shall be guilty of a misdemeanor, and upon conviction shall be fined in a sum not less than $50 nor more than $100, and may be committed to jail until such fine and costs are paid."

The Missouri Sales Tax Act provides:

"SEC. 11411. * * * The seller of any property or person rendering any service, subject to the tax imposed by this article, is directed to collect the tax from the purchaser of such property or the recipient of the service as the case may be. The tax imposed by this article is a tax upon the sale, service, or transaction and shall be collected by the person making the sale or rendering the service at the time of making or rendering such sale, service, or transaction. It shall be unlawful for any person to advertise or hold out or state to the public or to any customer directly or indirectly, that the tax or any part thereof imposed by this article, and required to be collected by him will be assumed or absorbed by the person, or that it will not be added to the selling price of the property sold or service rendered, or if added, that it or any part thereof will be refunded. Any person violating any of the provisions of this section shall be guilty of a misdemeanor.

"SEC. 11412. It shall be the duty of every person making any purchase or receiving any service upon which a tax is imposed by this article to pay the amount of such tax to the person making such sale or rendering such service; any person who shall willfully and intentionally refuse to pay such tax shall be guilty of a misdemeanor."

The New Mexico school tax laws provide:

"SEC. 203. (B) *Absorbing tax—advertisement.*—It shall be unlawful for any person engaged in any business or profession to directly advertise that any tax imposed by this act is not considered as an element of the price of property sold or service rendered."

The sales tax regulations issued by the State Tax Commission of Utah provide:

"4. *Mandatory collection of tax.*—Chapter 111, Laws of Utah, 1937, amends section 5 of the Emergency Revenue Act of 1933 to read in part as follows: '* * * The vendor shall collect from the vendee * * *'.

"Under the act, as amended, the vendor is required to collect the tax from the vendee with respect to all transactions subject to tax. In all cases the full amount of the tax must be added to the sales price and collected or charged as a separate item. The seller is responsible for all tax funds in his possession.

"It will be considered a violation of the act for the vendor to absorb the tax or to consider that the tax is included and collected as a part of the sales price. The total purchase charge on sales consummated must not be quoted in fractions of 1 cent for the purpose of eliminating the use of tokens."

The Wyoming Selective Sales Tax Act provides:

"Article 4, item 3. *Absorption of tax by vendor.*—It is unlawful for any retailer or vendor to advertise or hold out, or state to the public or to any user or consumer, directly or indirectly, that he will absorb the tax on sales of 25 cents or more, or consider the tax as part of the purchase price, or that he will refund the tax to the purchaser. A person who violates this rule is guilty of a misdemeanor."

Many of these mandatory passing-on provisions were added to State laws after experience had shown that the absence of such provisions was highly productive of unfair trade practices on the part of a few retailers who sought to utilize the tax as a vehicle to divert trade from its ordinary channels. Some retailers advertised that their prices did not include the sales tax, thus placing an enormous competitive burden upon the mass of retailers, mostly small in size, whom the State had designated as tax collectors. This will be the practice in this case if not expressly prohibited.

If this retail-sales-tax provisions is to be approved by this committee and by the Senate, we respectfully request that a mandatory pass-on provision similar to that found to be necessary in State retail-sales-tax laws, be provided for by appropriate language in this bill.

The retail druggists of the country have carried and will continue to carry the increasing burdens of taxation in the same degree as all other citizens. They cannot maintain their place in the national economy as employers, as taxpayers, and as distributors of necessary products, if they are forced to absorb this very heavy tax on the retail value of products which represent a substantial portion of their business. To expect them to do so is to ignore the plain economics of their business and the basic theory of the retail-sales tax.

We have one further suggestion: The bill provides that these retail sales taxes shall be remitted to the Treasury in monthly returns. We submit that the requirement of monthly returns by retailers is unnecessarily burdensome to retailers generally, and that a quarterly return would be far less costly to the retailers affected, as well as to the Treasury.

We believe that these two proposals are sound, in the public interest, and that they conform to every test of an enlightened tax policy. They will not subtract a single dollar from the estimated revenue provided for in this bill. Indeed, in the case of the nonbeverage alcohol tax differential proposal, the revenue will increase beyond

the conservatively estimated cost of administration. As for the mandatory pass-on provision in the retail sales tax chapter, the adoption of our proposal will bring with it a more efficient collection of the tax involved. Failure to adopt such a provision, if we must have a retail sales tax, will place a dangerous premium on evasion.

The CHAIRMAN. Thank you, Mr. Jones.

Mr. JONES. Thank you.

STATEMENT OF DR. E. F. KELLY, WASHINGTON, D. C., REPRESENTING AMERICAN PHARMACEUTICAL ASSOCIATION

The CHAIRMAN. Dr. Kelly, will you give your full name to the reporter, please?

Dr. KELLY. My name is E. F. Kelly.

The CHAIRMAN. What interest do you represent?

Dr. KELLY. I represent the American Pharmaceutical Association, 2215 Constitution Avenue, Washington.

I wish to supplement very briefly the statement which Mr. Jones has just made with respect to the use of alcohol and the tax on alcohol in the preparation of drugs and medicines. I have a statement here, but to save time I will just briefly refer to the outstanding points and then file the statement.

The CHAIRMAN. You may do that.

Dr. KELLY. With the sole exception of water, ethyl alcohol is the solvent most generally employed in the preparation of drugs and medicines and in filling prescriptions. It is also used as a preservative in many medicinal preparations in which it is not required as a solvent in order to prevent fermentation and other undesirable changes.

Other solvents and preservatives are available which in some instances are as effective as alcohol, but none of them can be used as a substitute for alcohol because they have undesirable, or in some instances, dangerous physiological effects when taken internally or applied externally in medicine. Alcohol is, therefore, a necessary and indispensable material in the preparation and preservation of many drugs and medicines which are essential to the health and welfare of our people.

The following table will give the percentage of alcohol contained in several well-known and widely used medicines:

	Percent		*Percent*
Fluid extract of belladonna root	70	Tincture of capsicum	85
Fluid extract of cinchona	60	Tincture of digitalis	70
Fluid extract of ergot	40	Tincture of nux vomica	70
Fluid extract of rhubarb	60	Paregoric	46
Tincture of asafetida	80	Tincture of arnica	68

In these preparations the alcohol content ranges from 40 to 85 percent. Those containing 50 percent of alcohol will carry a basic charge of $4 per wine gallon for the alcohol alone under the terms of the bill under consideration, and tincture of digitalis used in the treatment of heart disease will carry a charge of almost $6 per gallon. In many instances where the product is distributed through the usual channels, this basic tax is further increased by added expenses.

It does not seem reasonable to place this increasing tax burden on the treatment and prevention of disease.

Alcohol itself has certain undesirable physiological effects and since it is taxed because of its employment in many forms as a beverage, extensive and expensive research has been carried on for many years with the object of developing a satisfactory substitute for alcohol as a solvent and preservative in connection with drugs and medicines. It is a great disappointment to all concerned that these efforts have been without result up to this time and that they do not even indicate that such a substitute can be developed in the future.

The United States Pharmacopoeia and the National Formulary, which are recognized under the Federal Food, Drug, and Cosmetic Act and corresponding State legislation as providing standards for the drugs recognized in these books, both direct the use of alcohol as a solvent or preservative or both, in a majority of the preparations for which directions are given. The use of alcohol is therefore legally binding on those who make and distribute these products if they are labeled as official preparations. It is also required under this legislation, that the percentage of alcohol contained in medicinal preparations shall be stated on their labels.

The volume of such medicinal preparations runs into hundreds of thousands of gallons per year. An extensive survey of the ingredients of prescriptions made in 1931–32 showed that alcohol either as such or as an ingredient of other preparations, was contained in about 60 percent of the approximately 250,000,000 prescriptions filled annually in the United States.

The facts given in this brief statement illustrate that alcohol is a aluable and indispensable solvent and preservative in the preparation of many necessary drugs and medicines and that any tax on such alcohol except possibly such tax as may be required to cover the cost of administration and to prevent diversion, is a direct tax on articles required in the diagnosis, treatment, prevention and cure of diseases, or in other words, is a tax on health.

It is, therefore, urgently requested that favorable action be taken on the recommendation that differential be made in the tax on medicinal as compared with beverage alcohol, and that the rate be set at $2.25 per proof gallon as provided for in an amendment to be substituted during this hearing. The tax on beverage alcohol in Canada is now $7 per proof gallon and there a differential tax of $1.50 is provided for alcohol used in drugs and medicines.

A differential in the tax on medicinal alcohol as compared with the tax on alcohol for beverage purposes, is imperative at this critical time in order to prevent an increase in the cost to the public of official drugs and medicines which are not luxuries but necessities.

I also wish to add, Mr. Chairman, that we desire to be recorded as supporting the position taken by Mr. Jones with respect to the 10-percent tax. We ask that a definite and clear mandatory provision requiring that it be passed on to the consumer be included in the act.

The CHAIRMAN. Mr. Fred Griffiths.

Mr. JONES. Mr. Griffiths cannot be here today and he asked permission to file a brief.

The CHAIRMAN. Very well; I shall be glad to have him do so.

Mr. Friedman.

STATEMENT OF ELISHA M. FRIEDMAN, NEW YORK, N. Y.

The CHAIRMAN. Will you give your name?

Mr. FRIEDMAN. My name is Elisha M. Friedman, consulting economist, of New York City. I represent no group or interest. I am going to discuss the capital-gains tax from one angle: What is the possibility of increasing the yield? The subject is of general public importance. I am not going to try to persuade you or argue a point. I shall merely present some pertinent facts. I spent about 2 months analyzing Treasury statistics, and I have asked Mr. Felton Johnston to leave on each of your desks two documents which contain those facts: Statistics of Income for 1938, and Million Dollar Incomes. I have also here a copy of the Dow-Jones stock chart. You have been listening to witnesses who have asked that taxes be lowered on various items affecting their interests. All witnesses have pleaded "Do not tax us. Tax the other fellow." The tendency would be to reduce Government receipts. The presentation I should like to make is to find a method of increasing the Treasury receipts.

Now, my thesis in brief is that it would be possible to get an increase of income of 100 millions to 400 millions of dollars out of the modification of the capital-gains tax along the following major line. First, segregate capital gains and losses from regular income. This would have the effect of eliminating the deductions of capital losses against regular income, which amount to very substantial items, running as high as $584,000,000 in the year 1938. Second, eliminate the holding period. If you virtually compel a man, by high taxes, to hold securities or property for 2 years, you prevent the Treasury from taxing gains which it might have collected on a shorter period. Third, restrict offset of losses to segregated gains. Fourth, in fairness to the taxpayer permit him to carry the loss over a year or two. Fifth, fix a low rate of 10, 12, or 15 percent. Sixth, tax the professional trader at the full income-tax rates.

Now, I shall file this brief, but I can dash through it pretty quickly.

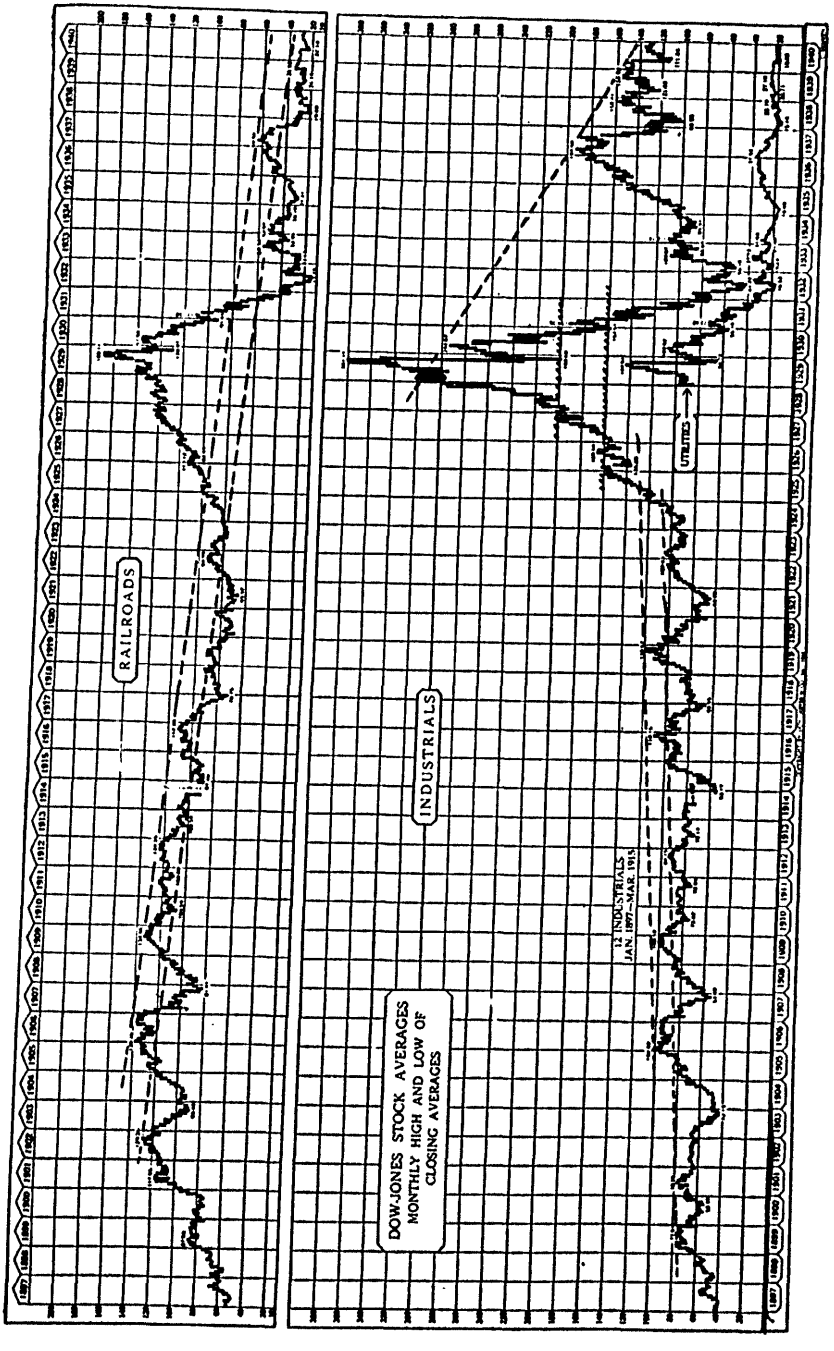
Senator TAFT. You propose to take the capital gains out of the normal tax and put it in a separate category?

Mr. FRIEDMAN. Precisely, and you will find in the two documents which you have on your desk, and other official sources, carefully prepared data and statistics which support my contention.

By the way, Mr. Sullivan, Assistant Secretary of the Treasury is here, and Mr. Johnston might give him a copy of the two documents and the stock price chart distributed to the Senators.

THE DOW-JONES STOCK AVERAGES, 1897–1940. MONTHLY HIGH AND LOW OF CLOSING AVERAGES

The following chart of stock prices shows that the trend for railroads is down since the early nineteen hundreds, except for the brief period in the late twenties. Utility share prices likewise show a declining trend. There are no long-term capital gains either in railroads or utilities. Industrial shares did show a rising trend up to 1925 but since 1930 the trend is sharply down. All industrial shares bought from 1926 to 1930 now show paper losses which will be realized and deducted from the income tax of future years. However, there are abundant short term capital gains which, if taxed at low rates, would yield handsome revenues to the Treasury.


DOW-JONES STOCK AVERAGES
MONTHLY HIGH AND LOW OF
CLOSING AVERAGES
INDUSTRIALS
12 INDUSTRIALS
JAN. 1897—MAR. 1915
UTILITIES
RAILROADS

The capital-gains tax has been part of our fiscal structure for about 20 years. At times it provided abundant revenue. At times it provided no revenue and even caused a reduction of receipts from the income tax. Always, it has been a fund-freezing device, without privilege of acting under a license. This freezing has been a detriment to our economy. It penalizes risk-taking. It checks switching into new securities issued for expansion and into defense bonds. Analysis and the experience with the various capital-gains acts leads inevitably to concrete proposals for legislation. Such legislation should, and will, both provide much more revenue, and at the same time, liquefy the now frozen portfolios of investors.

I. FACTS

A. *Retreat of capitalism.*—For a generation or so, capitalism has been on the retreat.

1. *In railroads.*—Social, economic, and political forces have compelled the retreat of private capital in the railroad industry since the early 1900's. To talk of long-term capital gains in railroad securities is utterly unreal. Such gains as are now possible in the railroad fields are now short-term, either cyclical or technical.

2. *In utilities.*—Likewise, utility equities have been declining so that 1941 prices for many shares are less than the bottom of the bear market in 1932. For the electric and gas stocks as a whole, the price trend has been down since the passage of the Utility Act of 1935. The utility investor is fighting a rear-guard retreat. Capital gains in utility shares just do not exist except in the minds of theorists who ignore facts.

3. *In industry.*—Industrial shares are in a long-term bear market. If on any chart showing any stock price index, you connect the top of the booms of 1929 and of 1937, the line forms a declining roof for prices. This is the evidence of a long-term bear market. Never has this down trend been broken. Perhaps it indicates that the private investor is slowly being expropriated. There were long-term gains in industrial securities until the 1920's. Since 1929, social, economic, and political forces have destroyed the long-term gains in the industrial shares index and left only the intermediate fluctuations. Therefore, merely by doing nothing, the long-term "sitter" of the 1900's has become the great speculator of the last decade.

TABLE I.—*Market value at the month end of all stocks listed on the New York Stock Exchange*

[In billions of dollars]

Year	High	Low	Difference	Year	High	Low	Difference
1925	$33.7	$26.9	$6.8	1933	36.7	19.7	17.0
1926	37.3	32.3	5.0	1934	37.4	30.8	6.6
1927	48.5	38.4	10.1	1935	45.0	30.9	14.1
1928	66.1	48.5	17.6	1936	60.0	46.9	13.1
1929	89.7	63.6	26.1	1937	62.6	40.7	21.9
1930	76.1	53.3	22.8	1938	47.0	31.9	15.1
1931	57.1	31.1	26.0	1939	47.5	40.7	6.8
1932	27.8	15.6	12.2	1940	46.8	36.5	10.3

B. *What are the odds in the market?*—There is a popular tradition that people always lose money in the stock market. To support the general public impression, the United States Government can provide exact evidence. In a report, entitled "Million Dollar Incomes," covering the 20-year period, 1917–36, the facts are revealed. Presumably, people with incomes of $1,000,000 or over, have access to adequate statistical data, economic advice and inside information. The group (No. 2), whose capital gains were more than regular income, suffered from 1917–36 a decline in annual income from $7,300,000 to $4,600,000 and a correspondingly substantial decline in principal. The group (No. 3) that took capital gains showed $97,000,000 lost to $63,000,000 gained—odds of 3 to 2 against the market. This group of millionaires, undoubtedly well connected, probably had a better performance than the average small trader. Yet, the chances of loss are so high as to cut the ground under the whole theory of the capital-gains tax. The Congress should call upon the Treasury for information similar to the above for a few selected years for a large group of returns classified by groups.

C. *Big market fluctuations and small capital gains.*—The present capital-gains tax is undoubtedly ineffective as a revenue producer. One needs but to compare the total fluctuations on the New York Stock Exchange alone with the estimated taxes on capital gains and losses. Such a comparison shows that although the market does swing, the Treasury collects little capital-gains tax on these swings.

TABLE II.—*Relation of net capital gain and tax revenue therefrom to fluctuation in market value of all stocks listed on the New York Stock Exchange*

Year	Difference in value, top to bottom (in billions of dollars) (A)	Total net capital gain (in millions of dollars) (B)	Tax revenue received (in millions of dollars) (C)	Year	Difference in value, top to bottom (in billions of dollars) (A)	Total net capital gain (in millions of dollars) (B)	Tax revenue received (in millions of dollars) (C)
1926	5.0	2,378	225	1934	6.6	313	17
1927	10.1	2,895	297	1935	14.1	730	85
1928	17.6	4,808	576	1936	13.1	1,418	(1)
1929	26.1	4,685	421	1937	21.9	(1)	(1)
1930	22.8	1,193	15	1938	15.1	(1)	(1)
1931	26.0	472	89	1939	6.8	(1)	(1)
1932	12.2	163	80	1940	10.3	(1)	(1)
1933	17.0	553	16				

[1] Not available.

In 1926–27 the capital gains rates were 12½ percent for holdings of 2 years or more. In 1934–35 rates ranged up to 47.40 percent on capital gains of 2 to 5 years. Assuming the same ratio of Treasury revenue to total fluctuation as in the average of 1926–27, viz, 1.59 percent, the Treasury net revenue in 1934 and 1935 would have been not $102,000,000 but $550,000,000, an additional tax of about $225,000,000 per annum. The law in 1926–27 had a 2-year holding requirement. Without it, the Treasury could have had even more revenue.

TABLE III.—*Relation of net capital gains and taxes thereon to net differences in market value and to gross market fluctuation in value*

Year	Total net capital gain (million) (A)	Revenue from capital gain tax (million) (B)	Difference in value of all stocks on New York Stock Exchange—top to bottom (billion) (C)	Ratio of capital gain to difference in value B/C (D)	Estimated travel ratio (E)	Estimated total fluctuation (billion) (F)	Ratio tax revenue to fluctuations B/F (G)
				Percent			*Percent*
1926	2,378	225	5.0	4.50	3.08	15.4	1.46
1927	2.894	297	10.1	2.00	1.72	17.4	1.70
Average	2.636	261	7.5	3.47	2.19	16.4	1.59
1934	313	17	6.6	.26	3.66	24.2	.07
1935	731	85	14.1	.60	1.78	25.0	.34
Average	522	51	10.3	.49	2.40	24.8	.21

In rising markets 1927 and 1935 the fluctuations were few and the the net advance large. In prebull market years 1926 and 1934 the market fluctuations were many and the net advance little. A striking example of a small net advance in the Dow-Jones index of industrial share prices is the experience of the last 3 years. On April 1, 1938, it stood at 98.75. On May 1, 1941, it stood at 115. The net advance was 16.33 points, but in the interval of approximately 3 years this index fluctuated without any trend over a range of 340 points on the Dow-Jones average. If there were no time limit or holding period, the Treasury could have received abundant tax revenue on intervening capital gains in the 340 point fluctuations or travel but could receive very little on the 16-point net advance.

D. *History of legislation on capital-gains taxation.*—Congress has tried in the 11 revisions of the past 28 years, since the Revenue Act of 1913, to arrive at "a practical, intelligent, and just law" on capital-gains taxation. The receipts from this tax indicate that "such a basis has not yet been found." (Source: Vinson Report, Exhibit I, Historical Summary, pp. 83, 84, 85.) The broad principles of past revisions are clear. First, gains were included with other income and losses were not deductible (1913 law). Then losses were made deductible to the extent of gains (1916 law). Thereafter, losses were allowed in full against any income (1918 law). Subsequently, came the principle of segregation of short-term from long-term capital gains or losses (1921 law). The long-term gains were subject to a flat tax of 12½ percent. It wais during this period that the Treasury received huge income. In 1934, the law introduced the complicated holding period with about 40 rate classes graded by months up to 10 years. This period shows woefully small receipts from the tax. In 1938, the law set rates of 20 percent on capital gains exceeding 18 months and 15 percent on capital gains exceeding 2 years. Short-term gains under 18 months were taxed at graduated income-tax rates. The tax receipts have not been published for reasons unknown.

E. *Capital gains nonexistent.*—Over a generation, losses and gains so completely offset each other that net capital gains were insignificant (Senate hearings 1938, p. 245). For the period 1917–31, the net capital gain was less than 3 percent of the taxable income for the period. If the years of wild stock market rise, 1926–29, are excluded, as being unlikely ever to recur, then the net result is not a capital gain but a capital loss of about 0.03 percent of the average taxable income. The Treasury has not published a continuation of this table showing net gains, net losses, and differences by years since 1931. However, an analysis of the six reports, "Statistics of Income" published by the Treasury yearly shows that, for the years 1934–39, inclusive, the percentage of net capital gain after deducting net capital losses is only 0.92 of 1 percent of total taxable income for all taxpayers.

Nor has the Treasury, to my knowledge, published a complete history showing the net receipts from the capital gains tax as well as the loss in tax revenue through deductions for capital losses for the period 1917–41. The Congress should insist on having the facts before it in order to reach intelligent conclusions. Probably, if the years, 1931–40 were included, then the entire period, 1917–40, would show either insignificant net capital gains or a net capital loss. Certainly, it is very easy to take periods of 5 or 10 years within the period 1917–41, which show on balance a net loss to the taxpayer and also a net deficit of revenue to the Treasury, as the period 1918–23, inclusive, or the period, 1930–35 inclusive (Senate hearing on H. R. 9682, pp. 245 and 472). Capital losses in 1930–32 caused a reduction of $184,000,000 from the income-tax receipts which more than offset the $118,000,000 receipts from capital gains taxes in 1933–35 (Vinson report, p. 90).

A study of the facts concerning 1938 capital gains is revealing. Net long-term losses were $584,000,000. Net long-term gains were $266. The net loss was $318,000,000. The total net loss came from taxpayers with incomes under $50,000. Taxpayers with incomes over $50,000 had an excess of net capital gains. The present tax law apparently hits the little fellow rather than the big fellow (Statistics of Income for 1938, Treasury Department).

F. *Volume of tax revenue depends on rates inversely.*—An official report (Vinson report, p. 88) shows for the year 1926–36 that small taxpayers took short-term gains under the income-tax class because their income-tax rate was low. However, short-term gains realized by taxpayers and taxes thereon paid into the Treasury declined sharply as the income-tax rates rose. On the other hand, the tax rate was low on long-term capital gains. In 1934, over 70 percent of total capital gains were taken by groups with incomes above $100,000 in securities held more than 10 years and enjoing the lowest rate. The high income group realized heavily on such capital gains and provided large tax receipts for the Treasury. Obviously, low rates stimulated realization and tax payments to the Treasury.

Again in 1938, long-term net capital gains were taxed at a low flat rate. Incomes under $5,000 reported $30,000,000 in long-term net capital gains. Incomes over $1,000,000 reported $60,000,000, or 200 percent as much. However, short-term net capital gains were subject to the graduated income tax. Incomes under $5,000 reported

$45,000,000 short-term capital gains. Incomes over $1,000,000 reported, not 200 percent as much or $90,000,000, but only $175,000, or four-tenths of 1 percent as much. Had all taxpayers reported short-term gains as freely as the low-rate group. the Treasury would have had $250,000,000 more in sources subject to tax. The present capital gains tax is not a revenue-producing measure but a revenue-preventing measure.

Statistics of Income, 1938 (table IV, p. 10), shows that as a percentage of total income, short-term capital gains subject to graduated income-tax rates declined from 1.35 percent for the $25,000 income group to 0.16 percent for the incomes of one million or over. However, as a percentage of total income, the long-term capital gains subject to a low flat rose from 0.21 percent for the income under $5,000 to 56.40 percent for the incomes over a million dollars.

On the other hand, in 1937 securities were much higher and book profits or unrealized appreciation was large. But the rates were high, up to 47-plus percent being under the 1934 law. Therefore gains realized were small for groups subject to high income-tax rates. In 1938 a low flat rate of 20 percent and 15 percent was reintroduced on long-term capital gains and stimulated the taking of profit.

TABLE IV.—*Percentage of net capital gain to total income*

Income group	1937	1938	Income group	1937	1938
	Percent	*Percent*		*Percent*	*Percent*
Under $5,000	0.78	0.55	$150,000-$200,000	4.35	11.95
$5,000-$10,000	2.27	1.66	$300,000-$500,000	7.60	18.77
$10,000-$25,000	3.15	2.62	$500,000-$1,000,000	2.20	26.69
$25,000-$50,000	3.46	3.52	Over $1,000,000	6.50	56.40
$50,000-$100,000	3.88	4.88			
$100,000-$150,000	4.32	7.64	Total	1.78	7.65

Source: Statistics of Income: Treasury Department.

G. *Congressional report on millionaire incomes.*—A report of the Joint Congressional Committee on Taxation, entitled "Million Dollar Incomes," has tremendous significance for capital-gains tax legislation.

1. *Capital gains of big traders.*—This report shows what an illusion underlies the theory that capital gains represent capacity to pay. Group 2 consisted of market operators who derived more than 50 percent of their net income in the years 1926-29 from net capital gains. This group suffered a shrinkage of income from $7,300,000 to $4,600,000 from 1917 to 1936, and their capital shrank from $146,000,000 to $117,000,000 (p. 13).

Group 3, or inept speculators, of the million dollar incomes consists of individuals for whom also there is a complete record from 1917-36 of their capital gains and losses. For this group the net gains total $63,300,000 and the net losses $97,800,000. The experience of this group is probably characteristic of the great rank and file of stockholders whom the Treasury is taxing on illusory taxable gains (Million Dollar Incomes, p. 16). Apparently the "big boys" with inside information strikingly disprove the assumption that capital gains represent regular and consistent capacity to pay. Neither in the scientific laboratory nor in the field would such striking observations be ignored. Yet the

present capital-gains tax legislation is based on an assumption which not only has never been verified but strikingly contradicted in a Government document.

2. *Capital-gains rates versus capital gains realized.*—A study of the million dollar incomes clearly shows that when the rates of tax on capital gains are high, the percentage of net capital gains realized to total income is small. When the rates are low, the percentage of such net gains to total income is high. (See pp. 20, 30, 40.)

3. *Capital gains rates versus deduction for capital loss.*—This study of million-dollar incomes also furnishes interesting laboratory results concerning the effect of tax rates on realization of losses. For the total number of million-dollar incomes as well as for the three groups, investors, active traders, and inept traders, the same conclusion holds. Under low rates of tax on capital gains, deductions for net losses are low as a percentage of total income and under high rates the deductions are high (Million Dollar Incomes, p. 43). High tax rates evidently stimulate the taxpayer to charge off all losses possible (ibid., p. 6).

Senator DANAHER. May I ask a question. Now, the rate was the same in the low-tax period from 1925 to 1929 as it was in the low-tax period from 1930 to 1931, inclusive?

Mr. FRIEDMAN. Yes; tax deductions for capital losses varied.

Senator DANAHER. But the percentage in the former was 1.81.

Mr. FRIEDMAN. Yes; but we were in the midst of the most violent deflation in history in 1930 and 1931, but compare the losses deducted in that period of great deflation with the years 1932 to 1936, which was a period of recovery, but when the rate was high, and you will find that in the most violent deflation in history they deducted 49 percent, but in the sensational rise, 1932 to 1936, they deducted 56 percent.

Senator DANAHER. Well, you attribute the disparity to the period.

Mr. FRIEDMAN. I am not trying to get away from the evident fact; I am not trying to say that; no one with any common sense would say that.

Senator DANAHER. What I am trying to get at is there are other factors involved.

Mr. FRIEDMAN. Of course, nobody would say that was the sole factor, but if you take comparable periods the point which I have made here becomes evident.

4. *Capital gains rates versus capital gains tax-exempt income.*—When capital gains rates are high, there is a penalty on risk money. Then the percentage of income from tax-exempt securities rises. From 1917 to 1923, under high rates of tax on capital gains the percentage of total income derived from tax-exempt securities rose from practically zero to 12 percent. When the capital-gains tax is low the percentage of income from tax-exempt securities declines. Thus from 1924 to 1930, under a low rate of tax on capital gains, such tax-exempt income declined from 13 percent to 7 percent. By 1934, when rates were again high, the percentage of tax-exempt income rose to 26 percent. Apparently high capital-gains taxes push risk money into hiding. Of course, the lowering of the income surtaxes 1924–30 had an important bearing as well (p. 32). If capital-gains tax rates were fair, capital would venture out of the tax-exempt "storm cellar."

II. EFFECT ON TREASURY AND NATIONAL ECONOMY

A. *The capital-gains tax is still in the experimental stage.*—Certainly, the final stage of capital-gains taxation has not been reached. For this purpose, the Treasury will have to prepare much more complete data. Receipts from capital-gains tax will have to be segregated from income taxes in general. Losses in actual tax receipts from regular income arising from deductions under the capital-gains tax will have to be specified by years. A classification of Treasury receipts by income groups of capital gains will have to be correlated with the various laws. A study of the effect of capital-gains taxation on free flow of capital and on new risk enterprises can be traced only generally. Various Government reports indicate that the capital-gains tax methods "are arbitrary and inequitable." Members of the Joint Legislative Committee on Taxation of the House and Senate have likewise expressed their criticism. This brief will attempt to apply constructively such criticism to the current tax bill.

B. *Little revenue is now produced.*—Such revenue as the Treasury now obtains is fortuitous and not the result of any calculation. No Treasury official can possibly estimate receipts from short-term or long-term gains or estimate diminution in tax receipts resulting from capital losses deducted from income. But, in addition to this direct loss to the Treasury, the freezing of securities and the immobilization of new enterprise has, in the opinion of one expert, caused a loss of tax revenue to the Treasury of $250,000,000 (Senate hearing on H. R. 9682, p. 653). The present capital-gains tax is not a revenue-producing measure. It is a revenue-preventing measure. It is a fund-freezing order.

Senator Connally, in the hearings before the Senate Committee on Finance on the Revenue Act of 1938, pithily summed up the whole problem, "If the holder does not sell, you do not get any tax" (Senate hearing on H. R. 9682, p. 107). The Governments gets no revenue from capital gains if the sales do no take place. The rate of tax determines whether the sale will or will not take place. The capital-gains tax has now become insignificant compared with the revenue it might produce if the law were revised with the prime intent of securing maximum revenue (Senate hearing on H. R. 9682, table 1, p. 472). For example, table 5 of the Vinson report, page 86, shows that whereas net capital gain was about 9 percent of the total income in 1936 of all reporting taxpayers, the income of a million to one and one-half million showed only 1.9 percent, incomes $3,000,000 to $4,000,000 showed 1.6 percent, and incomes of $4,000,000 to $5,000,000 showed no percent. The capital-gains tax was paid, not by the rich groups but by the low-income groups. Rates can be so high as to be nonproductive. The Treasury suffers a direct loss when it discourages sales to cash in profits.

When the rates were low the percentage of tax on capital gains to total individual income-tax liability was relatively high, about 33.5 percent, in the period 1926–27, about 41 percent for 1926–29, and about 28 percent for 1926–32. (See Senate Finance Committee Report, 1938, p. 708) When the capital-gains rates were high, as in the period 1933–35, the percentage of estimated net tax on capital gains and losses to total individual income-tax liability was only about 7.7 percent.

The exact figures are not published since 1935, but Treasury officials estimate their figure was less than 5 percent in 1939 and 1940. It may be 1 percent—they will not say.

The higher the income of the group, the worse was the performance, insofar as Treasury receipts from capital-gains tax were concerned (Senate hearings on H. R. 9682, pp. 248 and 708).

C. *Price fluctuations are exaggerated.*—Because a high rate of tax on capital gains prevents sales, the market becomes artificial. The Government becomes a great manipulator. Without malicious intent, the Government creates instability which would be regarded as a social danger if created by any group of operators. Volume is reduced. Markets become thin. Selling near the peak of a boom is deterred for many unrealized gains are in the so-called short-term class, subject to high tax rates. A stable market is essential for new issues for expansion of private enterprise, or for selling United States defense bonds. The Treasury Statistics of Income for 1938 and for 1939 show that most of the short-term capital gains were taken by the groups with low incomes, under $5,000. Practically no short-term capital gains were taken in the top income groups. Here is an ideal condition for market instability. The market is without leadership. There can be no courageous buying in a break or prudent selling in a boom. It is a market dominated by a mob. And, therefore, in 1937, 1938, and 1940, the market has been characterized by hysterical market declines, worst in history up to then.

A good speculator should buy low and sell high. If he is successful, he performs a public service. He is optimistic in a break and pessimistic in a boom. There are too few of him. For this service to the public he should receive a reward. But the capital gains tax punishes him. Or it prevents him from exercising the function of stabilizer. The market is left to the lambs and the herdminded.

D. *The mischief of the 2-year holding period.*—Because the law fixes an arbitrary holding period of 18 months to 2 years before capital gains can enjoy the advantage of the lower rate of tax, markets are made even more unstable. In 1937 a speculator who took some profits in the spring on 2-year holdings was virtually compelled to sell in the autumn to register losses in new 2-year holdings to offset the earlier profits. If there were no fixed period, it would be possible for an investor to sell all of his holdings both over and under 2-year limit on the rise in 1936 and hold his cash until the market had declined substantially. No 2-year time limit would check sales. In this event, the investor would keep the profit and the Government obtain a tax. If the investor must hold for 18 months or 2 years, he loses his profit and the Government receives no tax. The 2-year period is a fund-freezing order and not a revenue producer.

Of course, the whole concept of a fixed holding period is artificial as various Government reports concede. High capital gains taken in 18 months plus 2 days pay 20 percent, and gains taken in 18 months minus 2 days might pay 75 percent. Such a law defies logic, ethics, or common sense.

E. *Inequities of current capital gains tax provisions.*—When the capital gains provisions were equitable and short-term gains were taxed at full income tax rates, then short-term losses were deductible at full income tax rates. Treasury receipts thus were reduced in

periods of deflation when Budget requirements increased. To obviate this difficulty, the law was changed so that short-term gains are regarded as income and are taxed as such, but short-term losses are not deductible from income. This was regarded as unfair in a Government report (Hill report, p. 35):

> While your subcommittee believes that the protection of the income-tax revenue necessitates a general adherence to the limitations upon the deduction of capital losses imposed by the Revenue Act of 1934, it recognizes the existence of a widespread feeling among taxpayers that it is inequitable and arbitrary to include capital net gains in the tax base for progressive income taxation while at the same time refusing to take account of capital net losses. The existence of this feeling among the body of taxpayers, whether or not entirely justified, is prejudicial to the maintenance of proper relations and necessary cooperation between the Government and its citizens in the administration of the revenue laws.

This defect could be obviated if all capital gains would be removed from the category of the graduated income tax without distinction of long or short periods of holding, as shown below.

F. *New ventures checked.*—Senator Connally pointed out in the hearings on the 1938 revenue bill that capital gains tax can check business. The official report of the Senate Committee on Finance states:

> Thus, an excessive tax on capital gains freezes transactions and prevents the free flow of capital into productive investment. The effect of the present system of taxing capital gains is to prevent any individual with substantial capital from investing in new enterprises. This is most unfortunate, because it adversely affects the employment situation (Senate Finance Committee Report, 1938, p. 6).
>
> The committee is convinced that at the present time transactions are prevented by the capital gains tax and that the result has been a material hindrance to business and a considerable loss of revenue (Senate Finance Committee Report, 1938, p. 6).

This defect has been recognized in preceding Government reports:

> The conclusion has been definitely arrived at that normal business transactions in respect to the sales of real estate, stocks, bonds, etc., will not occur under high surtaxes and that it is to the advantage of the Government from a revenue standpoint to give some relief on long-term gains. It has not been proven, of course, that our present system is the best obtainable (Hill report, 1933, p. 35).

Yet no substantial relief has yet been granted. This Congress has the power to carry into effect recommendations made in both the House and Senate committee reports of 1934 and 1938.

New small enterprise involves high risk. The failure to develop small- and medium-sized business may be partly due to the fact that capital has been so heavily penalized both through the high capital gains rates as well as from inability to make offset of capital loss that risky and potentially profitable businesses languish for lack of suitable backing. Risk capital comes from the few. But these are subject to the high rates applicable to short-term capital gains.

As a defense problem, what is most needed now is the development of mines producing defense minerals, and also residential housing in defense areas. Our defense program requires a modification of the capital gains tax provisions.

The deterring effect of a restrictive capital gains tax is felt particularly in those sections of the United States which have substantial resources. The South and West would benefit particularly from a practical revision.

Most important of all, the Treasury drive to sell defense bonds requires a mobile fluid capital market. The holding period in the capital gains tax tends to immobilize funds which could, should, and would go into Government bonds. The requirements of defense financing would justify a liberization of the capital gains tax law.

III. CAUSES, PARADOXES, AND ERRORS

A. *False concept of income.*—The basic causes of the difficulties of capital gains taxation is the fundamentally false concept of what constitutes income. There is no definition of income by any competent accountant which would justify the identification of capital gains with income. Value represents a capitalization of income. Differences in value depend on earnings and the appraisal of earnings and future prospects. This difference in value represents capital gain or loss, but obviously not income. For example, income may decline but it cannot go below zero. A case where an income can become minus is where the office boy pays the boss. Income is always there to be taxed. But capital gains may and very often have gone below zero, become a minus or capital loss. Another vital difference is that income can persist year after year. In fact, salaries do persist. Dividends persist, generally. But speculative gains do not.

The facts are clear. The Government report shows for 1917 an excess of capital gains over losses, but the next 5 years an excess of capital losses over capital gains (Senate Hearing on H. R. 9682, p. 245). Similarly, there was an excess of losses over capital gains for 1930, 1931, 1932. The years 1938, 1939, show an excess of long term capital losses over long term capital gains (Statistics of Income, 1938, p. 10, Statistics of Income, 1939, p. 20).

Again, there is clear evidence that over a period of 20 years net capital loss exceeded net capital gains for several groups of million-dollar incomes.

1. *Capital gain is not income.*—Capital gain represents a shift of assets between two persons. The income of the country is not increased or decreased because of the shift. When individuals' incomes rise the national income rises, but when some individuals gain on switching assets the national income is unaffected. Viewed as a whole, the Treasury's efforts to tax capital gains is fiscal rainbow chasing. The Treasury suffers from the same illusion that the American investment trust do. When prises rise and the portfolio increases in value, some trusts pay a dividend out of the increase. Then when prices fall, the portfolio shows a deficit, so that the dividend was really paid out of principal. In Great Britain, both the Treasury and investment trusts ignore capital gains. The British Treasury assumes that losses will offset gains. The British trusts put their realized gains into a reserve account to take care of expected losses, generally realized subsequently.

In this sense the tax on capital gains is not really income tax but a tax on capital—a capital levy—a sort of instalment upon an ultimate inheritance tax. This view is supported by court decisions. In the case of a trust fund, the capital gains may not be paid to beneficiary entitled to income and capital losses of trust fund may not be deducted from such income.

B. *Capital gains and inflation.*—The fictitious character of the capital-gains tax is indicated in two Government documents. Both show that capital gains may indicate not an increase in real value but only in monetary value.

In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value (Senate Finance Committee Report, 1934, p. 11).

A large part of our tax on capital gains is derived from the taxation of appreciation in money value as distinct from actual value. In other words, a large tax is derived from these provisions merely because of the reduced purchasing power of the dollar (Report, Capital Gains, p. 2).

The present trend toward inflation with the accompanying rise in the value of all assets makes it particularly important to reconsider the capital-gains tax. The present tax would be not a tax on enrichment but a tax on impoverishment. The experience of inflation of Europe has been that no assets rose as fast as the currency depreciated, except gold or gold currencies.

C. *Tax on capital gains is contingent, not absolute.*—The most unique and most significant characteristic of the capital-gains tax is that it is contingent. This view was clearly stated by Senator Connally.

It seems to me there is a differentiation between ordinary income and income from capital gains. In the case of ordinary income, the taxpayer has to pay it; he has no choice. But in the case of capital gains he has a choice; he does not have to realize unless he wants to. We will get that revenue on ordinary income but we will not get it from capital gains unless he realizes it (Senate Hearing on H. R. 9032, p. 702).

It is also stated effectively in the report of the Senate Committee on Finance—

There is an essential difference between income derived from salaries, wages, interest and rents and income derived from capital gains. It is always to the advantage of the taxpayer to receive the first class of income, no matter what the rate of tax as long as it is less than 100 percent. On the other hand, the tax in respect of capital gains is optional. The taxpayer is not obligated to pay any tax unless he realizes a gain by the sale of the asset. "There is no tax under existing law if a taxpayer transfers his money from one bank to another, but there may be a very heavy tax if he wishes to transfer his investment from a bond in one company to a bond in another company (Senate Finance Committee Report, 1938, p. 6)—

or if he exchanges two similar stocks like Westinghouse and General Electric or if he exchanges any security into a United States defense bond.

The report of the House Committee on Ways and Means on the same revenue bill likewise states:

It must be recognized that differences exist in the characteristics of ordinary income in comparison with the characteristics of income from capital gain. For example, no matter how high the rates, a taxpayer always benefits from an increase in salary. On the other hand, there is no tax on the appreciation in value of property unless such appreciation is realized through sale or exchange. Thus, it becomes optional with a taxpayer whether to pay a tax on capital gains since he avoids the tax by refraining from making the sale (House Ways and Means Committee Report, p. 7).

In capital gains, however, he decides whether or not to realize the gain. That decision is affected by the rate. The Treasury is not the boss. The taxpayer is. Generally, however, he decides unwisely. A Wall Street aphorism runs—

The taxpayer who bases his market decision upon a capital-gains tax payment generally ends up by not having any tax to pay.

But the Treasury suffers through the taxpayer's folly.

D. *Artificial distinctions—Speculation versus investment.*—Various Government documents emphasize the distinction between speculation and investment on the basis of the holding period. The Government assumes that securities are speculative if held for less than a certain period, say 1 year or 2 years. Securities become investments if held 1 day longer than that period.

Interestingly enough, the House report on the revenue laws of 1934 sensed the fallacy in the tax legislation.

> Your subcommittee recognizes that a classification based solely upon the period of holding is not an exact method for segregating speculative from investment transactions, but it appears to be the only practicable method and is believed to be a sufficiently fair criterion for practical purposes. (Vinson Report, p. 37).

Of course the time factor is artificial, irrelevant and irrational. A widow buying a Government bond and selling it in 2 months for some reason or other still is an investor. The financial backers of a prospect or a new mine are speculators even well after the 2-year period. The time factor is meaningless. The intent is decisive. The 2-year time limit has been meaningless. Look at the stock market charts. What 2-year period, except for the period March 1935–March 1937, can one find from 1929–41, which showed a continuing market rise? The world is plunging at the speed of an avalanche, but the investor is supposed to sit quietly for 2 years. The Treasury states that it is on a 24-hour basis but under the present capital gains tax the investor must be on a 2-year or 17,520-hour basis.

IV. RECOMMENDATIONS FOR LEGISLATION

The preceding study showing the defects of our capital gains tax legislation and the cost thereof leads inevitably to recommendations for legislation.

A. *Segregate capital gains and losses from regular income.*—Such segregation would increase revenue, improve the workability and raise the ethics of the law. Under such segregation no capital losses can be used to reduce the regular other income subject to the graduated tax. Great Britain levies no tax on capital gains and her tax receipts are more stable.

B. *Restrict offsets of losses to segregated gain.*—However, all capital losses could be offset completely and without limit against all capital gains.

C. *Set a rate to produce maximum revenue.*—Certainly a low flat tax on capital gains, regardless of the holding period or the time of realization, would produce revenue, because it would not discourage or prevent holders from selling when the price seems high and from buying when the price seems low.

Senator Connally stated with admirable frankness:

> I am coming around to the view that as to capital gains and losses we should make it more attractive to a man to sell instead of offering him a premium to hold.

What rate would produce most revenue? Obviously the lower the rate, the greater is the incentive to take a risk and the greater the revenue to the Government. Would it not, therefore, seem desirable to experiment for a period of 1 year with a new low flat rate, perhaps 10 percent? It will probably produce a higher revenue than ever before.

D. *Eliminate the holding period.*—The holding period is arbitrary, as congressional reports admit. It ties the hands of anyone who would buy or sell in anticipation of some unforeseen contingency like the coming of peace, the emergence of a crisis, economic, or political. It prevents the Treasury from getting revenue on fluctuations in the market lasting less than 18 months. Since 1929 the markets rose only once for 18 months consecutively. Of course, under the S. E. C., manipulation by pools would be prevented.

E. *Carry losses forward during one whole business cycle.*—The business cycle runs generally about 33 months. It should be satisfactory to have a carry-forward privilege of 2 years or at most of 3 years. The shorter period would benefit the Government revenue. Since the retreat of capitalism for a decade, net capital gains accrue only as a result of the business cycle, not of long-term trend. The carry-forward period should conform to the business cycle and not to any arbitrary period like a year.

F. *Tax gains of professional traders at income-tax rates.*—A professional market operator makes his living out of trading to catch capital gains. His business is to try to stabilize the market. Therefore his gains and losses come under the category of ordinary income. Traders or professional speculators whose annual income consists of accumulated capital gains should be taxed differently from the rest of the several million stockholders who trade infrequently, and with whom capital gains may be followed, and generally are followed, by capital loss for 2, 3, or 4 years, as in 1930 to 1933.

Certain administrative standards would have to be set up to classify professional traders and investors. Speculation might be defined in terms of margin purchases, as against outright purchases by investors. Frequency of transactions might be another standard. An investor might be limited to two turns in the market, in and out, per annum for his whole list. Intent would be the determining factor. Certainly, stock specialists, floor traders, arbitrageurs, etc., would be in the professional category. Appeals from a decision as to status of professional speculator or private investor could be made to a board of review representing Government officials, businessmen, accountants, and tax advisers.

G. *What data must the Treasury furnish for Congress?*—Statistics of the capital-gains receipts are merged in the record with the regular income tax. Congress is, therefore, in a position of a blindfolded boxer, hitting wild.

Since 1917 there have been a great number of variations in the capital-gains tax. We changed the holding period. We separated long- and short-term gains and losses. We permitted, prohibited, and then limited deduction of losses from gains, long-term and short-term. There is no clear record of what were the results of the various procedures. Imagine a physician changing treatments and not recording the results. We have changed the rates from 12½ percent up to the maximum income-tax rates and down to 15 percent, but no one has compared the effect on the volume of tax receipts. We have had carry-over of losses for varying periods. The data in the Treasury has not been studied or presented. There can be no intelligent legislation on the capital-gains tax until the facts are presented.

The Joint Congressional Committee on Taxation should insist on having for the entire period of capital-gains tax legislation 1913–40 adequate statistics to show the effect on the volume of revenue as several features of the law were changed. The Treasury should furnish the following data:

(*a*) Losses to the Treasury from deducting capital losses from regular income, 1917–40.

(*b*) Short-term capital gains, short-term capital losses, and net excess, 1917–40, showing the features of the legislation then effective with respect to rate, holding period, offsets, etc.

(*c*) Similar data on long-term capital gains and losses.

(*d*) Both the long-term and short-term gains and losses should be classified by income groups. This would show the effect of rising tax rates upon the volume of Treasury receipt from the various groups.

From the little data thus far available, the evidence is clear that the groups in the brackets of low income and low rates tend to pay relatively more to the Treasury on short-term capital gains than do high incomes and high rates as shown above.

V. BENEFITS

A revision of the capital-gains tax in the light of adequate statistics by the Treasury would have important benefits to the Treasury, to the general economy, and particularly to the defense program.

A. *Revenue from capital-gains tax would increase.*—Revenue from capital-gains tax would increase. A simple calculation will make it possible to estimate how much additional revenue the Treasury would receive if the short-term rates were lowered to the level of current long-term rates. Assuming that the amount of the short-term gains bears the same proportion to the long-term gains for all groups as for incomes under $5,000, or that the higher income brackets paid the same low rates on short-term gains as on long-term gains, the Treasury could tax in 1938 an additional source of over $250,000,000.

Furthermore, in 1938, capital losses of $584,000,000 were offset against regular income. The two items would increase total taxable source by over $830,000,000. This is not an insignificant item. Compare it with the trifling amounts received from the various excise and luxury taxes on which much time and effort is spent both in discussion and in administration. There are billions of dollars of long-term capital losses on shares bought from 1926 to 1930 lying in wait to "soak the income tax."

Lacking the foregoing statistics, which the Treasury should furnish, one can attempt to estimate de novo what a capital-gains tax should yield under the following conditions, viz: (*a*) no time limit on holding, (*b*) a low flat tax, say 10 to 15 percent on all gains, short term as well as long term, (*c*) segregate capital gains from regular income and allow no offset of caiptal losses against regular income, (*d*) carry forward of losses for 2 or 3 years. The value of all shares listed on the New York Stock Exchange fluctuates from lowest point to highest point, from about $10,000,000,000 to $20,000,000,000 per annum. As against this net change in value from top to bottom, the total fluctuations or "travel" would be about three to five times as great, say $30,000,000,000 in a dull year to $100,000,000,000 in an active year according to H. M. Gartley, market analyst.

If some fluctuations could be cashed in as profits or as capital gains, then on the basis of past experience the yield should range between $100,000,000, or 0.33 percent, in a quiet year, to $650,000,000, or 0.65 percent, in an active year, on so-called short-term gains within any year. These amounts are far higher than the Treasury has been receiving since 1929. To this would have to be added tax receipts on longer held securities.

B. *Other phases of national economy would benefit.*—Other phases of national economy would benefit. Capital now frozen would become mobile. New enterprises, particularly small business, would revive. New sources of Treasury revenue would be opened up. Not least, the receipts of the Federal and State Governments from stock transfer tax would double, and this would amount to about $18,000,000 for the Federal transfer tax and about $21,000,000 for New York State transfer taxes.

C. *The defense program strengthened.*—The defense program would be strengthened. Capital now locked up could go into the development of mining defense minerals, now languishing for lack of risk capital. Furthermore, investors' portfolios now frozen by the 2-year holding clause deter them from subscribing to Government defense bonds. Abolition of the holding period and a low capital-gains tax would make capital resources available for subscription to bonds for the financing of defense by negotiable bonds.

The evils of the present capital-gains tax are patent. The causes are clear. The foregoing analysis indicates the remedy. Congress should act.

TABLE V.—*Relation of tax rates to gain and loss realized*

[Net gains and losses from sales of assets realized by individuals with net incomes of over $1,000,000 in 1924 and whose aggregate net gain from the sale of assets in the years 1926 to 1929, inclusive, were more than 50 percent of their net incomes for those years]

Variations in capital gains tax rates and in profits			Percentage of net gains to total income	Percentage of net losses to total income
Period	Profit trend	Tax rate		
1917 to 1921	War period	High	0.89	24.39
1922 to 1924	Moderate profit	Moderate	47.96	13.06
1925 to 1929	High profit	Low	66.18	1.81
1930 to 1931	Falling profit	do	29.97	49.74
1932 to 1936	Recovery	High	10.50	50.21
Grand total			47.43	15.16

Note that high rates of tax on capital gains cause realization of small gains and large losses. Low rate of tax on capital gains cause realization of large gains and small losses.

Source: Million-dollar incomes, report to the Joint Committee on Internal Revenue Taxation, Washington, 1938 (pp. 40, 43).

TABLE VI.—*Relation of short-term gains taxed at high rates to long-term gains taxed at lower rates, and relation of gains to losses, by income groups*

[Net income classes and money figures in thousands of dollars]

Net income classes	Short-term capital gain, a	Long-term capital gain, b	Ratio percent, short term to long term, a/b, c	Net long-term capital loss, d	Net long-term balance, b−d +gain, −loss
(1)	(2)	(3)	(4)	(5)	(6)
Returns with net income:					
Under 5	45,824	30,335	151	151,209	−120,874
5 under 10	30,307	23,220	130	78,872	−55,846
10 under 25	30,674	32,641	91	90,120	−57,479
25 under 50	14,048	22,589	68	41,791	−19,202
Subtotal					−253,301
50 under 100	6,065	20,818	32	20,404	+414
100 under 150	2,119	11,731	18	4,866	+6,865
150 under 300	1,138	19,011	5.7	4,332	+15,579
300 under 500	231	15,702	1.5	1,034	+14,668
500 under 1,000	244	21,868	1.1	1,651	+20,217
1,000 and over	175	60,762	0.3	502	+60,260
Subtotal					+118,003
Total	131,425	259,582	50.6	394,781	−135,199
Returns with no net income	7,684	6,367		189,332	−182,965
Grand total	139,109	265,949		584,113	−318,164

Note that the higher the income and the income-tax rate applicable, the lower the short-term gain realized in relation to long-term gain realized. Note also that the high-income groups furnished tax revenue to the Treasury on $118,003,000 of gains realized, and the lower income groups actually diminished Treasury tax receipts by charging off losses of $436,166,000 against regular income.

Source: Statistics of Income for 1938, U. S. Treasury Department, table 4, individual returns, 1938, by net income classes; sources of income and deductions.

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STATEMENT OF HARRY M. RIGHTER, SULLIVAN, ILL., REPRESENTING EASY CIGARETTE MAKER CO.

The CHAIRMAN. Give your name, please.

Mr. RIGHTER. Harry M. Righter.

The CHAIRMAN. On which question in this tax bill are you appearing?

Mr. RIGHTER. Not anything put into the bill this year, but on the tax on papers. There are now three different tax rates on the iden-

tical commodity. That is the tax on the papers people use in making their own cigarettes, if cigarette papers are put in books of less than 25, they are tax-free; if put in books containing 50 papers, they are charged at the rate of one-half cent on each 50, and if made into tubes and put in packages like this, then the tax is one cent per 50.

Now, I am not interested in which rate is used, but it should be the same rate on all of them. What has happened is that the tobacco companies putting out these machines, like this [indicating] are evading taxes by putting duplicate numbers of these tax-free packages in tobacco package instead of putting in a single tax-paid book. What I would like to eliminate is the three different rates and make only one rate. The major amount of it is used in this particular package of tobacco here, and beginning in the year 1932—these are from the internal revenue figures, these figures jumped that year for the use of free booklets more than 100 times the previous year and in that same year the number of ready-roled cigarettes dropped about 13,000,000,000, so that the Treasury is not getting any income from these papers, and the major companies are able to avoid the tax by putting in a number of free booklets where they should, in my opinion, be putting in one book of tax-paid papers.

We manufacture these [indicating]. If we put 1 in a box, we pay 1 cent on each, whether 1 or 50. Now, what I wish to see is that they should all be taxed the same. If these free books were eliminated, the Treasury would receive about $5,000,000, and if on the rate we pay on this, $10,000,000, which at the present time is not coming into the Treasury but is being evaded by the use of a number of tax-free books instead of one tax-paid book.

I have here a number of figures taken from the Treasury on the amount, and as near as I can figure there is a 20-percent loss of number of paper, meaning that about 20 percent of papers received with tobacco are not used. Twenty-eight percent of all the cigarettes smoked last year were made by hand. Those are Treasury figures, and of that amount 73 percent used these tax-free papers. What I wish to say is that if they are going to have free papers at all I would like to have them all in the same category.

The CHAIRMAN. Do you know what the yield is on this?

Mr. RIGHTER. Yes.

The CHAIRMAN. How much is it?

Mr. RIGHTER. The tax-paid number here in 1940—the Treasury received $12,500, and if they hadn't allowed them to avoid the payment of the tax by having this in here, they would have gotten $5,000,000. If they had made them pay a tax on the papers from one up, they would have gotten something like $5,000,000; actually it was only about $12,000.

The CHAIRMAN. Your position is, if taxed at all, the tax should be uniform?

Mr. RIGHTER. Yes.

The CHAIRMAN. Any questions you wish to ask?

(No response.)

(The tabulation submitted by Mr. Righter is as follows:)

Cigarette papers and tubes withdrawn during the fiscal years as indicated

Fiscal year	Tax-free papers withdrawn			Tax-free papers at average 24 papers per package, book, or set	
	Domestic packages, books, or sets (1)	Imported packages, books, or sets (2)	Total packages, books, or sets (3)	Individual papers (4)	After deducting 20 percent for wastage (5)
	Number	*Number*	*Number*	*Number*	*Number*
1940	2,276,827,218	400,000	2,277,227,218	54,653,453,232	43,722,762,586
1939	2,160,304,855	1,040,000	2,161,404,855	51,873,716,520	41,498,974,000
1938	1,952,699,101	500,000	1,953,199,101	46,876,778,424	37,501,422,000
1937	2,711,851,987	800,000	2,712,351,987	65,096,519,688	52,077,216,000
1936	2,860,219,326	1,333,333	2,861,552,659	68,677,263,816	54,941,811,000
1935	2,684,926,917	2,482,499	2,687,409,416	64,497,825,984	51,598,261,000
1934	1,930,133,447	539,025,666	2,469,159,113	59,274,218,712	47,419,375,000
1933	1,458,496,429	457,074,483	1,915,570,912	45,973,701,888	36,778,962,000
1932	1,018,676,818	242,599,233	1,261,276,051	30,270,625,224	24,216,500,000
1931	112,462,049	99,030,432	211,492,481	5,075,819,544	4,060,656,000
1930	28,952,334	107,040,000	135,992,334	3,263,816,016	2,611,053,000
1929	127,069,562	188,948,000	316,017,562	7,584,421,488	6,067,537,190
1928	186,250,224	208,171,000	394,421,224	9,466,109,376	7,572,887,501
1927	219,323,959	288,048,320	507,372,279	12,176,934,696	9,741,547,757

Fiscal year	Tax-free papers at average 20 papers per package, book, or set		Papers tax-paid at 1 cent per 100	Tubes tax-paid at 2 cent per 100	Total papers and tubes (columns 7, 8, and 9)
	Individual papers (6)	After deducting 20 percent for wastage (7)	(8)	(9)	(10)
	Number	*Number*	*Number*	*Number*	*Number*
1940	45,544,544,360	36,435,635,488	12,522,524,000	137,486,800	49,095,646,288
1939	43,228,097,100	34,582,477,680	14,779,317,600	76,409,500	49,438,204,780
1938	39,063,982,020	31,251,185,616	11,706,029,800	58,359,100	43,015,574,516
1937	54,247,009,740	43,397,079,792	11,031,145,900	65,510,100	54,494,335,792
1936	57,231,053,180	45,784,842,544	12,689,509,800	64,662,200	58,539,014,544
1935	53,748,188,320	42,998,550,656	9,637,581,600	61,440,000	52,697,572,256
1934	49,395,182,260	39,516,145,808	9,576,945,800	77,262,900	49,170,354,508
1933	38,311,418,240	30,649,134,592	9,185,528,400	197,598,700	40,032,261,692
1932	25,225,521,020	20,180,416,816	16,452,419,500	276,576,650	36,909,412,966
1931	4,229,849,620	3,383,879,696	14,379,999,700	19,020,698	17,782,900,094
1930	2,719,846,680	2,175,877,344	13,205,761,200	15,998,000	15,397,636,544
1929	6,320,351,240	5,056,280,992	11,763,455,300	15,900,000	16,835,636,292
1928	7,888,424,480	6,310,739,584	11,179,987,700	29,055,250	17,519,782,534
1927	10,147,445,680	8,117,956,464	11,241,487,400	33,302,400	19,392,746,264

NOTE.—Taxes were first imposed on cigarette papers and tubes by sec. 404 of the Revenue Act of 1917. However, figures similar to the above are not available for the fiscal years 1917 to 1926, inclusive.
28 percent of all cigarettes were made by hand in 1940.
73 percent of all hand-made cigarettes used tax-free papers in 1940.

STATEMENT OF ALBERT J. HART, AMES, IOWA, ASSOCIATE PROFESSOR OF ECONOMICS, IOWA STATE COLLEGE

The CHAIRMAN. You may proceed.

Mr. HART. As you will observe from my address, I have come a thousand miles from Ames, Iowa, to appear before you today. The material which I have to present is a report made of a study involving several months' time of a number of economists at our institution. While I do not expect to require very much time, I shall not be able to avoid going into some statistical questions which are rather complicated and I suspect that both you and I could do more justice to the problem when we are fresh. Accordingly, I should like to ask to be heard tomorrow instead of this afternoon, if it suits the committee's convenience.

The CHAIRMAN. We have a full list of witnesses tomorrow. We would be very glad to have you file your brief for inclusion in the record if you care to, with such statement as you may care to make in the next few minutes, or if you prefer to take a chance on us running out of witnesses tomorrow and it is possible to do so, we shall be glad then to hear you. I cannot promise you anything definite. Proceed now, but we have a very few minutes.

You are talking about the effect of the tax on the spending power?

Mr. HART. What I am concerned about, sir——

The CHAIRMAN. You are not talking to any particular thing in this bill?

Mr. HART. Only in relation to the inflation problem, which you can see is a large subject.

The CHAIRMAN. Yes; we have some considerable number of people working on that now in other branches of the Government, but go ahead.

Mr. HART. I am handing an outline of my testimony in to the reporter for inclusion in the record. It also shows my professional training, position held by me, and other pertinent matter. May I ask that that be included in the record?

The CHAIRMAN. Yes; it will be.

(The outline of Mr. Hart's testimony is as follows:)

Name: Albert Gallord Hart.

Position: Associate professor of economics, Iowa State College, Ames, Iowa.

Professional training: Took A. B. in economics at Harvard, 1930. Took Ph. D. in economics at University of Chicago, 1936. In addition did graduate work abroad in 1930–31, 1934–35.

Professional positions held: Teaching assistant in economics, Chicago, 1932–34. Instructor in economics, Chicago, 1934–39. Economic analyst (on leave from Chicago), United States Treasury, summer 1934. Lecturer in economics (on leave from Chicago), University of California (Berkeley), autumn 1936. Director of research, Committee on Debt Adjustment, Twentieth Century Fund, 1937–38. Associate professor of economics, Iowa State, 1939 to date.

Publications: Economic Meaning of the Townsend Plan (pamphlet), Chicago, 1936. How the National Income Is Divided (pamphlet), Chicago, 1937. Debts and Recovery (report of Twentieth Century Fund), New York, 1938. Anticipations, Uncertainty and Dynamic Planning (monograph), Chicago, 1940. Economic Policy for Rearmament (pamphlet), Chicago, 1940. Coauthor, Paying for Defense, Philadelphia, August, 1941. Also articles, papers in symposia, etc.

Appearance: As representative of the group of 11 members of the economics staff of Iowa State College participating in the study of defense financing reported in Paying for Defense.

I. Importance of defense financing methods is not so much providing money for defense as steering incidental effects of defense into right channels:

(*a*) Under modern conditions, governments never run out of money because they can always borrow at banks.

(*b*) "Real costs" of war—use of manpower, materials, equipment to prepare and use arms rather than for peaceful production—are about the same in total amount however financing is done.

(*c*) Real costs must be shared somehow among the people. Public finance is chiefly a question of how they are shared.

(*d*) Any attempt to avoid sharing out the costs—i. e., to "let George do it" without deciding who is George—results in inflation.

II. Heavy tax increases are essential to block inflation:

(*a*) It is already agreed that our problem is no longer to forestall inflation—it has already broken out, and the problem is to set bounds to it. Pace may be seen in fig. 11 of book (p. 182).

(*b*) Inflation represents an increase of spending power without an increase of output to match it. It may be accentuated if speculation holds goods off the market; but this is not our trouble in most fields so far—witness the history of automobile-tire prices.

(*c*) Defense has reached the point of reducing our ability to put goods on the market for consumers, but is still boosting spending power.

(*d*) To drain off spending power is thus essential for blocking inflation. This means taxes, or loans with strong pressure to make nonbankers take them up (really taxes with promise of refunds).

(*e*) Inflation can in principle also be blocked by direct restrictions on people's spending (as in Germany). But there are no signs that such measures are being prepared.

(*f*) "Price control" as a remedy for inflation is a delusion and a snare if not backed up either by consumer rationing or by taxes. Its advocacy is a disguise of "business as usual"—it is another scheme for letting George do it without naming George.

III. The basic tax for draining off spending power should be a tax on personal income.

(*a*) Sales taxes or revenue excises (the only practical substitutes) fall most heavily on very low incomes. This results from the fact that a higher proportion of low incomes is spent. (See fig. 3 of book, p. 124.) The regressive effect is seen in figure 4 of book (p. 126).

(*b*) The amount of revenue needed is so great that raising it by a sales tax would call for rates of well over 10 percent at retail, so that this effect would happen on a large scale.

(*c*) Even token increases in the very low brackets can scarcely be justified in view of the existing heavy burdens shown by the Temporary National Economic Committee publication, Who Pays the Taxes (boiled down into fig. 2, p. 98 of book).

(*d*) Sales taxes are inefficient tools for combating inflation because they raise prices directly and because they are ineffective in reaching the upper-bracket spending on durable goods which is peculiarly dangerous.

IV. Besides the basic tax on personal incomes, however, we need others:

(*a*) To avoid discriminating in favor of undistributed profits, we must raise corporation rates along with personal rates.

(*b*) For reasons admirably summed up by Mr. Eccles in Fortune, we need heavy excess-profits taxes.

(*c*) Excises on goods which cannot be produced in full volume without hampering defense (as advocated by Mr. Henderson) are also essential.

(*d*) Corporation taxes must be kept in line with personal taxes; excess profits taxes and selective defense excises cannot be based primarily on revenue needs; so personal income taxes remain the basic tax, to be varied with defense requirements.

V. To make personal income tax effective calls for changing the income tax system:

(*a*) We need a much larger tax base, as may be seen from figure 6 of the book (p. 146), remembering that extra revenue needs may be $10,000,000,000 or more. This means a substantial lowering of exemptions—perhaps by half.

(*b*) We need prompt collection. Taxes are now collected about 13 months after taxed income is received; and this means that the effect on spending cannot be timed right. Prompt collection means partly taxation at the source, partly offering real incentives (not a mere 2-percent interest) for prompt payment in the upper brackets.

(*c*) These proposals do not conflict with the concern expressed above for the lower brackets. The added tax liability from lowering exemptions is in the middle-class brackets (see fig. 9 of the book, p. 158) and opportunity for installment payment at the source is a benefit to low-income taxpayers.

(*d*) These proposals are in line with those placed before the House Ways and Means Committee this spring by a group of 178 economists (77th Cong., Committee on Ways and Means, Hearings on Revenue Revision of 1941, revised, vol. I, pp. 360–367).

VI. If we hesitate to make tax measures drastic, it is "out of the frying pan into the fire":

(*a*) Tax collections are now at an all-time high; but so is the public's consumption.

(*b*) The effect of the pending tax bill on consumption spending will not be enough to set it back below prosperity levels; though physical production of consumers' goods will fall to depression levels in the field of metal and rubber products.

(c) To say that the public cannot stand taxes beyond the contemplated level is to say that the defense of democracy cannot be allowed to reduce consumption spending appreciably below its all-time peak, which is obvious nonsense.

Mr. HART. The group that I am representing consists of 11 members of the economics staff of Iowa State College, all of whom have spent a large part of their time in the study of defense financing for some months past. The report of our investigation was published yesterday by Blackiston Co. of Philadelphia under the title "Paying for defense." Through the courtesy of the Iowa Agricultural Experiment Station and the publisher I have had the first copies available sent here and am asking the clerk to hand one to each member of the committee. As you can see from the first part of the outline, our attitude is that the problem of defense financing is a problem of sharing defense burdens not merely a finding of money to pay for defense. Lack of money never stops war activities, and the mere provision of funds need not worry us.

What war really costs, whether or not the country in question is belligerent, is the use of manpower, materials, and equipment for military instead of civil purposes. Somebody has to go without the goods which these resources would otherwise have produced for civil consumption. No method of financing can prevent costs in defense from existing or can eliminate the problem of sharing out those costs among the people. Somebody in particular has to bear the cost. The question is whether to have a definite rule for sharing the cost or to involve ourselves in inflation. Inflation simply means that the people who do without consumption are the people who drop behind in the race to get increasing money incomes. Now, to the second point.

The need of heavier taxes, if we are to avoid inflation, is becoming acute. The problem is no longer to forestall inflation but to limit and control that which has already broken out. The seriousness of the situation may be seen from the diagram on page 182 of the book. The upper half of the diagram simply records the cost of living index for all the dates for which it has been quoted; the lower half shows charges in the index in percent per month. If you will look at the right-hand end of the lower curve you will see that the pace of the price advance the last few months has been much more rapid than in any we have experienced since 1920. This impression would be strengthened if we had been able to include July data in the diagram.

When inflation develops on consumers' markets, as it is doing now, this is evidence that consumers' spending power is outpacing the flow of goods on to the consumer markets. To check inflation in such circumstances involves either increasing the flow of goods or cutting down the flow of spending. The defense program puts it out of our power to increase output in many important directions and we have reached the point where some check on the increasing flow of spending power is essential.

There are some possibilities for checking spending without the use of taxes. It may be done by direct prohibitions on spending beyond a certain level in a country which has a well-organized rationing and price-control system. In fact, this is done in Germany, but we lack the machinery for such regulation and, for good reasons, American public

sentiment is not likely to favor setting up such machinery. There are also possibilities of draining off spending power by compulsory loans along the lines proposed by the English economist, J. M. Keynes. Devices of this sort are in use in England and in some of the dominions, but loans of this sort are in fact taxes coupled with a promise of an eventual partial refund. Essentially they are forms of taxation rather than substitutes for taxation.

Some hopes are held out that price control without either consumer rationing or taxation can block inflation. This notion, however, is a delusion and a snare; it is only fair to add that it is not a fair representation of the views of Mr. Henderson, who has often fought for drastic taxes to back up price control. Even if prices could be held down by such a program, which in the light of history is extremely doubtful, the problem of sharing the available goods among the public remains to be solved.

The third point is that the basic tax for draining off spending power should be a tax upon personal income. The principle of ability to pay excludes the use of sales taxes unless they are carefully limited to apply to commodities which are bought only by the more prosperous groups. This sort of taxation has been advocated before your committee—for instance, in the form of differential tax on the highest grades of clothing, and so forth, and in principle is entirely defensible. The British experience with the so-called purchases tax, which is of just this character, shows clearly that if exemptions are wide enough to protect the low-income people the tax base is destroyed. The goods consumed by people in the different income levels are so much alike that the goods which are not important articles of mass consumption are not important at all on the consumer markets.

The reason the general sales tax bears unfairly on low incomes may be seen at a glance in the diagram on page 124 of our book. Heights on the diagram represent amounts spent, and distances from left to right, amounts of income. It will be seen at once that the proportion of income spent decreases rapidly as we move up the income scale; at the $1,000 level everything is spent, at the $20,000-a-year level only about half.

On page 126 we show a resulting distribution of burdens in terms of percents of incomes. The three taxes represented in the diagram are calculated not to yield equal amounts of revenue but to reduce consumption spending by equal amounts, about 5 billion in each case. Since taxes on the upper income brackets reduce saving more and spending less than taxes on the lower income brackets, this reduction in the spending calls for about 10 billion of income tax and about seven and a half of sales tax, by our best estimates. I may say parenthetically, though, the details of these estimates are open to some question in view of the necessary round-about statistical methods used, but we have confidence that the general results are reliable.

Senator BARKLEY. Can you regulate inflation by taxation without hitting a lot of people they do not inflate?

Mr. HART. No, sir; I am afraid we cannot. In a sense, the people responsible for inflation are the people whose incomes are rising and, therefore, have more to spend.

Many of these people are so low in the income scale that I feel they should be excused entirely from paying defense taxes. If the man

with a large family gets his income up from $20 to $30 a week, I cannot see that that makes him a fit object for taxation. People whose incomes are not rising will surely feel it if we make income taxes heavier; that is, if their incomes are above the exemption level—and I am recommending much lower exemption levels. But, of course, either a sales tax on a necessary scale or rapid inflation would also be very unpleasant for the fixed-income people.

As you can see from our diagram on page 126, a sales tax to reduce spending by the amount in question would have to be a jumbo tax. In fact, we estimate that a general sales tax, to have this effect, would have to be about 16 percent at retail and a similar tax, exempting food, 28 percent; for a manufacturers' sales tax the rates would have to be higher. Taxes on this scale would take as much as 10 percent of income at the income levels in a range from, say, $500 up to $2,000 per year per family. In view of the existing heavy burdens on those classes, which are officially estimated to amount to more than 20 percent of income, taxes which will do this cannot be justified, even in the present emergency.

I wish to stress also that sales taxes are inefficient tools for reaching the consumption spending which is most important in raising prices. The goods of which we are short are very largely consumers' durable goods of types chiefly bought by the upper-income brackets. The lower-income brackets buy largely goods whose production can still be increased, like cigarettes and moving picture shows. Even taking a completely hard-boiled attitude about the relative claims of the more or less prosperous groups in the population, the necessity of taxing the people whose spending strikes the scarcest goods cannot be denied.

As the fourth point of the outline indicates, we do not wish to be understood as opposing a proper program of taxes other than income taxes. We see a great field for excess-profits taxes and agree with Mr. Henderson on the advisability of heavy excise taxes on goods which cannot be produced in volume without hampering defense. In this connection I should say that the House Ways and Means Committee appears to have made a great effort to eliminate proposed excise taxes not of this character. Mr. Henderson estimated that 85 percent of the originally proposed excise revenue was from items not competing with defense. Under the bill as it came to you from the House, 50 percent instead of 15 percent of the revenue can be defended on Mr. Henderson's grounds, and a large part of the residue is represented by taxes on the use of automobiles, which are correct in principle but incorrect in form.

Taxes which cut down the use of automobiles can economize labor, gasoline, transport, mechanical services, spare parts, and a lot of other things which compete with defense. The trouble with the proposed tax is that it doesn't tax the use of cars by the mile. Possibly a few cars will be left unregistered to avoid the tax; but once a car is registered the tax comes along and gives no inducement to reduce the mileage. From a standpoint of defense a revival of the proposed increase in gasoline taxes would be a more satisfactory substitute.

The CHAIRMAN. What about a combination of sales and income taxes?

Mr. HART. I should not be for it. On the other hand, selective taxes on commodities conflicting with defense do not seem to me to work like general sales taxes. They really apply to and belong in the class of specialized excess-profits taxes. We argued that question at some length, I might say, in chapter 13 of the book.

Besides excess-profits taxes and and excises along Mr. Henderson's lines, we believe in the desirability of raising a general corporation income tax in line with individual taxes, as is in fact the policy expressed by the pending bill, though we believe that the individual income tax must be made substantially higher for two reasons. In the first place, these other taxes used to legitimate limits will not drain off enough spending power to do the job of blocking inflation, in our judgment.

In the second place, it looks as if these taxes will not be used up to a legitimate limit and in that case personal income tax is certainly a very much better second choice than sales taxation.

As I point out, under the fifth head of the outline, the personal income tax will have to be reformed before we can really count on it to do the job of stopping inflation. There are two difficulties. In the first place, present exemption levels, provisions for deductions, and so forth, are so generous that a remarkably small proportion of the national income is actually subject to tax. We present on page 146 of the book a diagram which shows what becomes of the potential tax base. The lowering of exemptions recommended by the Treasury will be a long step toward the correction of this deficiency. We may find it necessary eventually to cut exemptions in half from the 1940 levels, though I should certainly recommend maintaining the credit for dependents at the present level.

The importance of prompt collection is perhaps less understood. In view of the very short time in which you are obliged to limit me, I should welcome an opportunity to insert in the record an admirable article by a leading English student of public finance, Mrs. Ursula K. Hicks. This article is a brief report of an extensive study of the history of war finance in a number of countries and shows conclusively that a slow-acting tax system is likely to fail in the pinches.

The CHAIRMAN. How long is it?

Mr. HART. Here it is [indicating volume].

The CHAIRMAN. We don't want to make it too long. If you can shorten it, we will be very glad to include it.

Mr. HART. Perhaps I can shorten it.

(The matter referred to follows:)

LAGS IN TAX COLLECTION—A NEGLECTED PROBLEM IN WAR FINANCE

One of the most striking features of the financial history of the last war was the universal failure of the belligerent governments to collect an adequate tax revenue during the actual period of the war. The worst case of all was that of Imperial Germany, where total tax revenue hardly kept pace with the normal peacetime needs of government and the whole of the war expenditure was financed by borrowing. More than two-thirds of the revenue received from the special war taxes was not collected until after the war was over and when the mark was rapidly depreciating.

The case of France was hardly better. In the early years of the war tax revenue actually fell as compared with the pre-war situation. Throughout the war period revenue barely sufficed to cover ordinary expenditure. Up to December 1919 the excess-profits tax had brought in no more than 1.4 milliard francs, although eventually something like 18 milliard francs was collected.

In America, where things might have been expected to be better, the collection of income and profits taxes was 25 percent in arrears in 1918, and the peak tax collection did not come until 1920.

In Great Britain the general fiscal situation was fairly well under control. Throughout the war period between 20 and 34 percent of total expenditure was annually financed out of revenue. But the problem of arrears was hardly less serious, especially in respect of E. P. D. In 1918 its arrears amounted to 164 pounds mn., by 1919 they had increased to 217 pounds mn. The maximum tax collection was realized in the financial year 1919–20, when the postwar boom was already showing signs of cracking.

For some of these failures obvious explanations suggest themselves. France and Germany both had quite inadequate revenue administrations, and in addition that in Germany was very inexperienced in direct taxes. But the charge of incompetence cannot be brought against the United States Bureau of Internal Revenue; and, in any case, the war strain in America was much less severe. British and American experience clearly demonstrates that the prompt and adequate collection of tax revenue during war conditions is a matter of no little difficulty.

Unless the lag in tax collection can be removed, it is clear that taxation, one of the most important instruments for the control of consumption in wartime, is really much less useful than it is generally held to be. This is a very serious matter. There is inevitably some rise in prices in war conditions, and partly as a consequence there is a very rapid rise in incomes, particularly during the early stages of expansion for war purposes. In these circumstances the tax currently collected, being only that appropriate to the old lower incomes and prices, can have only a relatively small effect. In respect to the old incomes it would no doubt be a heavy burden, but in respect of the new incomes it is not a heavy burden—not nearly so heavy as it is intended to be. Its power of controlling expenditure is inevitably disappointing.

It may be objected that taxpayers do not spend balances which they know will shortly be required to discharge tax liability. In normal times this is no doubt true. But when prices are rising there is a very strong temptation not to keep adequate liquid balances, since to finance even the existing scale of operations or consumption requires additional expenditure. To leave large sums in taxpayers' hands for a period of months is thus exposing them to a very grave temptation to spend their tax quotas. The fact that tax is collected not on current but on past income is indeed tantamount to giving taxpayers a loan out of public money from the moment when the incomes are earned to that at which the tax is paid. This is clearly the reverse of what is desirable. So far from taxation exercising an adequate control over consumption, the lag in collection may actually minister to inflation.

The first necessity of a wartime tax structure is, thus, that it should be capable of producing revenue quickly. This implies that weight must be put, in the first place, on taxes that have a naturally quick reaction; and in the second, on those which are easy to collect. New taxes are always slow taxes, whatever their inherent rate of reaction, because they require the setting up of new fiscal machinery. Special taxes of an emergency or temporary nature are usually abnormally difficult to collect, because they can more easily be evaded than permanent taxes. Germany's total failure in the last war can largely be ascribed to the fact that she tried to rely wholly on emergency taxes. The French taxes were of a more reliable nature—more akin to the British income tax than anything which had previously been attempted there. But for France they were new taxes, and the result was hardly better. The relative success of Britain was largely due to the fact that she already possessed an excellent income tax, of which it was possible to increase the rates fivefold, and also some very reliable indirect taxes.

With the experience of the last war in mind, we must now turn to examine the position of Great Britain in the spring of 1941.

Economic factors suggest that the most critical moment in the control of consumption in wartime is in the early stages of the expansion of government expenditure, when private incomes are being heavily increased as a result of the building up of the new industrial equipment required for armament production. Later the rate of increase may well be less hot.

If taxation can intervene effectively in this early period, especially before private budgeting has adjusted itself to the new incomes, then the problem of the control of expenditure is well on the way to being solved.

In 1914–16 the adaptation and expansion of British industry for war purposes was slow and long-drawn-out, owing to our great unpreparedness in 1914.

In 1940–41 it has been very much more rapid. The period of rapid acceleration started in the early summer of 1940, and in the spring of 1941 the pace is still quickening. The problem is therefore of much greater urgency and hence of greater difficulty than it was in 1915 and 1916.

It is widely realized and with some dismay that taxation should by now be playing a more effective part in controlling consumption than it is doing at present. It is consequently asserted that successive chancelors have neglected their duty by failing adequately to increase the tax burden. But in the presence of 100 percent E. P. T. a 5-percent tax on total profits where there is no excess, a 42-percent income tax on undistributed profits, coupled with a personal income tax which rises to over 85 percent on the largest incomes, and, in addition, a full schedule of indirect taxes, the charge of undertaxation does not look very plausible. We have, in fact, saddled ourselves with a tax burden the like of which has probably never been seen before. It is undoubtedly very much heavier than that imposed in any other free country at present. Even in Nazi Germany the maximum rate of personal income tax is only 65 percent—a quota we impose on a relatively moderate income of 12,000 pounds—and it is accompanied by an excess-profits tax which, on British standards, is little short of derisory.

It would thus appear that it is not so much the dimensions of the present British tax structure which are at fault, as that the lag in collection is too great. When we have examined the extent of this in the various taxes we shall be in a better position to suggest possible improvements or accelerations. With the time factor in view, it will also be pertinent to consider some proposals which have recently been made for the reform of the income tax.

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The smallest lag in collection is naturally that of the indirect taxes. The check on consumption is immediate. Income generated in 1940–41 and spent on taxed goods has already mainly reached the exchequer. This is the one good argument for the purchase tax, and in wartime it is a good argument, although in the British case the initial effect, at least, has been lost through anticipation, owing to the unconscionable time consumed in settling the details and establishing the machinery—the natural penalty of attempting to establish a new tax. But the customs and excise formed less than 40 percent of the estimates of tax revenue put forward by Sir Kingsley Wood in the last budget, of July 1940. And since many of the taxed articles are rationed, either directly to the consumer or at an earlier stage of production, demand cannot reach its normal proportions, so that even a high rate of tax can have only a small effect on personal budgeting. Moreover, most of the duties are specific. This means that tax receipts will not rise, with rising prices. Indeed, it is to be feared that they will fall, even in money terms. In real terms the burden of indirect taxes will grow progressively lighter unless the rates are repeatedly raised.

Of the direct taxes, E. P. T. has in theory at least the quickest reaction. It is assessable at the close of the firm's accounting period, and payment is due 1 month from assessment. In contrast to this, the income tax appears quite a slow tax. The slowest part of it is the surtax. Surtax on the incomes generated in 1940–41 will not be payable until January 1943, and as the inland revenue always points out, owing to the difficulty of assessment, collection cannot be considered complete until 6 years have elapsed. By 1947 our need for the control of consumption will probably be considerably less pressing. The amount of income tax which is thus lagged is by no means negligible. In the July estimate surtax represented 8 percent of total receipts from income and profit taxes.

Broadly speaking, income tax (in the narrow sense) has a lag of 1 year in collection, but this general statement conceals several important differences.

Under the new arrangement tax on wage and salary incomes is deducted from earnings as they are paid out. However, this does not eliminate the lag, since liability is assessed on previous and not on current income. For "manual workers" who are assessed half-yearly, the lag is relatively small. Tax on the first half of the financial year 1940–41 (up to October) began to be deducted from the wages of manual workers in January 1941, while other incomes in this category will not begin to pay tax on 1940–41 earnings until November 1941. The first installment of these will reach the exchequer the following month. By the end of the financial year 1941–42 the exchequer will have received five-twelfths of these 1940–41 incomes. Under the old arrangement of half-yearly payment

in January and July, it would have received the full half-year's tax by that time, but the additional lag is a small matter and has to be set against the convenience of more frequent receipt of revenue. It is important, however, that a lag of a year is the usual interval between receipt of income and tax payment in these categories (schedule E), since schedule E is now a very important part of income tax.

In the last normal year (1936–37) it accounted for more than 50 percent of taxable income. With the increase of remuneration, on the one hand, and the effect of E. P. T. in damping down profit incomes, on the other, its importance is considerably enhanced.

The remainder of the incomes generated in 1940–41 will be declared for tax in April 1941, but here again tax will also not begin to flow back into the exchequer until January 1942. Thus income receivers taxed under schedules A, B, and C, or deriving their incomes from the profits of private business, will also enjoy a considerable breathing space before they become taxable.

But these categories are all relatively unimportant. By far the most important part of the tax on schedule D incomes will have left the taxpayers' hands some little time before; rather, it will never have been in their hands at all, having either been deducted "at the source" from dividends and interest, or else have formed part of the profits tax on undistributed profits which is included in British income tax. This section of schedule D is thus capable of exercising a check on expenditure well in advance of any other part of income tax, with the possible exception of the manual workers' section of schedule E. Schedule D is a very important part of the income tax. In the last normal year it accounted for more than 30 percent of taxable income. As the tax on this section is all paid at the standard rate, at least, in the first instance, it is capable of exercising a much stronger check on expenditure than deductions under schedule E, which are made directly at the rate appropriate to each individual and hence usually at substantially less than the standard rate.

The effect of this curious timing of income-tax payments is to cause the tax on, by far, the greater part of the incomes generated in a particular period to reach the exchequer about the same time. Salaries and wages are distributed in advance of the accounts which determine profit incomes; service incomes (professional fees, etc.) are also realized immediately.

Tax is collected on these quick sources of income as soon as practicable but, owing to the standard rate device, it is actually possible to accelerate the collection of the tax on most profit incomes so that it is received in the same financial year as that on the quick categories. This acceleration is not possible in the case of direct-profit incomes from private businesses, which consequently enjoy a greater lag. On the other hand the half yearly assessment of manual workers' earnings enables that part of schedule E to be collected slightly in advance of the rest. A parallel practice is followed in respect of surtax except that, since the business of adjusting the additional quota is a troublesome one, an extra year all around is allowed. In the case of surtax the timing does not appear to depend on technical consideration to the same extent as in income tax. The synchronization may be a matter of policy or convenience.

It would appear that the established indirect taxes cannot be expected to play a greater part in the control of consumption than they are doing at present. The opposition encountered in introducing the purchase tax demonstrates the difficulty of extending their scope and, indeed, there are strong distributional arguments against attempting to do so. The main burden of the task of controlling expenditure must therefore fall on the direct taxes.

It is evident that the Treasury is placing great reliance on the effectiveness of 100 percent E. P. T. for this purpose. If there were a good prospect that E. P. T. would live up to its paper qualifications, this would be quite a plausible policy. The inconvenience of the lag in income-tax collection, and especially in the surtax end of it, would be completely surmounted, since there could be little if any expansion in the upper-income ranges. But it must be remembered that an excess-profits tax can exert no control at the most relevant and vital point—over wage and salary incomes. Especially with high rates of tax, its influence is rather in the opposite direction; and over profit incomes its effectiveness depends on the retention of the 100-percent rate, a policy which is certainly undesirable economically and may become politically difficult. Moreover, it is extremly doubtful if E. P. T. will prove as quick a tax as is hoped. The experience of E. P. D. is very ominous.

The fact that assessment to E. P. T. follows quickly after the declaration of profits does not mean that there may be a considerable lag between the earning of profits and their assessment. In wartime company accounts tend to get considerably delayed and assessments must wait upon them. An important cause of such delay is the difficulty of determining the sums due from various Government departments for war production undertaken. The delay is thus likely to be especially great in the case of those firms whose activities are most expanded and whose tax quota it is consequently most desirable to collect quickly.

Another cause of delay, common to both E. P. D. and E. P. T., is the necessity for the revision of past assessments in every accounting period in order to determine deficiency payments under the suspense accounting principle. This need not, however, impede the discharge of the greater part of current liability. But an additional trouble in the case of E. P. T. is that N. D. C. has always to be assessed as well.

For practical purposes E. P. T. must be considered a new tax. It does not build closely on the experience of E. P. D. The new bits of machinery will require time to settle down before they can be expected to run smoothly. In particular the applicability of the substituted standard to firms which were depressed before the war, and also the liability of interrelated companies, will both require a great deal of care and experiment. E. P. T. aims at being a more precise tax, which implies that its administration is more complicated—a further factor causing delay. A striking instance of this greater complication is the requirement that "average capital employed" must be calculated throughout the period of chargeability with all its ups and downs, instead of as formerly, merely taking the capital actually employed at some one convenient date.

Finally, excess-profits taxes suffer to a greater degree than personal-income taxes from the progressive illiquidity of taxpayers as prices rise. Firms have a greater temptation than individuals to raid their tax quotas in order to maintain existing output. There is no doubt that the enormous arrears of E. P. D. at the end of the last war were mainly due to this cause. In E. P. T. it so happens that the rates allowed for capital are themselves an inducement to firms to use their liquid balances, quite apart from price movements.

Administration difficulties will no doubt be greatest in the early days of the tax. But when these are considered, and also the fact that most of the tax being collected now and for some time to come will only have been assessed at the 60-percent rate current from 1939–40, it becomes very doubtful how much control E. P. T. can exercise in the critical period of expansion. The other difficulties of assessment and collection will tend to increase with the passage of time. The cumulative arrears of E. P. D. are not at all difficult to account for. If there is a danger of E. P. T., thus proving a broken reed, a heavy responsibility for the control of expenditure falls upon income tax, and specially on that part of it which, being assessed at the standard rate, has an exceptionally short lag in collection. It will be useful to examine the mechanism of this method of assessment a little more closely.

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In addition to raising the standard rate, it would certainly be desirable to consider whether further means of accelerating income-tax payments could not be discovered. Of all the lags, that on surtax is the most considerable. In practice, this is not quite so serious as it looks, since the rate to which the income of a particular year will be liable can be announced after the income has been returned, but before the tax is due for payment. Still, the delay is bad enough. It would introduce some acceleration in the collection of surtax if the practice of lagging "quick" income sources, so as to coincide with the taxation of "slow" sources, were abandoned at least for the duration. There would seem to be no important distributional objections to such a course.

An acceleration of the collection of income tax on wages, salaries, and professional fees would be more effective in controlling consumption. In the straits of the depression we were not chary of resorting to the dodge of exacting tax a quarter in advance of normal practice. There was but a poor economic argument for it then, but there would be a strong one now. Further, while it would be difficult and perhaps administratively impossible to make final assessments for wage and salary deductions on current incomes, it would at least be possible to make a provisional assessment to be collected exceptionally this year, along with the normal quota on last year's income. The additional quota could be set off against future liability. If necessary, a small discount would gild the pill of double deduction. This would be a particularly useful device in the period of rapid expansion, and need only be continued as long as seemed desirable.

It would also be extremely useful in new inducements could be provided for the prompt—or better still the pre—payment of E. P. T. In the last war prepayment of E. P. D. was encouraged by a bonus, but it was too small to be an adequate deterrent to reinvestment. Too large a bonus, on the other hand, would lead to an unnecessary sacrifice of revenue. A way out might be found by an adaptation of the Nazi device of tax certificates. Compulsory investment in war loan would be enforced, the scrip serving for the discharge of future tax liability of the firm. The (low) rate of interest would serve as a small bonus on prepayment.

The certificates should of course be issued only against estimated future tax liability, and not used as a means of attracting funds in general, as they have been in Germany. Collection of E. P. T. might also be speeded up if a preliminary assessment were made actually on the published balance sheet, without waiting for books to be investigated. For the problem of taxpayers' illiquidity another German device might be found useful.

In the last war a portion of the current profits of German firms was blocked on declaration. The amount was sufficient to cover estimated liability at the highest (marginal) rate of excess-profits tax, so that it was considerably greater than true liability. Ample liquid funds for tax payment were thus assured.

With the rates of income tax, surtax, and E. P. T. now in force it would hardly be extravagant to estimate that a third of the additional incomes generated in 1940–41 will sooner or later flow back to the exchequer. If inflation continues the proportion which will do so will tend to rise, it thus appears that the danger of disastrous inflation is very largely due to lags in tax control of consumption and further increases in tax rates will no doubt be necessary. But the more collection can be accelerated the less drastic these will need to be, and the less trouble we shall have in getting back to normal when the war is over.

The CHAIRMAN. Did your committee give any consideration to the imposition of a tax from any and every source derived?

Mr. HART. Yes; that is exactly what we are proposing if I am right in understanding you to feel that the exemptions should be allowed at the source in taxing wages and salaries. We don't recommend allowing exemptions in taxing interest and dividend payments because the incomes into which these payments flow are characteristically large enough to go into the upper surtax brackets, or bound up with salaried incomes on which exemptions would be allowed, or derived from such scattered sources that if exemptions were allowed at their source no tax would be paid.

Taxes of very much the character you ask about are in operation in British Columbia (1931), in Germany (since long before Hitler), in the Dominion of Canada (since 1939), and now in England. A successful tax at the source without exemption at a low rate is levied by the city of Philadelphia. The administrative experience gathered under these taxes, combined with that of our own social-security taxes, should make it a comparatively simple matter to tie in source-collected taxes with our existing income-tax system.

The CHAIRMAN. That gives you a quick tax withheld on all items of income.

Mr. HART. That is exactly what we are advocating, a tax of that character integrated with the income tax to be a basic means of collecting revenue.

The CHAIRMAN. The time the committee has set for recessing has arrived, and you will have to supplement your presentation by either filing a brief or appearing again in the morning, but I cannot say you will have an opportunity tomorrow. We have a very heavy schedule.

Mr. HART. I should like to ask permission to be heard on the special point of prompt collection of income taxes.

The CHAIRMAN. I cannot promise it at this time.

(Mr. Hart submitted additional material for the record, as follows:)

Effect on taxable income of families of lowering exemptions, assuming $90,000,000,000 national income and allowing no earned-income credit [1]

A. FAMILIES TAXABLE UNDER 1940 LAW

[In millions of dollars]

Family income bracket	Aggregate net income	Aggregate exemption (1940 law)		Aggregate amount taxable under—				
		Head-of-family exemption at $2,000	Credit for dependents at $400 per dependent	Exemption $2,000, credit $400	Exemption $1,500, credit $300	Exemption $1,000, credit $200	Exemption $1,500, credit $400 [2]	Exemption $1,000, credit $400
Over $4,200	$16,488	$4,924	$1,989	$9,576	$11,304	$13,030	$10,807	$12,038
B. ADDITIONAL FAMILIES TAXABLE UNDER $1,500 HEAD-OF-FAMILY EXEMPTION								
$3,500 to $4,200	$3,541	$2,721	$1,088	.....	$685	$1,637	$413	$1,093
$3,150 to $3,500	2,446	2,161	804	.....	223	964	22	562
$3,150 to $4,200	5,987	4,882	1,892	.....	908	2,601	435	1,655
All taxable at this exemption: over $3,150	22,475	9,806	3,831	$9,576	12,212	15,631	11,242	13,693
C. ADDITIONAL FAMILIES TAXABLE AT $1,000 HEAD-OF-FAMILY EXEMPTION WITH $400 CREDIT FOR DEPENDENTS								
$2,800 to $3,150	$2,958	$2,942	$1,112	.....	.....	$930	.....	$374
All taxable at this exemption: over $2,800	25,433	12,748	4,993	$9,576	$12,212	16,561	$11,242	14,067
D. ADDITIONAL FAMILIES TAXABLE AT $1,000 HEAD-OF-FAMILY EXEMPTION WITH CREDIT FOR DEPENDENTS REDUCED TO $200 PER DEPENDENT								
$2,450 to $2,800	$3,407	$3,927	$1,453	.....	.....	$717	.....	.....
$2,100 to $2,450	3,672	4,851	1,805	.....	.....	344	.....	.....
$2,100 to $2,800	7,079	8,778	3,258	.....	.....	1,061	.....	.....
All taxable at this exemption: over $2,100	33,512	21,526	8,251	$9,576	$12,212	17,622	$11,242	$14,067

[1] From Iowa State College study of defense financing; derived from statistics of National Resources Planning Board and U. S. Bureau of Internal Revenue.
[2] System now recommended by the Treasury.

Effect on taxable income of single individuals of lowering exemptions, assuming $80,000,000,000 national income and allowing no earned income credit [1]

[In millions of dollars]

A. INDIVIDUALS TAXABLE UNDER 1940 LAW

Individual income bracketed	Aggregate net income	Aggregate exemption under 1940 law (at $800)	Aggregate amount taxable in exemption			
			$800	$750 [2]	$600	$400
Over $1,050	[3] $10,433	[3] $4,599	5,834	6,122	6,984	8,134

B. ADDITIONAL INDIVIDUALS TAXABLE UNDER $600 AND $400 EXEMPTIONS

$700 to $1,050	[3] $1,329	[3] $1,631	0	0	104	512
All taxable at lower exemptions: Over $700	[3] 11,762	[3] 6,233	5,834	6,122	7,088	8,646

[1] From Iowa State College study of defense financing; based on statistics of National Resources Planning Board and U. S. Bureau of Internal Revenue.

[2] System now recommended by the Treasury.

[3] These figures are very unreliable on account of the large size of the income brackets relative to the exemptions in question. But the amount taxable, depending on differences between these figures, is much more reliable. The reason is that exclusion of a large number of individual whose exemption and net income are nearly equal has little effect on the excess of aggregate net income over aggregate exemptions.

Under 1940 exemptions, most of the individuals in the bracket just above $1,050 are taxable, and a few below. Under the $750 exemption, more below $1,050 become taxable. Under the $600 exemption, most of the $700 $1,050 people are taxable, but few of the people below $700. Under the $400 exemption virtually all over $700 are taxable, and many in the $350-$700 bracket; but on the average those in this bracket are not taxable.

[4] Note that brackets represent not net income but a concept of "total income" including deductions, noncash income, and items not reported, which is considerably larger (on the average perhaps one-third larger) than net income.

Taxation of Small Incomes and Collection-at-Source (With Special Emphasis on American Administrative Experience)

By Walter W. Heller, University of Wisconsin

[Note.—This report is based largely on the writer's field investigation of the income-tax administrations of 34 States, the Federal Government, the Dominion of Canada, and 2 Canadian Provinces. The field work was made possible by a fellowship grant from the Social Science Research Council]

Introduction

America's great defense need is revenue now! Correlated with that need is an increasing pressure for curtailment of civilian consumption to permit the maximum war-essential productive effort. The most equitable means of providing the fiscal grease for the wheels of production is a net income tax. It fits the canons of taxation according to ability; it is the least capricious method of controlling consumption. But to meet redoubled emergency demands, taxation as usual is no more realistic than business as usual. The income tax must strike virtually the entire income scale to accomplish its objectives and to ward off more onerous revenue and control measures. Lower-bracket taxation—lower and heavier than the Federal Government has yet been obliged to apply—seems inevitable.

Authorities agree that the question of administration becomes crucial in the downward extension of income taxes. If administration breaks down or becomes so costly as to absorb much of the incremental revenue, the cause is lost. Vital to the problem, then, is the administrative feasibility of taxing small incomes.

What light does previous experience in the taxation of small incomes and in collecting taxes at source throw on the administrative problem? Foreign experience in Britain, in Germany, in almost every European country—is extensive, and much can be gained from it.[1] But more can be gained from experience on our own continent with the same raw materials of taxation that tax programs now under consideration must utilize. And such experience is not lacking. "Grass roots" experiments in lower-bracket taxation have been carried on in a number of our State income-tax laboratories. Even more important, the most reliable administrative weapon thus far developed for taxing small incomes; namely, collection at the source, has been employed by several North American jurisdictions. These domestic experiences and precedents demand attention and evaluation, for they bear directly on the problem at hand.

Accordingly, this report will briefly compare State and Federal income-tax coverage, review State administrative experience in lower-bracket taxation, and examine in more detail the techniques and results of collection at source as practiced in the Dominion of Canada, in British Columbia, in Philadelphia, and, for nonresidents, in New York State.

A COMPARISON OF STATE AND FEDERAL INDIVIDUAL INCOME-TAX COVERAGE

Precedent for downward extension of income taxes, even below the present Federal exemptions, can be found in a number of income-tax States. Reference to table 1 reveals that prior to the 1940 reduction in Federal exemptions, 20 States had lower personal exemptions for married persons, 8 for single persons, and 18 for dependents. In a sense, these States had prepared the way for extension of Federal coverage. Even now, there remain a number of States whose income-tax laws are doing the spadework for reduced Federal exemptions. Thus, exemptions for single persons are still below the Federal in Idaho, $700; Kansas, $750; North Dakota, $500; South Dakota, $600; and Utah, $600. For married persons, ten States provide a lower exemption than the Federal; the lowest is in South Dakota, $1,100; followed closely by Utah, $1,200; then Idaho, Iowa, Kansas, North Dakota, and Oregon, $1,500; Wisconsin, $1,600; Oklahoma, $1,700; and South Carolina, $1,800. Since the Federal credit of $400 for dependents was not changed, 18 States still have smaller credits than the Federal. Clearly, further reductions in Federal exemptions would be no great novelty in those States which have already tapped the very low brackets.

Moreover, exemptions are not the whole preparedness story, for establishment of the filing habit, which may or may not be related to exemptions, depending on the terms of a State's filing requirements, is also an important trail blazer for the lowered exemptions that may follow. Table 1 compares the number of State and Federal 1938 individual returns filed in each income-tax State during 1939. This was prior to the enactment of the lowered Federal limits, but even if these result in an expansion of 50 or 75 percent in Federal filing, the increase will not be great enough to wipe out the numerical superiority of State filing in a number of States. Thus the filing requirements of Delaware, Idaho, Iowa, Kansas, North Dakota, Oregon, South Dakota, Utah, Vermont, and Wisconsin have been sufficiently broad-gaged to elicit at least twice as many State as Federal returns. Oklahoma's figure almost doubles the Federal, and several other States have also had substantial margins in the volume of filing. The application of increases in Federal coverage is obviously facilitated in certain areas by the preexistence of broad State coverage.

STATE ADMINISTRATIVE EXPERIENCE IN TAXING SMALL INCOMES

Several States which have dipped into the lower-income brackets shed valuable light on the administrative feasibility of taxing small incomes. Such States as Delaware, Iowa, Kansas, North Dakota, Oregon, South Dakota, Utah, and Wisconsin have applied taxes to incomes sufficiently far down the income scale to raise most of the problems that must be faced in administering taxes on small incomes. The discussion in this section will highlight those State experiences which are pertinent to the administrative problems involved in broadening the Federal base.

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[1] For a discussion of German, British, and Australian experiences in taxing small incomes, see Paul J. Strayer, The Taxation of Small Incomes, New York, 1939, ch. 6.

TABLE 1.—*Comparison of Federal and State individual income tax coverage*

State	1940 exemptions in terms of income			Number 1938 returns filed in 1939		
				State		Federal total
	Single	Married	Dependents	Taxable	Total	
(Federal 1940)	$1,000	$2,500	$400			
(Federal 1941)	800	2,000	400			
Alabama	1,500	3,000	300	[1] 20,000	[1] 31,000	39,885
Arizona [2]	1,000	2,000	400	[1] 24,000	[1] 32,000	21,092
Arkansas	1,500	2,500	400	[1] 6,000	[1] 6,700	20,226
California	1,000	2,500	400	342,178	493,728	538,186
Colorado [3]	1,000	2,500	400	44,152	58,026	43,131
Delaware [4]	1,000	2,000	200	17,283	[5] 85,494	17,246
District of Columbia	1,000	2,500	400	76,462	[7] 100,816	114,445
Georgia	1,000	2,500	400	[1] 32,000	[1] 52,000	50,295
Idaho	700	1,500	200	24,842	34,772	13,601
Iowa [3]	1,000	1,500	500	89,620	170,320	77,206
Kansas	750	1,500	200	[1] 70,000	[5] 108,625	53,865
Kentucky	1,000	2,500	400	27,000	[5] 40,000	54,431
Louisiana	1,000	2,500	400	40,000	62,000	60,168
Maryland	1,000	2,000	400	[1] 85,000	[1] [5] 165,000	137,104
Massachusetts [3]	2,000	2,500	250	238,223	420,330	307,403
Minnesota [3]	1,000	2,000	500	84,960	136,950	109,841
Mississippi	1,000	2,500	400	[1] 9,000	[1] [5] 13,000	20,612
Missouri	1,000	2,000	200	[1] 125,000	[1] 150,000	147,150
Montana	1,000	2,000	300	24,717	38,235	28,453
New Hampshire [3]	(200)	(200)		8,800	[1] 18,000	21,563
New Mexico	1,500	2,500	200	[1] 8,000	[5] 11,318	14,118
New York	1,000	2,500	400	681,056	998,050	1,082,965
North Carolina	1,000	2,000	200	[1] 42,000	[1] 70,000	51,324
North Dakota	600	1,500	200	17,058	25,338	11,849
Oklahoma	850	1,700	300	51,235	[5] 91,488	57,599
Oregon [3]	800	1,500	300	85,802	137,395	54,924
South Carolina [3]	1,000	1,800	200	25,850	[5] 39,102	24,567
South Dakota [3]	600	1,100	200	[1] 34,000	[1] 50,000	12,105
Tennessee [3]					21,698	58,788
Utah	600	1,200	300		65,031	19,991
Vermont [3]	1,000	2,000	250	[1] 17,000	[1] 37,500	13,822
Virginia	1,000	2,000	200	47,401	[1] [5] 63,000	73,522
West Virginia	1,000	2,000	300		[1] 75,000	57,710
Wisconsin	800	1,600	400	207,532	535,216	149,884

[1] Indicates estimate made by State income-tax officials.
[2] Exemptions in form of offsets against tax. Income equivalent in lowest tax brackets is given in table.
[3] Has special provisions for taxing income from intangible property.
[4] Has universal-filing requirement.
[5] Tax is only on income from intangible property.
[6] Figure shown is number of 1937 returns filed in 1938.
[7] Figure shown is number of 1939 returns filed in 1940. The 1939 figures are given for the District of Columbia, Maryland, and Mississippi because the exemptions listed for them were not in force during the filing of 1938 returns.

Source: State exemptions: As listed on income-tax-return forms used for 1940 filing on 1939 incomes. Number of State returns filed: Figures furnished by State officials or taken from State tax reports. Number of Federal returns filed: Figures taken from table 1, Treasury Department press release (Aug. 7, 1940) on Statistics of Income for 1938, pt. I.

Delaware

Delaware's experience is unique and significant, because (1) it involves the superimposing of an extremely low-bracket county tax on a State tax which had been in operation for years, and (2) the tax was so set up that various phases and effects of this excursion into the low-income field can be isolated and appraised.

Delaware, then as now, provided exemptions of $2,000 for married persons, $1,000 for single persons, and $200 for dependents. Rates were 1 percent on the first $3,000 of net taxable income, 2 percent on the next $7,000, and 3 percent on all income over $10,000. A return was required of every Delaware resident 21 years of age or over. This universal filing requirement was an important factor in setting the stage for the introduction of the New Castle County tax in 1934. In response to pressing demands for relief funds in that county, the Delaware Legislature enacted a 2-year county tax, applicable to

1934 and 1935 incomes, strictly paralleling the State tax except in exemptions and rates. The county tax was to be administered as part of the State tax. Rates were to be set according to relief needs (but not to exceed the State rates) by the levy court of New Castle County, while exemptions were fixed at $100 for dependents, $1,000 for married persons or heads of families, and nothing for single persons. Fortunately for those who would evaluate the Delaware experience in small-income taxation, the levy court chose for the income year 1934 to impose rates identical to those of the State, thus permitting isolation of the effects of the drastically reduced exemptions.

New Castle County, which includes the city of Wilmington, regularly produces over 95 percent of the Delaware State income-tax revenue, the other two counties contributing less than 5 percent. In other words, although the Delaware low-bracket tax experiment was limited to one of its three counties, that county contains the great bulk of the State tax base. Of the census-estimated Delaware population of 250,000 in 1936, approximately 170,000 resided in New Castle County.

The New Castle County tax on 1934 incomes produced a total revenue of $960,782, while the Delaware State tax at identical rates but higher exemptions produced only $779,898 in New Castle County for the same period.[5] The incremental revenue realized from the lowered exemptions (zero, $1,000, and $100) thus amounted to $180,884, or 23.2 percent more than the amount realized in this county by the State under its exemptions of $1,000, $2,000, and $200. This increase was achieved in spite of the very heavy concentration of Delaware taxable income in the upper brackets, and hence in the hands of relatively few individuals.

Given the same total income, a lowering of exemptions clearly brings far more income into the tax base if the income is concentrated in the low rather than in the high brackets.[6] On 1935 incomes, at rates reduced to one-fourth, one-half, and three-fourths of 1 percent, respectively, on the three income brackets, the New Castle County tax produced $245,463.

The Delaware experience also yields some approximate cost figures. A separate county expense fund was set up to finance the New Castle County tax. Costs were allocated to this fund, apparently on the basis of the increment that could be attributed to the addition of the county tax. The figure thus arrived at was $21,676 for the fiscal year ended October 31, 1935.[7] Expressed as a percentage of the total revenue realized on 1934 incomes under the county income tax, this is a cost of administration of but 2.3 percent. This cannot properly be accepted as the cost of applying the tax to low incomes, however, since less than one-fifth of the total yield came from the decrease in exemptions. But even if the entire cost of the New Castle County tax is allocated solely to the revenue increment realized by the $1,000 reduction in personal exemptions, the percentage cost of collections is shown to be only 12 percent. It is safe to assume that at least $5,000 (and probably much more) of the $21,676 would have been expended for administration of the separate county tax even without any decrease in exemptions below the State levels. It is safe to conclude, therefore, that in spite of the low rates of only 1, 2, and 3 percent, the cost of applying the tax to married persons' incomes between $1,000 and $2,000, and to single persons' incomes between zero and $1,000 was less than 10 percent.

The question of administrative feasibility is not wholly answered by a revenue and cost analysis. Some of the other facts of administration must be examined. What special administrative resources were available? A very important factor in the background of the low-bracket county tax was the existence of almost universal filing prior to its enactment. This assured very substantial filing under the lowered exemptions, although it did not, of course, guarantee proper re-

[5] These and subsequent Delaware figures are taken from the 1936 report of the Delaware tax commissioner.

[6] Thus, $728,823 of the total Delaware income tax of $863,175 on 1935 incomes was paid by 727 individuals with net incomes above $10,000. These 727 persons reported about $28,000,000 of the total $55,500,000 of Delaware taxable income. If the $28,000,000 had been distributed among, say, 20,000 persons with an average income of $1,400, the productivity of the reduction in exemptions would have been greatly increased.

[7] The over-all costs of the Delaware Tax Commissioner's office increased about $37,000 from 1934 to 1935, but since some $15,000 of this increase can reasonably be attributed to other causes—unrelated litigation and assumption of the collection of license and death taxes—the figure of about $22,000 for the New Castle County tax seems reasonable. The 1936 cost of administering the tax on 1935 incomes rose to about $30,000, but is not used for purposes of the comparative analysis here, since the county rates had by then been reduced below the State rates.

porting of income. To complete as far as possible both taxpayer and income coverage, two chief devices were used. The first was a broadened requirement for reporting of incomes at source; information-at-source blanks had to be made out and filed by the payers for all payments of income amounting to $100 or more. Second, a door-to-door canvass of most of New Castle County was conducted during the 2-year life of the county tax. A substantial minimum of compliance was assured by these measures.

Delaware tax officials feel that their experience proved the feasibility of taxing lower-bracket incomes—though not as low as the zero exemption for single persons forced them to go—under the conditions existing in Delaware. As one official put it:

"Our 1934-35 experience with the New Castle County tax proves that there is a tremendous revenue resource down in the lower brackets. But you have to be careful not to go too low. Most of our trouble was with incomes under $500 many of the recipents of which were living on the very relief funds that the tax was supposed to supply. Naturally, there were cases where we couldn't collect at all. And we applied collection by suit only to tax liabilities of $3 or more. Exemptions of $500 for single persons and $1,000 for married persons are rock bottom with present methods of income-tax collection."[6]

There is little question about the success of Delaware's experiment in taxing small incomes. Revenues, costs, and opinions of the administrators who handled the tax all substantiate the position that "it can be done." Delaware Tax Commissioner James P. Truss summarized the experience in these terms:

"We feel that we were able to give New Castle County good administration at minimum cost. We geared our office and field work to get the great bulk of the tax, even in the low brackets, and we limited evasion largely to single individuals with incomes less than $500 or $400. If we had had longer than 2 years of the county tax, we could have assured even better compliance. In view of our Delaware experience, I believe that exemptions of $500 and $1,000, or, surely, exemptions of $600 and $1,200, can be applied if it is considered good fiscal policy to enact them."[7]

Utah

The Utah experience in lower-bracket taxation also demands close examination. Like Delaware, Utah had a universal filing requirement, but, unlike Delaware, Utah felt obliged, because of administrative difficulties, to abandon it in 1935.[8] However, Utah has retained personal exemptions of $600, $1,200, and $300, which amply qualify it for inclusion in this study. In 1940, 68,555 individuals out of Utah's population of 550,000 filed returns on 1939 incomes and paid taxes totaling $742,074.[9] Although Utah's rates are comparatively low, ranging from 1 percent on net taxable incomes under $1,000 to 5 percent on incomes over $5,000, costs of administration as a percentage of collections have been held within reasonable limits. Costs as computed under Utah's sound cost allocation system have averaged approximately 5 percent of collections during the past 4 years.

Within bounds of reasonable administrative costs, Utah tax administrators have successfully applied the income tax to the broad base created by their low exemptions. Universal filing prior to 1936 has been a decided advantage as a prelude to taxing of small incomes, but the intelligent use of all available resources of information by the Utah tax agency has been responsible for the maintenance of good compliance. To achieve proper coverage, both in the filing of returns and in the reporting of income, Utah has employed a large variety of informational sources. Thus, in addition to information returns, Federal income-tax returns, Utah inheritance tax and sales-tax returns, and property-tax rolls, tax agents use unemployment compensation records, lists of physicians and dentists in the office of the State department of registration, motor-vehicle registration files, brokers' customer ledgers, real-estate transfer records, and records of such State agencies as the banking, insurance, and public service

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[6] Statement made to writer by F. A. Hession, Delaware assistant tax commissioner, during interview in April 1940.

[7] Statement made personally to writer in April 1940.

[8] For a discussion of the Utah experience with universal filing and an accompanying filing fee, see Strayer, op. cit., 131. See also biennial report, Utah State Tax Commission, 1931–32, 1933–34.

[9] Biennial report, Utah State Tax Commission, 1939–40, 56. The tax figure does not include some $60,000 of deficiencies, penalty, and interest on prior years' returns.

commissions.[10] Each of these sources yields information on potential taxpayers or on certain types or characteristics of incomes. By diligent exploitation of these sources and by a good deal of field work, adequate coverage of both taxpayers and income has been achieved, despite low exemptions.

In applying taxes to the lower-income brackets, tax administrations presumably have more difficulty in gaining compliance among farmers, small businessmen, and professional groups, than among wage earners whose income can be checked at its source. In view of this presumption, the results of two Utah surveys to determine delinquency among farmers and professional groups are particularly interesting:

"In 1938 one man spent 6 months' time in making a check on the income of all the farmers in one county. * * * By securing information concerning payments made to these farmers for their various farm products from elevators, flour mills, feed stores, dairies, canneries, packing houses, wool buyers, and others who buy from farmers, we were able to obtain an accurate indication of each individual's farm income. The result of this check conclusively indicated that the farmers not only filed their returns when a return was due, but that they also included in their returns the small items of income which might easily have been overlooked. The amount of tax assessed as a result of the survey was nil.

"In 1939 a similar check was made of the professional groups, including physicians, dentists, engineers, and attorneys. The entire file of licenses granted by the State department of registration was obtained, and with this file a careful check was made. It was determined that few persons failing in these groups and having any possible tax liability had failed to file a return."[11]

The writer does not wish to suggest that compliance is everywhere as good as indicated by those Utah surveys. In fact, the very experience that prompted the Utah surveys, namely, an Oregon State income tax "delinquency drive," which utilized property rolls, records of buyers of farm products, and other local sources, revealed considerable noncompliance among farmers and small businessmen, and netted a handsome tax yield. And undoubtedly, States which have not been sufficiently progressive in tax administration to undertake such surveys as these and to exploit the available sources of information are not achieving compliance commensurate with that in Utah. What the Utah and Oregon experiences do suggest is that there are methods of administration and sources of information the proper use of which can at least assure adequate coverage of the "difficult" occupational groups, i. e., of farmers, professional men, and small businessmen.

One additional device utilized by Utah in applying its tax to small incomes is worthy of brief mention. On the theory that there are many individuals who are ignorant of filing requirements, or are unwilling, or, in a sense, unable to fill out a complicated income-tax return, but who are willing and able to answer specific questions, the Utah Tax Commission has developed an income-tax questionnaire. "The questionnaire is so drawn as to make possible the determination of the taxpayer's liability for payment of a tax as well as his liability for filing a return. It is accepted in lieu of a return where no tax liability is indicated."[12] These questionnaires are enclosed with the initial return sent to each potential taxpayer, who is thus given the alternative of informing the commission in a simple manner of his income and exemption status. Utah officials are convinced that improved compliance in the lower income brackets has resulted from the use of this simple device.

On the experience of the Utah Tax Commission in taxing small incomes, its chief auditor, W. W. Dansie, comments as follows:

"Our opinion is that Utah's low exemptions are reasonable, both administratively and fiscally. The difficulties of going down to $600 and $1,200 are not at all prohibitive, and the work in our delinquent section combined with the independent checks we make indicates that adequate compliance has been maintained.

"Out here, we have to get into the lower brackets to get revenue, and to make the income tax justifiable from the standpoint of administrative cost. Our larger coverage means a lower cost per return, since the variable cost per return does not increase as fast as the fixed cost per return decreases. We have to go into the lower brackets to justify the cost of collection of our revenues."[13]

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[10] Some of these sources are discussed by W. W. Daniels, chief auditor, Utah State Tax Commission, in Proceedings of the 1938 Conference, National Association of Tax Administrators, 34 ff.

[11] Biennial report, Utah State Tax Commission, 1939-40, 55.

[12] Ibid.

[13] Statement made in conversation with writer, July 1940.

Other States

The Delaware and Utah experiences in administering low-bracket income taxes are more informative and instructive than those of any other State. Nevertheless, the experiences of several other States bear on the problem, and should not be ignored.

Wisconsin.—Wisconsin has for a number of years had exemptions in the form of tax credits. In terms of their income equivalents in the lowest rate brackets, these credits amount to exemptions of $800 for single persons, $1,600 for married persons, and $400 for dependents. With rates ranging from 1.6 percent to approximately 12.2 percent (including surtaxes), Wisconsin's individual income tax produced $8,532,000 in the fiscal year 1940;[14] its 1940 population numbers some 3,126,000.

The feasibility of administering income taxes on the rather small incomes reached by the Wisconsin law has never been seriously questioned by its administrators. By judicious use of available information sources, by careful office and field auditing, and by development of an annual filing volume of over 500,000 returns through widespread application of the unusual discretionary power to require returns regardless of the size of net income, very good income and taxpayer coverage has been achieved. In fact, field investigation of State income tax administrations reveals none superior to that of Wisconsin. Hence, its experience is of particular interest.

An estimate of potentially taxable income which is escaping the income tax dragnet has been made for Wisconsin. Over a million Wisconsin returns for the period 1929-36 have been examined and tabulated in the course of an exhaustive statistical survey. For purposes of evaluating the resulting income data, the director of the Wisconsin income study, Frank A. Hanna, has estimated the probable underreporting during the income year 1936. On the basis of experience with the returns, combined with evidence from office and field auditing activities of the Wisconsin income tax agency, he states:

"It would be hard to conclude that those filing returns in 1936 received more than $40,000,000 in addition to the reported $810,000,000 total income."[15]

Thus it appears that despite its comparatively low exemptions, Wisconsin's income tax is probably not missing more than 5 percent of total income. This underreporting is occasioned in part by taxpayer ignorance, in part by failure to remember small items of income, and only in small part by successful deliberate evasion.

Of the feasibility of applying an income tax to lower-bracket incomes, A. E. Wegner, director of the income, inheritance, and gift tax division of the Wisconsin Tax Department, says:

"Administratively, it's quite possible to achieve reasonably full reporting down to income levels of maybe $500 and $1,000. We certainly have had no great difficulty with our present exemptions of $800 and $1,600. But there is the question of cost in the lower-income levels. You can't really process a return thoroughly for less than a dollar or two. So, even though you find the income, it may be too costly to get the tax due on it. If you establish a minimum tax of a dollar or two, you could go down the income scale a long way without getting prohibitive administrative costs."[16]

Iowa and South Dakota.—These two States originally had exemptions (in the form of tax credits) amounting to $600 for individuals and $1,100 for married persons. While South Dakota has retained these exemptions, Iowa has raised its tax credits to the income equivalent of $1,000 and $1,500. Iowa's change was made at least in part for administrative reasons, and constitutes a counter to the experiences of Delaware, Utah, and Wisconsin. South Dakota, while experiencing some difficulty in applying the low-income tax to farmers and small businessmen, has nevertheless found it advisable to retain these low exemptions. An interesting and unique feature formerly operative in the Iowa law and still operative in the South Dakota law is the provision for a deduction of 10 percent of gross income (or a maximum of $100 for a single, $160 for a married, individual) in lieu of all other deductions from income. Tax officials report that between one-half and two-thirds of all South Dakota income taxpayers use this "in lieu" deduction, and that the revenue loss is more than offset by the saving

[14] Bureau of the Census, U. S. Department of Commerce, State Tax Collections: 1940 (State and Local Government Special Study No. 10), March 26, 1941, 20-21.

[15] From report prepared for presentation to the Conference on Research in National Income and Wealth, New York, May 1941.

[16] Statement made to writer during interview in April 1941.

in administrative cost and time through elimination of the necessity of verifying myriad deduction items.

North Dakota.—The North Dakota personal exemption for single individuals, $500, is the lowest in the country, while the exemption for married persons, $1,500, shares the distinction with four other States of being the third lowest. In terms of yield, no State with a general income tax ranks lower then North Dakota, which received but $589,000 from its individual and corporate income taxes combined in the fiscal year 1940.[11] Considerable difficulty has been encountered in applying the low exemptions to farmers, although administrative officials feel that the level of exemptions is, in general, not unreasonable. However, the State itself is a rather barren income field, and since, in addition, its income-tax administration is not adequately financed and staffed, its experience in taxing small incomes cannot be counted as evidence either for or against the administrability of a lower-bracket income tax.

Idaho and Kansas.—Idaho, with exemptions of $700 and $1,500, and Kansas, with $750 and $1,500, both feel that their income taxes are capable of application without undue difficulty except in reference to farm income. Kansas has utilized a widespread publicity and taxpayer education campaign to promote good compliance, and its filing figures (see table 1) indicate that it has attained a very substantial taxpayer coverage. An attempt has been made to encourage farmers to keep better accounts, and, in the face of occasional refusal to institute some type of accounting system upon specific request, farm deductions which could not be substantiated were disallowed. Idaho has given more attention to taxpayer coverage work as compared with auditing than most States. Various local and State records are extensively utilized to increase compliance in the lower brackets.

Oregon.—With exemptions of $800 and $1,500, Oregon also falls into the class of States taxing small incomes. Moreover, it has an intangibles income surtax which brings in many additional returns, a considerable percentage of which report only small amounts of income. Oregon has experienced no disproportionate difficulties in administering its tax and has found (see the discussion of Utah, above) that proper use of available information resources can assure adequate compliance throughout the entire taxable income scale.

General discussion and conclusion

What administrative measures are desirable as part of a program of taxing small incomes? What limits do administrative factors set on the downward extension of income taxes? What conclusions relating to the administrative applicability of lower-bracket income taxes, particularly as a Federal measure, may be drawn from the State experiences just reviewed?

Attaining taxpayer coverage.—The first task of an agency charged with the administration of a tax on small incomes is to build up its "tax clientele." Those who are, or may become, liable for taxes must be either induced or forced to file income-tax returns. Not until the filing habit has been established among those at the lower-income levels can administration achieve real success. For until substantially all potential taxpayers are regularly filing returns, administrative effort will be diverted from the essential tasks of discovering and checking incomes, and of collecting taxes that have been assessed. State experience suggests (1) that techniques for the attainment of an adequate filing volume are available, and (2) that the establishment of a broad base of taxpayer filing is good insurance for the success of low-bracket taxation.

Publicity is a primary technique of stimulating taxpayer filing. Radio talks, press releases, public notices, the conducting of tax forums throughout the State, and administrative assistance to taxpayers during the filing period all contribute to taxpayer readiness to file. Kansas has used this general approach to very good advantage.

Administrative power to request returns either under a universal filing requirement such as that of Delaware or under a discretionary provision like Wisconsin's enables tax agencies to achieve wide coverage. Most States are restricted to requesting returns only of those whom they believe to have a net income above exemptions; in a sense, this places the burden of proof upon the State rather than on the taxpayer and hampers the State in attaining broad coverage among the marginal income recipients, who are sometimes in, sometimes out, of the taxable-income range. It is particularly important to the suc-

[11] Census Bureau, State Tax Collections, 20–21.

cess of a small-incomes tax that steady filing be maintained among this marginal group. To that end, it seems desirable to equip income-tax agencies with broad powers to request returns, either by direct grant of discretionary power—as in Wisconsin—or by low-gross-income filing requirements—as in the Federal law.

Publicity and power to require filing of returns are important administrative weapons. But the administration must know whom to ask for returns. A mailing list can be built up by exploiting the various private and governmental sources referred to by Utah, for example, and by intelligent use of city directories, classified sections of telephone directories, and the like. Even a door-to-door canvass has been found profitable by at least one State—Delaware. And, of course, information returns from income payers (which are required by all income-tax States) are a ready clue to additional taxpayers. The methods of improving filing volume are legion, but one of more special interest in the taxing of small incomes, namely the extensive use of a questionnaire, merits another word. Other administrations might well follow the lead of Utah in using the questionnaire method of eliciting returns from those who are either reluctant or unable to tackle the more formidable tax return itself.

The contribution of a broad base of filing to the success of lower bracket income taxation is attested to by the experiences of Delaware, Utah, and Wisconsin. The previous establishment of the filing habit on a broad, if not universal, base, greatly facilitated the successful application of income taxes to small incomes in these States. And the greatly broadened Federal filing requirements will have a similar preparatory effect. Given proper enforcement, filing requirements based on gross income of $2,000 if married, and $800 if single, extend the filing habit to hundreds of thousands of persons whose net incomes fall below these levels, and who will become taxable only by further decreases in exemptions (or increases in income).

The discovery and verification of income.—Discovering and verifying income is the second task of administration. Widespread filing is, of course, a guaranty of a substantial minimum of income reporting. But to check accuracy of reporting and to insure the inclusion of taxable income, a wide variety of information sources must be utilized. Some indication of their nature can be gained from Utah's experience. Generally, in addition to information returns, the records of other tax agencies, of State regulatory bodies, or local property tax administrations, of local real-estate deed and transfer offices, of stockbrokers, of banks, and of buyers of farm products will yield valuable income data. The lower the exemptions, the more widespread and intensive must be the exploitation of these information sources. The consensus of administrators in the States reviewed is that income can be ascertained—and rather accurately—even in very low brackets, but that certain difficulties arise in the farmer, small business, and professional groups, and that the percentage cost of attaining income coverage mounts rapidly when taxes begin to strike income strata below about $1,300 for married persons and $700 for single persons.

The absence of proper accounting is the chief handicap in the attempt to ascertain incomes of low-income farmers and of business and professional men. A widespread frontal attack on the problem of improving accounting procedures has not yet been made, and there is a real question whether income-tax administrations should be charged with this task. But it may become a necessity in downward extension of income taxes income-tax penalties—either direct or through the disallowance of unsubstantiated deductions—may be the only means of forcing compliance with accounting requirements. In educating the farmer group to keep books properly, the aid of the Department of Agriculture and its far-flung, decentralized services and personnel (e. g., the county agents) might well be enlisted. And, on the assumption that most small businessmen can produce at least a gross-receipts figure, the use of standard ratios of gross to net to determine income in the absence of adequate books might be a real stimulant to improved accounting.

To eliminate in large part the main problem of verification in the bulk of small income returns, namely, the checking of deductions, allowance of something similar to the 10 percent "in lieu" deduction utilized at present only by South Dakota should be seriously considered. It contributes to ease of both administration and compliance, and might be set up on a basis which would contribute to equity. That is, if the percentage deduction were set up so as to diminish with an increase in income, the existence of greater proportionate occupational expenses in the lower-income groups might thus be recognized under the income tax.

Tax collection.—Even with a proper determination of taxable income, there remains the problem of collectibility of the tax. In the very low brackets, this is a real problem, since ability to pay taxes cannot be held in abeyance. Income is spent almost as quickly as it is received, and accumulation of a tax burden for lump-sum payment, however small, may work a hardship. All States taxing in the lower brackets have had to face this dilemma in many instances: The income had been received and verified, but the ability to pay taxes on it had disappeared by the time the tax was due. And where very small amounts are involved, willingness to pay is almost a prerequisite of any tax receipt at all, since the cost of suing for the tax is greater than the tax itself. Both correspondence and field delinquency work so planned as to provide a sufficient density of cases in a given area can, however, stimulate "voluntary" payments at a reasonable cost. To strike at the roots of the problem, it may be necessary to provide means of payment while the income is being received. Collection at source is one method, while another, which may be considered either as an alternative or as a supplement to deduction at source, is the stamp payment plan. Under the latter the taxpayer would on his own initiative purchase stamps in small amounts during the year and pay his tax with accumulated stamps at the time of filing his return.

Costs of administration.—Costs of collecting taxes and processing returns are a primary problem in taxing small incomes. Because of the concentration of incomes in the lower brackets, the number of marginal returns, i. e., those on which little or no tax is realized, increases more than proportionately to a decrease in exemptions. Those costs which depend directly on the number of returns handled thus increase without a commensurate increase in revenue. Three points arise in this connection. First, the marginal cost of handling a return—beyond a volume of reasonable magnitude—is not very great. Second, marginal returns which are relatively or absolutely unprofitable exist at every exemption level; and, while the reduction of exemptions increases the number of marginal returns, it very probably decreases the per-return cost at the margin, while converting formerly marginal and submarginal returns into supramarginal returns. Third, the problem is not really wholly one of exemptions, but one of rates as well. For if the initial rate or filing fee or set minimum tax is high enough, the cost of processing the small-income return can be covered. This is not intended as a suggestion for enactment of a filing fee, since at least two—those of Montana and Utah—fell by the wayside because of the difficulty of administration. But all three points are made with the intention of throwing into relief the problem of the administrative cost of broadening the income-tax base.

General conclusions.—The significance of State experiences in taxing small incomes is briefly this: Given good administration, adequately supported, the income tax can successfully reach into very low income strata. Among the States taxing small incomes, those with high-grade administration uniformly concluded that lower-bracket taxation is feasible at reasonable cost, although beset with difficulties. This conclusion was reached even though none of the States—with the possible exception of Delaware—is a particularly fertile income field to break with the low-bracket tax plow. The industrialized States, a large proportion of whose income recipients are covered under information-at-source provisions, are a much more fertile field; territorial density and information-at-source coverage greatly facilitate the application of a low-bracket income tax.

What lessons capable of Federal application may be gained from the State experiences in taxing small incomes? First, it appears administratively feasible to lower Federal exemptions still further. The lower limits cannot be categorically set, since much will depend on the staff which administers the tax and on the methods of collection and checking employed. But if the States reviewed can or could successfully apply exemptions of $600 and $1,200 or even $500 and $1,000, the Federal Government should be able to dip at least that low. For Federal administration has both jurisdictional and staff superiority over State administrations, and deals with a more fertile field, on the average, than do the States now taxing low-bracket incomes. Second, if the Federal Government goes into lower income strata, it must further decentralize its checking and compliance activities, and must utilize many local and State sources of information. Third, an attack on the problem of accounting procedures of farmer, small business, and professional groups should probably be a part of the low-income tax campaign. Fourth, to reduce costs of collection, to increase the ease of payment, and with it the volume of payments, and to

release administrative funds and energies for application in more difficult sectors of lower-bracket tax administration, the devices of (*a*) collection at the source on all types of income to which it is adapted, and (*b*) prepayment of taxes on other incomes through the purchase of stamps, should be carefully weighed and speedily adopted.

NORTH AMERICAN EXPERIENCE IN COLLECTION AT THE SOURCE[18]

The experience of four North American jurisdictions[19] now applying collection at source to varying portions of their tax bases offer valuable evidence both on the efficacy of this scheme of collecting taxes and on the mechanics of its operation. Each utilizes the device in a manner differing from the others, and each involves a different degree of employer participation in administration. Each therefore contributes to the experiential background of the problem.

Philadelphia's tax probably contributes least, since it is a gross income tax and does not, therefore, involve the crucial problem of adjusting for personal status. New York applies its withholding-at-source provisions only to (apparently) taxable nonresident wage earners in the State, but since these number 75,000, the New York experience is on a sufficient scale to merit close attention. British Columbia's system is outstanding in the length of its operation (since 1931), in the proportion of total individual income tax collected by deduction at source (over one-half), and in the success it has achieved. It was at least partially the forerunner of the Dominion-wide collection-at-source system applied for the first time in 1940. The Dominion system is significant not only because of its wide territorial coverage, but also because of its broad income coverage; whereas the other three systems apply only to wages and salaries, the Dominion system applies to corporate dividends and interest on registered securities as well.

Philadelphia

In December 1939 the Philadelphia City Council passed an ordinance providing for a tax of 1½ percent on gross wage income and net business and professional profits earned in Philadelphia, whether by residents or by nonresidents.[20] It was realized that the tax would be both difficult and costly to collect directly from employees, particularly from nonresidents, and a collection-at-source scheme was therefore adopted. Some of its features are worthy of attention here.

The employer's only obligations are to deduct a flat 1½ percent of the compensation paid all employees at the time of payment, to remit the deducted sums once monthly, and to submit each quarter a list of employees and the amount of tax withheld from each. One or two items are interesting in this connection. The monthly return is a summary form made out in duplicate by the employer and stating only the total number of taxable employees, their net earnings (compensation paid to nonresidents for services outside Philadelphia is not taxable), and the tax withheld. If the employer desires a receipt, he must send the duplicate along with the original and enclose return postage. The quarterly return of tax withheld lists employees' names, Social Security account numbers, addresses, compensation, and, if the employee has entered or left the firm during the quarter, the dates of accession and separation. After the first month, addresses need be reported only for those employees whose addresses have changed and for those who have newly entered the employer's employ.

Employees are required to file returns under certain circumstances. No return is required if "* * * the entire earnings for the year are paid by one and the same employer and the * * * tax has * * * been withheld. * * *."[21] The deputy receiver of income taxes estimated in 1940 that this would exempt approximately three-fourths of all wage earners from the filing of individual returns. Those who are in the employ of more than one employer, or who are employed by nonresident employers, or by the State or Federal Government, or for whom the employer has not deducted the tax at

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[18] Collection at source is also variously referred to as indirect collection, withholding, stoppage, deduction, or taxation at source.

[19] In addition to the 4 systems discussed here, the Province of Manitoba has a system for deduction of taxes at source on wages.

[20] City of Philadelphia, Income Tax Ordinance, approved December 18, 1939. See also Philadelphia Income Tax Regulations, issued by the receiver of taxes pursuant to terms of the ordinance.

[21] Philadelphia Income Tax Regulations, art. III.

source, must file an annual return by March 15 of the year following the year of receipt of income. The taxpayer may pay the full tax at that time, or in four quarterly installments beginning with the date of filing, or he may elect to pay his tax monthly in advance under a special provision. This provision for current payment of taxes even though not collected at source is of some interest. A form has been provided for applications for permission to pay the city income tax monthly in advance. Upon receipt of this form, the tax agency sends out monthly forms, abbreviated tax returns, which the taxpayer returns with his remittance. At the end of the year, he makes out his regular annual return, but claims credit for the advance payments. Evidently, many employees are using this method of paying their taxes at the time they earn the income.[32] Both employers and employees are fully liable for payment of taxes which are subject to withholding at source.[33]

Some 42,000 employers' accounts representing a million wage earners were already set up by April 1940. Reasonably good compliance, despite unfavorable publicity and considerable opposition to the tax, was apparently being realized. As one tax official put it, "My personal feeling is that we are getting fine cooperation on the part of most employers, and even in those cases where they refuse to withhold the tax, we have recourse to the employee."[34] Administrative problems, are, of course, at a minimum under this system. No adjustment to personal status is necessary, other than wage income (except business profits) is not taxable, and no deductions need be allowed or verified. The main problem is to see that 52 weeks are accounted for in the case of each employee, by either the employer or employee. Other than that, the problem is mainly one of getting employers to comply regularly and of collecting the tax. There is little doubt that collection at source has minimized both evasion and costs of administration and compliance.

New York

The use of the withholding device on the nearly 75,000 eligible nonresident wage earners in the State of New York is a considerably more instructive experience than that of Philadelphia, despite the lesser volume. For the tax involved is a net income tax, and adjustments for personal status, for deductions, and for items of income other than those taxed at source raise added administrative and compliance problems. The system employed for the handling of these problems contains elements that might be desirable in any scheme for application of collection at source to incomes taxable under a net income tax. Substantial duties are imposed on employers in adjusting for the personal status of the employee.

Briefly, the system operates as follows: (1) Employees are required to file with their employers either (*a*) a certificate of residence in New York (Form 101), thus absolving the employer from further duties, or (*b*) a certificate of nonresidence and claim for personal exemption (Form 102). (2) Form 102 is a small card which serves the dual purpose of being the employee's certificate as well as the employer's report to the tax commission of tax withheld at source for that employee. The employer fills out his side of the card, showing the total taxable income, the personal exemption deducted therefrom, the tax withheld after application of the New York rates to the remainder, and the names and addresses of both employee and employer. If the employee is a nonresident, but fails to file Form 102 with the employer, the employer must withhold tax on all payments above the exemption for a single person, viz, $1,000, and fill out his side of Form 102 for submission to the tax agency. (3) On or before February 15, the employer submits to the tax commission (*a*) all the Forms 102, (*b*) the tax withheld, and (*c*) Form 103 summarizing Forms 102 and listing each of the employees for whom a Form 102 is included, together with the amount of tax withheld. (4) The nonresident employee then files a regular income-tax return (Form 203 for nonresidents) listing additional income taxable by New York and allowable deductions from income. From

[32] Tax officials state that letter carriers as a class are making the most use of this privilege.

[33] Thus art. IV–4 of the Income Tax Regulations provides: "Every employer required to deduct and withhold the income tax at the source is liable for the payment of such tax," while section 4 of the Income Tax Ordinance provides, in part, "* * * that the failure or omission by any employer * * * to make such return and/or pay such tax, shall not relieve the employee of responsibility for the payment of such tax."

[34] Statement to writer by Walter Camenisch, deputy receiver of income taxes, during conversation, April 1940.

the computed tax he deducts the tax paid for him at source. If the result is a negative item, his return constitutes an automatic claim for refund.

Several points regarding the mechanics of the system deserve mention. (1) While the employer must make adjustment for the personal status of the employee and compute the tax at the rates provided under New York's graduated scale, thus performing a substantial task, he "* * * is not obliged to verify the nonresident's claim for personal exemption."[15] (2) "The responsibility for payment of the tax required to be withheld at the source is on the employer. However, the failure to withhold does not relieve the employee of the liability for the payment. In other words, where no payment is made either by the withholding agent or by the nonresident employee, we may assess either or both."[16] (3) Although it is assumed that the employer will anticipate the tax payment by withholding an amount each month, the common practice is to deduct the entire amount from the December compensation of the employee. This facilitates adjustment to the employees' personal status, but clearly negates one purpose of the stoppage-at-source system, namely, to liquidate the tax liability regularly as the income is being earned.

As mentioned before, the magnitudes involved in the at-source deduction system are substantial. For the income year 1939, 9,058 employers' summary Forms 103 were filed, together with 73,831 Forms 102 joint employer-employee cards. Approximately $3,350,000 was collected at source. Tax officials estimate that of the 58,654 nonresident income-tax returns (Forms 203) filed, at least 10,000 were filed by employees claiming refunds.[17] No estimates of the amounts refunded are available.

The system is held in high regard by New York administrators, who feel that it greatly simplifies the problem of collecting taxes from nonresidents, and improves compliance very considerably. Relatively few complaints are heard from employers, who are now accustomed to the system, after a number of years of operation. The New York experience deserves close study by those who would set up an administrative scheme for the collection of net income taxes at the source.[18]

British Columbia

The Province of British Columbia has been carrying out a highly significant and successful experiment in taxing wage income at source since 1931. This system differs from that of New York in that the employer is not required to make any adjustment to the personal status of the employee, but merely deducts a flat 1 percent from all wages, salaries, etc. The volume of refunds is thus much greater, and, in a sense, burdens are thus shifted from the employers to the tax administration.

The mechanics of the system involve a number of steps. (1) To initiate the deduction-at-source procedure, an information and instruction sheet is sent the employer, stating that on all earnings of employees amounting to $60 or more monthly, $30 or more semi-monthly, $14 or more weekly, the employer is to deduct and remit monthly a tax of 1 percent of the total compensation paid. His liability for the tax and penalties in case of failure to comply are also stated. (2) The employer files a monthly summary (Form 6) of pay rolls and of the wages subject to tax, and remits with it the amount withheld, but gives no detail concerning the individuals for whom tax is withheld. (3) The office of the commissioner of income tax sets up a folder-ledger card for the employer, recording thereon his monthly payments, the number of employees covered, etc. (4) Each month, using an addressograph machine, the commissioner's office sends out (*a*) a receipt for the previous month's taxes, and (*b*) a form for the reporting of the next month's taxes withheld at source. (5) Annually the employer files a summary (on Form 57) of his monthly wages paid to employees,[19] the amount subject to tax withholding, and the amount withheld. (6) Accompanying Form 57 are individual Forms 57–1 for each em-

[15] Instruction 6, New York Income Tax Form 103, 1940.

[16] Statement in a letter written to the author on April 8, 1941, by Roy H. Palmer, first assistant director, income-tax bureau of the New York State Department of Taxation and Finance.

[17] Data furnished by Roy H. Palmer in letters to author written April 8 and April 16, 1941.

[18] A number of other States also provide for withholding at source for nonresidents, but none approaches New York in magnitude nor working efficiency.

[19] This figure is later checked against the total amount deducted for wages on the employer's business income-tax return.

ployee,[30] listing (*a*) his name and address, (*b*) whether he is married, single, widow, or widower, (*c*) the period employed, (*d*) his total earnings, (*e*) the total 1-percent deductions, and (*f*) the name of the employer. (7) The employee must, if he has additional income, and may, if he has no other income, file an individual income-tax return (Form 7A). He lists thereon his income, deductions, and exemptions; computes the tax; subtracts the tax paid for him at source; pays additional tax if his liability is over $1; and automatically claims a refund if the resulting negative figure is over $1. (8) The individual's Form 57–1 filled out by the employer is matched with his return, and after this verification, refund is allowed in all cases where the amount is over $1.

The magnitudes involved in the British Columbia at-source collection system during 1940 are as follows:[31]

Number of employers' annual returns (Form 57) filed	17,158
Number of employees' annual slips (Form 57–1) filed	324,276
Number of individual tax returns (Form 7A) filed	152,850
Number of refunds paid to employees	141,516
Number of employees receiving refund of full amount withheld	42,488
Total amount of individual income taxes collected	$2,115,537
Amount of tax withheld at source by employers	$2,000,356
Amount refunded to employees	$1,000,576

Relative to the operation and success of the system, which operates in a setting of income-tax exemptions of $600 for single individuals, $1,000 for married persons, and $200 for dependents, the remarks of C. H. Peterson, British Columbia Commissioner of Income Tax, may profitably be quoted at length.[32]

"Although it [the British Columbia collection-at-source system] involves the making of a large number of refunds, it seems the only logical method of collecting taxes from low-income groups. It is much easier to make refunds than to try to collect small amounts at the end of the year. Prior to the adoption of this method we wrote off hundreds, yes thousands, of small amounts every year because it would cost more to enforce collection than the amount of tax involved. Once the system has been brought to a well-established routine, it is not expensive to operate. We have only about seven people wholly and permanently engaged on this particular work, plus an equal number for a temporary period of 3 or 4 months following the filing date for returns. I would note here that no application for refund is necessary; for filing of a return insures a refund if one is due—of course, no return, no refund.

"A very great proportion of our refunds would be eliminated if the employers were required to apply the appropriate exemptions. A large number might also be eliminated if the basic rate of income tax were increased from 1 to 2 percent (the deduction at source still being left at 1 percent).

"It might be interesting to mention that this deduction at source is far from being unpopular with the employee. In fact, once they become accustomed to it, the deduction is not missed and the refund at the end of the year is very popular. We find them very appreciative of getting a few dollars back, and they seem to forget about the larger amount that has been retained as assessed tax. Even those who have an additional tax to pay appreciate the fact that a portion of it, at least, has been taken care of."

It is apparent that the British Columbia scheme has been popular both with its administrators and with those for whom taxes are deducted at source. Although a definite allocation of expenses to income-tax administration is not available for British Columbia, it seems that costs are comparatively low. And unclaimed refunds constitute "a substantial sum of what one might call 'found money.'"[33] This is said by provincial officials to more than pay the cost of administering the collection-at-source system.

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[30] These forms are made out in quadruplicate, on sheets each containing 9 employee forms. 1 copy goes to the employer, 1 to the employee, and 2 to the tax agency. 2 sheets are perforated, 2 are not. 1 each of the latter goes to the employer and to the tax agency as permanent records. 1 perforated sheet is retained by the employer for distribution of the individual slips to employees, the other is sent to the tax office, where the individual slips are attached to the employees' returns.

[31] Figures furnished by British Columbia Commissioner of Income Tax C. H. Peterson, in a letter to the author written April 8, 1941.

[32] These are excerpts from a letter written to the author by Commissioner Peterson, April 8, 1941.

[33] Ibid.

The system has been an unquestioned success. However, in order to synchronize the provincial scheme with the Dominion system of deduction at source recently initiated, the Dominion exemptions and methods are being adopted. Commissioner Peterson summarizes the changes now in progress as follows:

"Up to the present time no distinctions have been made between married and single persons in the matter of deductions from wages, the deduction being made from everyone receiving wages in excess of the stated amounts. The purpose of this was to save trouble to the employers in applying different exemptions; but of course it increased the work of the Department in making a larger number of refunds. Now that the exemptions have been raised, employers will have to be required to apply the appropriate exemptions. Since the enactment last year of the national-defense tax by the Dominion Government, employers are required to apply the appropriate exemptions for the purpose of that tax, and our increased exemptions are made to conform thereto." [34]

Canada [35]

The Dominion system to which the quotation above refers was put into effect during 1940. It contains many elements which are worthy of note, and adds a number of features not present in the three systems thus far examined. Not only wages but also dividends on corporate stock and interest payments on registered bonds are subject to taxation at source. The tax at source is part of a national-defense tax at rates of 2 and 3 percent, which is applicable to total net income (before deductions of donations and personal exemptions) of all Canadian residents who have an income above $600 if single, or $1,200 if married. The tax is not part of the regular Canadian income tax assessed on net incomes above $750 and $1,500 at steeply graduated rates, but is administered in conjunction therewith.

The steps in administration of the collection-at-source phases of the national-defense tax to wage earners may be summarized briefly. (1) Married employees and employees with dependents file N. D. T. Form 1 in duplicate with their employers.[36] This form establishes the tax status of the employee so far as the employer is concerned. (2) For individuals not filing Form 1, the employer deducts 2 percent of the total annual income, if that income is between $600 and $1,200, and 3 percent if the income exceeds $1,200. For married persons the deduction-at-source is 2 percent of total income, if the income is above $1,200. Adjustments for dependents are made on the basis of a reduction of $8 in the tax at source to be allowed at the rate of 16 cents a week, 34 cents semi-monthly, or 67 cents a month, depending on the pay-roll period. (3) The employer remits the withheld tax once a month to the Receiver General of Canada. Failure to remit the tax subjects the employer to full liability for the tax and a penalty of equal amount. At the time of making first remittance of tax deducted for a given employee, the employer sends one copy of Form 1 to the inspector of income tax for the district in which he resides. (4) The employer accompanies his monthly remittances with N. D. T. Form 2, which summarizes those remittances, but, as under the British Columbia system, he also files summary slips (similar to British Columbia Forms 57–1 described above) for each employee at the end of the year. (5) Employees need not file a tax return with the Dominion tax agency if the at-source-deduction for the national-defense tax applies to their entire income. If it does not, the individual must file a return with the Dominion and pay additional tax, and this is done on the regular Dominion income-tax form. Refunds are made in cases where deductions-at-source have been larger than the individual's tax liability. Such is ordinarily the case only if the individual has been employed for only part of the year.

The deductions at source on account of interest and dividends are made at the rate of 2 percent regardless of the marital status of the taxpayer or the size of the payment. Summaries of the payments and withholdings similar to those for wage earners are submitted annually. Of the Canadian system, Commissioner of Income Tax C. F. Elliott says:

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[34] Ibid.

[35] An informative summary of the Canadian collection-at-source system is contained in a brochure entitled "National Defense Tax," which is issued by the Income Tax Division of the Canadian Department of Revenue. Revised edition issued January 1941, at Ottawa.

[36] "The employer will rely upon the truth of the information contained in the form unless he has a reasonable suspicion that it is not true, when he will then either request verification from the employee or report his doubts to the inspector of income tax at the time of lodging the form with him so that such report may be fully investigated."—National Defense Tax, 4.

"So far as we are aware, the war legislation imposing the national-defence tax has been well received by the public, and all employers and payers are cooperating fully in complying with its provisions. There is no doubt that the at-source system is an effective method of expediting collection of the revenue."[*]

It is too early to evaluate the Canadian system fully, since it has been in operation less than a year, but it appears that it is achieving the objective of collecting taxes with a minimum of administrative difficulty and with maximum taxpayer ease. It is producing revenue immediately, as needed.

Conclusion

The collection-at-source experiences reviewed plainly establish the feasibility, and in fact the desirability, of applying this system to the collection of income taxes on small incomes. From the elements of the various systems, and upon closer examination of their experience, the United States could unquestionably build a successful collection-at-source system which would, at reasonable cost, produce "revenue now!"

FINANCING DEFENSE

CHAPTER X—SUPPLEMENT: DETAILS OF PROPOSALS FOR PROMPT COLLECTION OF INCOME TAXES

Prepared by A. G. HART, Iowa State College

I. COLLECTION AT THE SOURCE

Collection of taxes on individual incomes at the source is not a totally new idea

The United States income tax was collected at the source in 1913–16. In Great Britain, collection at the source has been optional with the taxpayer for years, and was finally made compulsory at the beginning of 1941. The defense tax on incomes levied by Canada is collected at the source, and so is the regular income tax of the Province of British Columbia. The city of Philadelphia has a tax on earned incomes collected at the source. Many American States tax nonresidents at the source. Some of these systems permit no exemptions, and others collect only once a year; but among them they offer quite a body of experience.[**]

Taxation without exemptions or refunds

As a starting point, we may consider the relatively simple problem of taxing incomes at the source at time of payment without permitting exemptions, and without refunding overpayments of taxes. This type of tax is in use in Philadelphia; and the Philadelphia system may serve as example.

The basic collection procedure of the Philadelphia system is to require employers to withhold tax (1½ percent of compensation paid to employees) and to remit monthly, not later than the 15th of the following month, by mail. The form accompanying the monthly remittance is simplicity itself. Its face reads as follows:

EMPLOYER'S RETURN OF TAX WITHHELD

Form W–1
City of Philadelphia
Receiver of taxes
Under Income Tax Ordinance Approved December 13, 1939

(See back of duplicate copy for instructions)

1. Number of taxable employees		
2. Total salaries, wages, commissions and other commpensation paid	$	
3. Nontaxable items (compensation of nonresidents for services outside Philadelphia)		
4. Taxable earnings of employees	$	
5. 1½ percent city tax withheld		
6. Penalty		
7. Interest		
8. Total (make check or money order payable to "Receiver of Taxes")		

[*] Statement made in letter written to the author, April 17, 1941.

[**] This list of experiences, and much of the interpretation, rest upon information supplied by Mr. Walter Heller, of the University of Wisconsin, who is an expert on taxation of of small incomes.

RECEIPT NO. _____ BANK NO. _____

Enter above employer's name and address.

I hereby certify that the information and statements contained herein and in any schedules or exhibits hereto attached are true and correct.

(Signed) _____

(Official title) _____
Owner, partner, member, president, treasurer, etc.

(Date) _____

Pennsylvania unemployment compensation identification No. _____

Enter above your Pa. U.S.I.No. if it does not agree with account number shown below.

For mo. of	year	Account number

Mail to Philadelphia Income Tax Bureau, Tenth Floor, Market Street, National Bank Building, Philadelphia, Pa.

If receipt is required, duplicate copy must also be filed, accompanied by return postage.

In April, July, October, and January, employers are required to send in, attached to the above form, a schedule itemizing the handling of each individual employee's account during the preceding 3 months, and showing:

(*a*) His social security number.
(*b*) His name.
(*c*) His address.
(*d*) Total compensation paid him.
(*e*) Tax actually withheld.

The total tax withheld from all employees must be shown to be equal with the amount remitted for the 3 months.

Individual taxpayers are required to file annual returns unless they have been employed throughout the year by only one employer and had taxes deducted from gross compensation without allowance for expenses. This exception, plainly, is intended to apply to most employees. For residents of Philadelphia who file returns, the basic form is as follows:

Name_____ Street address_____
Post Office_____ State_____ Ward_____
Federal Social Security Account No._____ Occupation_____
1. Net earnings (column 5, schedule B)_____ $_____
2. Less: Salaries, wages, commissions, etc., on which tax has been withheld at source (schedule C)_____ _____
3. Amount subject to tax_____ _____
4. Tax at 1½ percent_____ _____
5. Interest (½ of 1 percent per month)_____ _____
6. Penalty (½ of 1 percent per month)_____ _____
7. Total owing_____ _____
8. Paid with return (make check or money order payable to "Receiver of Taxes")_____ _____

On the reverse of the return, taxpayers are called upon to account for expenses deductible from income, income from salaries, wages and so forth (with deduction of these expenses), and salaries, wages, and so forth, on which tax was withheld.

Under this system, taxpayers who have not had the full amount of tax deducted are called upon to pay the difference. Taxpayers who have overpaid because employers have withheld too much are entitled to refunds from their employers. Taxpayers who have overpaid because they did not get the benefit of deductions for expenses are entitled to credits which may be transferred to other taxpayers or applied to future taxes. Cash refunds from the city are not contemplated.

Individual returns, when required, can plainly be checked against the employer's report of withholding.

Expenses of collection for the Philadelphia system are about $200,000, or 1.2 percent of budgeted revenue of $17,000,000. These expenses cover also taxes on the net profits of all businesses operated in Philadelphia by private individuals or partnerships. The high percentage of revenue spent on administration reflects in part the low rate of 1½ percent; if the rate were raised, costs would rise only slightly. While no figures are available on the total number of employees taxed, Philadelphia is a city of 2,000,000, and the number taxed is certainly not under 500,000. Costs are thus less than 40 cents per employee account.

Collection at source, with exemptions and refunds, on annual basis

Collection of income tax at the source, with allowances for exemptions, is common practice among governments levying income tax on nonresidents. (The Federal Government, for instance, applies this method to nonresident aliens.) A good example of procedure is New York State, which taxes some 85,000 nonresidents.

A nonresident taxpayer is required to file with his employer a certificate, on a card (Form 102), stating his residence, explaining his family status, and claiming appropriate exemptions. This card is passed on by the employer to the tax authorities after the end of the tax year. On the reverse of the card the employer figures he employee's tax bill. The employer's side of the card reads as follows:

To whom paid (employee): _____
Name in full Address
By whom paid (employer): _____
Name in full Address

1. Total paid to this employee while a nonresident during the calendar year _____ $ _____
2. Paid for services within the State while a nonresident _____
3. Amount of personal exemption to which entitled during the period or nonresidence _____
4. Balance—amount on which total tax withheld _____
5. Normal tax withheld (2 percent from first, $1,000; 3 percent from second and third, $1,000; 4 percent from fourth and fifth, $1,000; 5 percent from sixth and seventh, $1,000; six percent from eighth and ninth, $1,000; 7 percent from all over, $9,000) of the amount shown at item 4 _____
6. Emergency tax withheld (1 percent from item 4) _____
7. Total amount withheld (tem 5 plus item 6) _____

Along with his cards for nonresident employees, each employer files a list of employees with amount of tax withheld from each. Where item 3 on the card exceeds item 2, of course, there is no withholding.

The individual taxpayer is required to file a return if his gross income exceeds $5,000 or his net income exceeds $1,000 (if he is single) or $2,500 (if he is married). This return carries all income from sources taxable by New York State, but permits deductions of business expenses and contributions to arrive at "net income." Tax is calculated on the excess of net income over exemptions, at the same rates used on the card. The amount withheld at source is subtracted from the total tax so calculated. If withholdings are

less than total tax, the taxpayer is obliged to remit. If they exceed total tax, the taxpayer's return is treated as a claim for refund.

Current collection at source, with exemptions, deductions, and refunds

To collect taxes currently at the source, with full allowance for taxpayers' claims to exemptions and deductions, is more complex. But it can be done, and is done effectively in various places. The British Columbia system, which has been in force since 1931, will serve for illustration.

Employers in British Columbia are required to make deductions from wages and salaries if the wages of the employee in question exceed:

$60 or more on a monthly pay roll.
$30 or more on a semimonthly pay roll.
$14 or more on a weekly pay roll.

Where deductions are made, they are from the entire amount of earnings. This may push the actual amount paid out in cash to people earning just the minimum a few cents below the amount paid out to people earning just below the minimum. The reason for the arrangement is to make it easier for returns to be computed and checked.

Employers are required to file a monthly "Return of Deductions from Wages." The form of this return is simple:

Employer: _____. File No. _____. Date for filing _____.
See instruction to employers on this form.
This return covers deductions made from wages for the period from_____ _____ to _____.
Total wages, from summary of pay rolls_____ $_____
Add value of free board, lodgings (if any)_____ _____
Total_____ _____
Less wages not subject to deduction_____ _____
Balance, wages from which deductions have been made_____ _____
Amount of 1-percent deductions for which remittance is attached___ _____

Certified a full and correct statement of wages paid, and deductions made therefrom, during the period covered by this return.
Dated:_____, 19___.
(Signature)_____.

Penalty.—For not filing return by due date, one-tenth of 1 percent; not less than $1.

On the reverse, a separate listing of all pay rolls during the period (weekly, semimonthly, or monthly) is made. Details regarding individual employees are not listed on the monthly return.

On an annual basis, employers file a more detailed return. A summary on the first sheet, lists the 12 monthly totals from the forms described above. On sheets which follow, separate listings are given for individual employees. These sheets are made out with three carbon copies. The original and first carbon are for the provincial assessor's office, the second carbon for the employees, the third carbon for the employer's records. The original and second carbon are perforated, so that they can be torn into separate slips for each employee. Each slip reads:

Province of British Columbia, 1940 earnings

Name and address of employee	Married, single, or widowed	Period employed	Total earnings	Total 1-percent deductions	Name of employer

The employer's general list as filed must check with his over-all return. The employee's copy is available to him for making out his personal return. The

original filed with the Assessor, torn into individual slips, is available for matching with individual returns when filed.

Annual returns are also required from "financial agents, brokers, and other persons" for "interest dividends and rents received * * * for clients." These returns list the clients by name and address, and itemize receipts by source, type (interest, dividend, or rent), amount, agent's charges, and balance going to the client.

Corporations, further, are required to report annually the total amount of "cash dividends, stock dividends, and shareholders' bonuses" paid during the year to each shareholder receiving as much as $100, giving the shareholder's name and address. Thus most income payments are reported to the provincial assessor at the source; though current collection applies only to wages and salaries.

Personal income-tax returns, on an annual basis, are required from all executors and trustees under a general rule in the Income Tax Act that "every person, in whatever capacity acting, who is in receipt of any income of or belonging to any other person shall furnish * * * a return." Returns from individuals on their own account are made on forms of two types (like our 1040 and 1040A). The simple form (I. T. Form 7A) is for "individuals whose principal income is derived from salaries or wages"; the other (I. T. Form 7B) provides space for analyzing business expenses and determining taxable income.

Form 7A is designed to fit into the source-collection system. The essential points on its face are as follows:

Name: _____ Occupation: _____
Residential address: _____
Return of income for the year ended Dec. 31, 1940.
Salaries, wages, commissions, bonuses, or gratuities (give name and address of employer) _____ $_____
Perquisites (free board, living accommodation, etc.) received from _____ _____
Other income (give full particulars in each case; attach separate schedule if necessary) _____ $_____
Deduct exemptions and expenses (if any) _____ _____
_____ _____
_____
Less personal exemptions (from p. 2) _____ _____
_____
Balance, net taxable income _____ _____
_____
Tax thereon as per table of rates on p. 2 _____ _____
Subtract the amount of 1-percent deductions from wages during 1940 (particulars of earnings and 1-percent deductions may be obtained from employers, who have been provided with forms for this purpose) _____ _____
_____
Balance:
Additional tax payable _____ _____
Refund due _____ _____

Additional tax is payable in quarterly installments, the first with the return (which must be filed by February 28). If refunds are due because deductions have exceeded tax liability, the return described above "will be accepted as application therefor."

The British Columbia tax rates apply to all income in excess of personal exemptions. "Exemptions" in British Columbia include life-insurance premiums up to $300, contributions up to 5 percent of income, and contributions of employees to retirement funds, besides what corresponds to the American "personal exemption and credit for dependents"—$1,000 for a head of family, plus $200 per dependent, or $600 for a single person. (These levels are being increased in 1941 to match Dominion regulations.)

Calculation of taxes is made by the taxpayer from a very simple table on the back of Form 7A:

RATES OF TAXATION

On the net taxable income.—One percent on the first $1,000 or any portion thereof, or $10 on $1,000 and 2 percent on the remainder where the income does

not exceed $2,000; $30 on $2,000 and 3 percent on the remainder where the income does not exceed $3,000; and so on, the rate rising by 1 percent with each $1,000 addition to income up to $1,530 on $17,000 and 18 percent on the remainder where the income does not exceed $18,000; $1,710 on $18,000 and 19 percent on the remainder where the income does not exceed $19,000. Where the net income exceeds $19,000 the rate is 10 percent on all the net income.

Over and above these rates, surtaxes have been charged on incomes which exceed exemptions by more than $5,000; but these are being repealed to avoid interfering with Dominion revenues.

According to a letter to Mr. Heller, dated April 7, 1931, 324,000 employees were covered by employers' slips filed for 1940 out of a population in British Columbia of about 750,000. Of the employees a large proportion were, of course, nontaxable. About 153,000 individual income-tax returns on Form 7A were filed; 142,000 taxpayers received refunds and 10,000 showed additional taxes or refunds due of less than $1, on which no action was taken. Thus there were only about 1,000 employees owing additional tax; 48,000 of the refunds (chiefly to married persons) were for the full amount of tax withheld at source; the other 94,000 for part of the tax. About 48 percent of the $2,000,000 withheld by employers was refunded by the Province to taxpayers. It is believed that a large number of taxpayers entitled to small refunds failed to file returns.

The reason for the large number of refunds is the crude method of handling exemptions. A single individual who earns $13 a week for 50 weeks (an annual total of $650) is not taxable at the source. If he files an annual return, his income will exceed exemptions by $50; and under the rule which excuses taxpayers owing less than $1, he is nontaxable, so that no return need be filed. But an individual who earns $15 a week for 50 weeks (an annual total of $750) has deducted at the source 15 cents each week (an annual total of $7.50). On his annual return, his income in excess of exemptions will be at most $150, so that he is entitled to a refund of $6—more if he has paid life-insurance premiums, made contributions, etc. If he is married, he is entitled to a refund in full. In fact, a married man with 2 children must average over $28 a week if he is not to receive a refund in full, and over $73 a week if he is to have additional tax to pay. These figures assume 50 weeks' work; if work is irregular, the corresponding weekly rates are higher.

The actual inconvenience resulting from this system is surprisingly little. The Commissioner's letter to Mr. Heller states that the full-time staff working on these taxes numbers only 7 people; and as many more are employed temporarily for about 4 months a year. In short, about 10 man-years of work handles accounts of 324,000 taxed employees and takes care of 141,000 refunds. British Columbia has about one one-hundred and seventy-fifth the population of the United States. On a comparable scale, therefore, we should need about 2,000 persons (principally clerical help) to administer such a system—waiving possible short cuts through incorporating its administration with existing income taxes or social-security taxes or both.

If amounts of tax withheld were larger, inconvenience to employees through having funds tied up might be considerable. The Canadian defense tax requires employers to apply a more accurate (though still crude) exemption system, differentiating between single and married persons, and British Columbia is following suit.

Current collection at source with current allowance for exemptions

The systems we have examined so far fail to allow for exemptions except retroactively. But it is entirely possible to collect taxes on wage and salary incomes at the source on a basis giving taxpayers immediate benefit of exemptions.

Such a pattern of collection has long been in use in Germany, where a number of different items are deducted from wages. Employees file with employers cards stating the employee's family status—much as nonresident employees do in New York State. Employers are provided with tables applying to daily, weekly, and monthly pay rolls, telling them how much to deduct from each size of payment for each family status. For example, a man earning 40 marks weekly (as of 1934) had deducted RM 1.00 if single. If married, he had deducted RM 1.00 if childless, RM 0.80 if he had one child, RM 0.45 if he had two children; nothing if he had more than two. If widowed, he had deducted RM 1.00 if he had one child, RM 0.60 if he had two, nothing if he had more. (Besides all this, there were deductions for social insurance, etc., which did not depend on family status.) Such a system imposes a good deal of clerical work on employers. Its advantage is

fairness among employees and the avoidance of refunds. Besides giving immediate benefit of exemptions, it can be used to apply any desired number of different rate levels at different income levels. As German experience shows, it can be integrated with the regular income-tax system.

Another type of system is represented (though in reverse) by our social security system. Employees' contributions to social-security funds are deducted at the source by employers. But deductions are not based on the whole of incomes, since the excess of incomes over $3,000 per annum is not affected. If this system were turned upside down and deductions made from the excess of income over a certain amount—as is done on a noncurrent basis in New York State—exemptions would be crudely provided for.

Another entirely practicable method would be to calculate tax on income without exemptions and then exempt individuals from a certain amount of tax—as is done on an annual basis by many American States. This might involve simpler arithmetical operations for employers than calculating tax on an excess of income above exemptions. It is not in the least different in principle.

Keynes plan variants

Proposals for "deferred pay" or "forced loans" advanced by J. M. Keynes and others involve having a percentage of income withheld at the source and handed over to the Government by employers, just like the tax schemes we have just examined. The difference in the Keynes proposal is that part of the amount withheld—a larger proportion in low-income groups, a smaller proportion higher up the pyramid—should be regarded as a loan to the Government, to be repaid after peace returns.

Adoption of a scheme of this sort might somewhat simplify the exemption problem, since account could be taken of family status in deciding what proportion of each individual's payments was eventually to be returned. But having $3 a week, say, withheld for repayment years later would be much more of a burden to a married man earning $30 a week than to a single man earning the same amount. Possibly it would be tolerable to make no distinction according to number of children when deducting at the source; but a distinction would have to be made, in fairness, between persons with and without dependents.

Handling exemptions by coupons

Another way to give current benefit of exemptions would be to issue to employees books of exemption coupons. These coupons should be issued in different denominations, each representing tax upon the amount of income upon which some type of taxpayer was entitled to exemption. Single-person coupons, say, might be green, married-with-no-dependents red, married-with-one-dependent yellow, etc.

Responsibility for determining the type of coupons to be issued would fall entirely upon the agency set up to issue them. Each coupon should carry its owner's social security number, and should be negotiable only through the owner's employer. Employers should be instructed to send in the coupons as part payment to the Bureau of Internal Revenue of tax withheld.

With each pay roll, employers would have to classify employees into two groups: those whose coupons had a face value exceeding the amount which was to be deducted, and those whose coupons had a face value equal to or less than the deduction. For the first group, pay checks would be issued as though there were no source-deduction. The amount of coupons received from such employees would then be totaled. For the second group, the tax rate would be deducted from the amount payable, and the face value of the coupon added in. In drawing up his report, the employer would show deductions from the second group at the stated percentage of employees' pay checks, deductions for the first group at the face value of their coupons. (That is, on his books it would appear that he had deducted from the first group's checks not only the official tax rate, but also the excess of the face value of coupons over the tax deduction proper.) Against the total deduction shown for both groups combined, he could apply his coupons at face value when sending in his remittance.

This system has one loophole. The coupons held by persons whose exemption exceeded their incomes would be worth to them less than face value. Persons with larger incomes could afford to offer them payment in cash if they would exchange coupons. Insofar as large earners got undeservedly high exemptions in this way, there would be a leakage of potential revenue. The benefit would be divided between the low earner who sold his exemption and the large earner who bought it.

This difficulty would have to be faced. It has been suggested above that it should be handled by trying to prevent transfer of coupons. Use of Social Security numbers for identification, negotiating coupons only through employers, and (perhaps) filing of coupon books with employers would be fairly effective safeguards. At the other extreme, transfer might be permitted and care taken to see that the original holder got face value for his coupon either from the employer or from some other employee. If this were to be done, however, it would be more straightforward simply to send employees weekly or monthly checks for the amount of tax chargeable on their exempt income, and have employers deduct taxes with no exemptions whatsoever. On this basis exemption would have to be pushed extremely low if there were to be any net revenue; so that it is clear nontransferability would have to be enforced.

IMMEDIATE REFUNDS THROUGH BANKS

Still a further possibility would be to provide immediate benefit of exemptions through the banking system. Employers could be required to deduct taxes without benefit of exemption, giving the employee a receipt along with his pay check. The employee should then be permitted to clip together his receipt and his exemption coupon and pass them both across a bank counter. The banker would give credit for the face value of the receipt or the exemption coupon, whichever was smaller, and on presenting both (still clipped together) would be reimbursed by the Government. The banker would be obliged to confirm the matching of the social-security number on receipt and coupon.

For persons who kept bank accounts, transactions of this sort could readily be handled by mail. In fact, the procedure could be short-circuited by letting the depositor file his exemption-coupon book with his banker and instruct his employer to mail his tax receipt to the banker, which would involve very little work in handling and would greatly simplify the banker's task of matching numbers on tax receipts and coupons.

On this basis the major problems would be to assign exemption levels correctly and to guard against forgery of tax receipts where the authentic receipts are smaller than the exemption coupons.

Setting exemptions to reduce the refund problem

No system of weekly, semimonthly and monthly exemptions for employees can be devised which will prorate annual exemptions so evenly as to avoid both refunds and excess amounts of tax payable. The reason for this is that different employees work for different parts of the year.

If it is desired to minimize the number of employees owing additional tax at the end of the year, an exact proration of the annual exemption will do this. Nobody is paid on a weekly basis more than 52 times a year, so that on this basis nobody will have received the benefit of more than his total annual exemption. This is approximately the system in British Columbia. The minimum $14 weekly at which tax starts corresponds to an annual total of roughly $700—$630 of exemption plus an additional $100 on account of the rule that taxpayers owing less than $1 need not remit. As we have seen, virtually no additional taxes are collected from employees there.

This situation—where refunds are common but claims for additional tax are rare—has the advantage of giving full collections. Small claims for additional tax are hard to collect; a few hundred such claims burden the administrators more than thousands of refunds.

At the other extreme, absolutely to eliminate refund claims requires letting taxpayers apply exemptions against their incomes till the entire exemption is exhausted. This has the serious drawback of bunching tax collections at the end of the year; and if taxes are substantial the taxpayer is likely to miss the benefit of installment payment.

If it is desired to hold refunds below the maximum in number and amount, it is desirable to prorate exemptions so that persons continuously employed will enjoy more than their exemption, at least during most of the year. There are two basic possibilities.

(1) Make the total of weekly or monthly exemptions exceed the annual total (making each week one-fortieth, say).

(2) Allow every taxpayer to claim a limited number of oversized weekly or monthly exemptions (say 40 on a weekly basis), spreading them through the year in any way he sees fit so long as he does not claim more than one in any one week.

Either of these systems could be applied through exemption coupon books. On one basis, the total face value of coupons would exceed the annual exemption. On the other the total face value of coupons would equal the annual exemption, but there would be less coupons than there are weeks or months.

Adjusting exemptions if rates change during the year

It is likely that in the next few years tax-rate changes will have to be frequent, and rates may well change several times a year. It would be relatively easy to notify employers of new effective rates. On the side of exemptions, if employers handle them, it will be necessary to issue new deduction tables. If they are handled by a coupon system, the value of coupons not yet due can be changed by decree. If it is desired to push exemption limits down when raising tax rates, coupon values can be left unadjusted or changed less than in proportion to tax rates.

Taxing property income at the source

Taxation of interest and dividends at the source is a very simple matter relative to taxation of wages and salaries since no exemptions need be allowed at the source. The reason is that almost all interest and dividend payments go to persons who also have salaries and will have their exemptions taken care of there; while a good proportion of the residue goes to persons who have incomes in the surtax brackets. Persons with small property incomes and no salaries commonly depend largely upon annuities, and can be provided for by exempting annuities in whole or in part.

A further slice of property income (including a good share of rent income) can be taxed currently by requiring trustees and other agents to deduct tax from items passed on to clients, as is done in British Columbia. Clients who are prepared to certify that they are not getting the benefit of exemptions in connection with salaries should be given the privilege of having their exemptions cared for by trustees, much as wage-earners' exemptions are handled.

II. CURRENT TAXATION OF INCOMES NOT TAXABLE AT THE SOURCE

The arrangements described above are calculated to reach wages, salaries, interest, dividends, and such part of rents as may pass through the hands of agents or trustees. But they cannot reach the incomes of farmers, professional men, shopkeepers, and other self-employed persons, rent incomes not passing through agents, etc. If small employers are exempted from collecting tax on their employees, moreover, some salary incomes may escape.

Furthermore, the arrangements described are adapted to collection of normal tax (or elements of surtax applying uniformly to all taxpayers), not of progressive surtaxes. Surtaxes could be worked into the system; but the complications would be enormous.

Extension of existing system of returns

The mechanism for reaching these important elements of tax liability must almost necessarily be an extension of our present system of collecting income taxes through annual returns. The chief types of extension to be considered are:

(1) Making returns more frequent (say quarterly).

(2) Approximating tax liability from the previous year's return.

(3) Encouraging prompt payment in advance of final determination of liability by discount, etc.

Frequent returns

It is not impossible to draw up quarterly income-tax returns on a basis similar to that of present annual returns from many taxpayers not reached at the source. This would apply to professional men, brokers, shopkeepers, etc. The chief exception is the farmer—if his income springs from annual crops, there are several quarters of the year for which his income can simply not be estimated.

A quarterly return, both to spare the tax collectors needless work and to avoid injustices among taxpayers with different seasonal income patterns, should be regarded as merely provisional. It should be in abbreviated form, and should

be open to correction by the taxpayer at the time of his next quarterly return or of his annual return.

The chief use of quarterly returns is as an option open to individuals who would be handicapped by the system of presumptions described below.

Taxation by presumption

In the defense period the rule among taxpayers will be to have higher rather than lower money incomes in successive years. Accordingly, the tax liability of most taxpayers can be approximated by assuming their income to be the same as last year. Quarterly current payment could thus be obtained by requiring payment each quarter of one-fourth of the tax which would be due at the current year's rates in case income was as shown on last year's tax return.

With the number of tax returns increasing, this would catch the overwhelming bulk of the tax liability, though it might leave a numerous fringe of new taxpayers not required to pay quarterly. Individual taxpayers who find this system overestimating their tax liability should have the option of substituting a rough estimate of income based on current data, as suggested above.

Taxpayers—particularly farmers with annual crops—whose income receipts are highly seasonal should be permitted to postpone quarterly settlements coming before the date when the bulk of their receipts comes in. This might be taken care of by blanket provisions for certain types of farmers and special applications for nonfarmers in comparable positions.

Encouraging prompt payment

The Treasury has already made public the outline of a scheme for encouraging prompt payment of taxes on a voluntary basis. This could be much strengthened through offering discounts to persons who pay promptly—particularly if these discounts were available only to taxpayers whose prompt payments cleared the bulk of their tax liability.

A workable system would be to offer a special class of nontransferable security which would apply against tax liability with interest. To make the inducement strong, interest should be allowed only if (say) 20 percent of total liability had been covered by March 31, 40 percent by June 30, 60 percent by September 30, and 80 percent before the end of the year. If the taxpayer has overpaid, the excess of his securities should be redeemed in cash, with interest at a rate enough below the standard rate to prevent reaping windfalls by such overpayment.

In case tax rates were changed during the year, the amount of prepayment required in each quarter to qualify for interest should be determined by the tax rates ruling within that quarter.

This system would be a substitute for the presumptive-tax system (with its optional variant of quarterly returns) described above. It would work both for incomes of the self-employed and for surtax liability of persons taxed at the source.

III. ANNUAL EQUALIZATION

It is a principle of fair taxation that persons in the same family status and with the same incomes should have the same tax bills. But all the techniques described above are aimed not to measure tax liability precisely but only to approximate it. Consequently, annual returns must be used to equalize burdens.

Limiting use of annual returns

To keep the number of annual returns within manageable limits, it is necessary to avoid requiring them of the whole population. For this purpose the present device of requiring returns only from persons with certain gross incomes and/or certain net incomes must be continued. It will be necessary, however, to require returns also from persons paying taxes on a quarterly basis. In practice, this amounts only to requiring returns from persons who filed taxable returns last year—a rule which now exists informally.

By setting the limits of gross and net incomes in proper relation to exemptions, the number of nontaxable returns can be kept within reasonable bounds. As regards persons taxed at the source, the object should be to have a large group of taxpayers who are slightly undertaxed and need not be called upon to pay in the difference. This can be done by fixing weekly exemptions so high as to total rather more than annual exemptions, and waiving returns from incomes only slightly above annual exemption limits.

Option to file for persons overtaxed

Some persons taxed at the source are sure to have deductions from their incomes, claims to exemptions which they could not prove in time to get the benefit currently, etc., etc. Accordingly, some taxpayers will find that they have overpaid unless current exemptions are fixed extremely high relative to annual exemptions.

Such taxpayers should be permitted to file returns as applications for refund of amounts overpaid. Regulations should be set up and funds provided for prompt refunds (without requiring data not given in the return) under the following conditions:

(1) The individual in question was taxed at the source.

(2) Either:

(*a*) His gross income was less than, say, $3,000 and his refund claim was greater than $1; or

(*b*) His gross income exceeded $3,000 and his refund claim was between a lower limit of $1 and an upper limit of $10 or 10 percent of tax (whichever is less).

More substantial claims should be refunded only after fuller inquiry.

Uniform treatment of prompt payments

It was indicated above that a potent weapon for securing prompt payment of taxes by persons not taxed at the source is to credit interest on prompt payments down to the date of final settlement. If this system of inducements is adopted, interest should also be credited on sums collected by withholding at the source, and at the same rate. For convenience in calculation, interest should be either at 3 percent (i. e., one-fourth of 1 percent monthly), or 6 percent (one-half of 1 percent monthly).

If rates of tax change during the tax year, the rate charged on annual returns should be the average of the rates applying in the 12 months of the year. This would mean equal treatment of incomes of equal size, regardless whether they were received in an even flow over the year or were bunched at certain dates. If we experience a sharp rate of price increase, this may mean discriminating in favor of persons receiving the bulk of their income early in the year (when dollars are worth more goods); but we must hope to keep prices within bounds.

IV. THE PERIOD OF TRANSITION

As soon as we start collecting income taxes currently, each taxpayer must start applying part of his current income to taxes upon that income. But whenever we start, taxpayers will still have some taxes to pay on previous incomes under present regulations. Until this accumulated tax liability is worked off, current income must support both current and back taxes. Obviously this creates a problem.

Low rates during transition

If the revenue and price situations do not require double revenue during the period of transition, the taxpayer should be helped either by a reduction of his liability for back taxes or by low rates on the current period. The former is possible if the transition begins at the start of a calendar year. In collecting taxes in 1942, for instance, it would be possible simply to reduce normal rates on 1941 incomes to zero, levying corresponding rates on 1942 income collectible in 1942. But if collection starts within a calendar year, the fact that some taxpayers settle in full while others now pay in quarterly installments makes this procedure unfair. To cut rates on 1940 incomes in order to permit taxation of 1941 incomes during the last half of 1941 would mean discriminating against those who paid their 1940 taxes in full on March 15, 1941. Accordingly, rates on 1941 incomes should be made low. This would also simplify the problems of 1942, when collections of taxes on 1942 incomes and of the unpaid residue of tax on 1941 incomes would run concurrently.

Maintenance of surtax during transition

The above argument for temporary abatement of rates applies to "normal" tax and to the part of the proposed new surtax schedule which strikes all taxable incomes. But the progressive part of the surtax should not be excused, since this would grant a windfall amounting to a substantial part of income to taxpayers liable for surtax. They expect at present to pay surtax on each year's income in future, and to remit surtax for 1 year is not required by fairness.

If surtax is not to be remitted, it may be desirable to permit transition to a current collection basis to be spread over more than 1 year for taxpayers in the

upper brackets who apply for the privilege. Pressure for current payment (through quarterly payments based on previous returns, or through discount schemes) need not extend beyond the uniform part of the surtax. The monetary effect of permitting late payment of the rest of the surtax is bound to be mild—firstly, because the amount of taxes involved is not likely to exceed $500,000,000 or $600,000,000; secondly, because taxpayers in these brackets are more likely than those in lower brackets to adjust this year's spending to taxes payable next year.

DEPARTMENT OF FINANCE,
THE GOVERNMENT OF THE PROVINCE OF BRITISH COLUMBIA.

WALTER W. HELLER, Esq., *April 7, 1941.*
% University of Wisconsin, Madison, Wis.

SIR: I am in receipt of your letter of the 2d instant, and return herewith the credential enclosed. I am also sending you a copy of the Income Tax Act, taxation act, a short synopsis of the tax legislation for ready reference, forms covering the operation of the 1-percent wage deduction, with accompanying explanation, and the forms in use for general income-tax purposes; also a booklet giving full particulars of the new Dominion national-defense tax.

Referring first to the synopsis, the changes indicated in item 1 (income) are proposed changes recently announced; but not yet enacted. The changed exemptions will conform with those applicable to the Dominion national-defense tax, and the surtax is being repealed in order to give the Dominion a freer hand in this field of taxation for national and war purposes.

Item 1 is, of course, covered by the Income Tax Act.

Item 2 (a), (b), (f), (g), and (h), as well as item 3, will be found in the taxation act. (2 (c), (d), and (e) are covered by section 32 of the Income tax Act.

Items 4, 5, 6, and succession duties are each separate statutes and I imagine of no concern to you in your present study.

Answering your questions in numerical order:

(1) The tax has been deducted from wages at source since 1931.

(2) Although it involves the making of a large number of refunds, it seems the only logical method of collecting taxes from low-income groups. It is much easier to make refunds than to try to collect small amounts at the end of the year. Prior to the adoption of this method, we wrote off hundreds, yes, thousands, of small amounts every year because it would cost more to enforce collection than the amount of tax involved. Once the system has been brought to a well-established routine, it is not expensive to operate. We have only about seven people wholly and permanently engaged on this particular work, plus an equal number for a temporary period of 3 or 4 months following the filing date for returns. I would note here that no application for refund is necessary, the filing of a return insures a refund if one is due—of course, no return, no refund.

(3) This is partially answered above. A very great proportion of our refunds would be eliminated if the employers were required to apply the appropriate exemptions. A large number might also be eliminated if the basic rate of income tax were increased from 1 to 2 percent (the deduction at source still being left at 1 percent).

(4) (*a*) No; compliance by employers is good.

(*b*) Some difficulty has been experienced with employers who have only a couple of employees. We overcome this to a large extent by permitting quarterly returns to be made in such cases. We are not strict with these small employers in the application of penalties, as we feel they have to be given some credit for doing a lot of work for us for nothing. Penalties are only applied where evasion is flagrant.

(5) The forms requested are enclosed. We do not issue any report.

(6) I will number these questions in the order asked:

	1940
(*a*) Number of employers' returns filed (Form 57)	17,158
(*b*) Number of employees' slips filed (Form 57–1)	321,276
(*c*) Number of Form 7a income-tax returns filed by individuals	152,850
(*d*) Number of persons receiving a refund of the full amount deducted	48,488
(*e*) Number paying added tax (approximately)	10,000
(*f*) Total individual and corporation income-tax collections	$10,236,183.33
(*g*) Total individual and corporation income-tax collections	$2,115,537.20
(*h*) Amount paid by employers at source	$2,066,356.00
(*i*) Amount refunded to employees	$1,000,575.81
(*j*) Number of refunds	141,516.00

I am also enclosing, from our classifications, statements showing the source from which our total tax is received and the income groups under the head of "Employment," which may be of interest for your purpose.

In connection with the figures given above, under 6 (*d*), the figure of 48,488 is also included in the figure of 141,516 under 6 (*j*), and is composed largely of married persons in the two low-income groups. Practically this whole number of refunds would be eliminated if employers were required to apply the exemptions; also a very large number of partial refunds would be thus eliminated.

It might be interesting to mention to you that this deduction at source is far from being unpopular with the employee; in fact, once they become accustomed to it, the deduction is not missed, and the refund at the end of the year is very popular. We find them very appreciative of getting a few dollars back, and they seem to forget about the larger amount that has been retained as assessed tax. Even those who have an additional tax to pay appreciate the fact that a portion of it, at least, has been taken care of.

In further explanation of 6 (*b*) and (*c*), the difference between these two figures represents the number of persons from whom sundry small deductions have been made, but who have not bothered to file returns to obtain a refund. This represents, in the aggregate, a substantial sum of what one might call "found money."

I think this covers pretty well the information you wanted; but if I can be of further assistance to you I will be glad to hear from you.

For your information in this connection, the population of this Province is approximately 750,000.

Yours respectfully,

———— ————,
Commissioner of Income Tax.

DEPARTMENT OF FINANCE,
THE GOVERNMENT OF THE PROVINCE OF BRITISH COLUMBIA,
April 7, 1941.

Re tax deductions at source from wages.

Attached are forms in use in connection with the deduction at source from wages:

(1) *"Information for Employers."*

(2) *Form I. T. 6.*—This is a monthly return made by employers covering deductions made during the preceding month. You will note that no details are given concerning the individuals from whom deductions were made. This information being given on the annual return—Form 57.

(3) *Folder-Ledger Card.*

(4) *Form I. T. 57 and 57-1.*—This is the employer's annual return of wages paid to employees. The total on Form 57 must agree with the aggregate of monthly returns. You will note that all wages are required to be shown whether deductions have been made from them or not—that is, they may have been below the exemption level. This is for the reason that the total wages shown here must agree with the wage deduction claimed on the income tax return.

Forms 57-1 are in quadruplicate, two for the department, one for the employee, and one for the employer. The reason for the two copies for departmental use is that the perforated one is attached to the individual employee's return and the copy that is not perforated is for subsequent ready reference.

As you will see, we use an addressograph machine and the forms are put through this machine before being sent out to the taxpayer, so that when they are subsequently received the filing is simplified. The folder-ledger card is also made from this addressograph plate.

Form I. T. 6 is sent out monthly, along with the receipt for the previous month's payment, window-envelopes being used.

Up to the present time no distinctions have been made between married and single persons in the matter of deductions from wages, the deduction being made from everyone receiving wages in excess of the stated amounts. The purpose of this was to save trouble to the employers in applying different exemptions; but of course it increased the work of the Department in making a larger number of refunds. Now that the exemptions have been raised (as indicated by the synopsis enclosed) employers will have to be required to apply the appropriate exemptions. Since the enactment last year by the Dominion Government of the national-defense

tax, employers are required to apply the appropriate exemptions for the purpose of that tax, and our increased exemptions are made to conform thereto. I am enclosing a booklet giving full information respecting this Dominion national defense tax, which I think you will find of interest and service.

———— ————,
Commissioner of Income Tax.

COMMISSIONER OF INCOME TAX, DEPARTMENT OF FINANCE,
Victoria, B. C.

INFORMATION FOR EMPLOYERS

INCOME TAX ACT—1 PERCENT WAGE DEDUCTIONS

Subject to the limitations set out hereunder, every employer is required to deduct 1 per cent. from the wages of every employee at the time the wages are paid, and to remit the amount so retained to the Provincial Collector for the district on or before the fifteenth day of the following month. The prescribed form (I. T. 6) must be completed and forwarded with the remittance. It is the practice to mail this form monthly to every employer of whom the Department has a record, but this is for convenience only, and the non-receipt of the form does not relieve the employer from the liability of making a return.

These deductions are only to be made if the earnings of the employee amount to—

$60.00 or more on a monthly pay roll.
$30.00 or more on a semimonthly pay roll.*
$14.00 or more on a weekly pay roll.

(NOTE.—Only wages *below* these amounts are exempt. In all other cases the 1-per cent. deduction must be made from the full amount of the wages.)

The liability to deduction is not determined by the rate of pay, but by the total amount payable to the employee during any one of the pay-roll periods.

The term "wages" has a broad interpretation and includes and includes any compensation for labor or services measured by the time, piece, or otherwise. This covers commissions, bonuses, etc, as well as ordinary wages or salary. It also includes any incidental perquisites or privileges, such as free board or lodging, and these must be valued by the employer at prevailing rates and be added to the earnings.

Records.—Every employer must keep accurate records relating to all his employees, which will show their names and addresses, whether married or single, rate of wages, time worked, wages paid, and the amount (if any) deducted from each. At the end of the year a complete list of employees will be required from all employers, showing the total wages and deductions for the year in each case.

Liability of Employer (Sec. 23 (3)).—Every employer who deducts and retains any amount from the wages of an employee under the provisions of this section shall be deemed to hold the same in trust for His Majesty and for the payment over of the same in the manner and at the time provided under this section; and the amount shall until paid form a lien and charge on the entire assets of the employer's estate in the hands of any trustee having priority over all other claims of any person.

Penalty (Sec. 53 (1)).—Every person who, in contravention of any provision of this Act, fails to make any return required by section 23 in the manner and within the time prescribed therefor shall forfeit and pay to the Minister an amount of money equal to one-tenth of one per centum of the total wages paid by that person during the period to be covered by the return; but the amount so forfeited in any case shall not be less than one dollar or more than fifty dollars.

C. B. PETERSON,
Commissioner of Income Tax.

*Although section 23 (5) of Income Tax Act states the exemption as $50 per month, section 24 (2) provides that no tax be assessed for less than $11, which in reality makes the exemption $100 more, or approximately $60 monthly. Note that under section 23 (4) no refunds of less than $1 are made. P.

I.T. Form 6.

DO NOT DETACH.
This copy will be receipted and returned.

Employer's Return of Deductions from Wages pursuant to the provisions of the "INCOME TAX ACT."

To be filed with the Provincial Collector, — NOT LATER THAN Apr. 15th 1941

Begg Motor Co., Ltd.,
865 Yates St.,
Victoria, B. C.

File Number.
V1
97-10-8

CASH REGISTER FIGURES BELOW CONSTITUTE OFFICIAL RECEIPT.

SEE INSTRUCTIONS TO EMPLOYERS ON THIS FORM.

This Return covers deductions made from wages for the period

from __________ to __________

Total wages, from summary of pay-rolls	$
Add value of free board, lodgings, etc. (if any)	
Total	$
Less wages not subject to deduction	$
Balance, wages from which deductions have been made	$
Amount of 1% deductions, for which remittance is attached	$

Certified a full and correct statement of wages paid, and deductions made therefrom, during the period covered by this Return.

Dated __________ 193__

(Signature) __________

PENALTY.—For not filing Return by due date 1% of 1%, not less than $1.

I.T. 6—1636-889-8400

(over)

SUMMARY OF PAY-ROLLS.

The totals of each separate pay-roll prepared during the period covered by this Return must be listed below.

Period. From.	Period. To.	Total Wages.	Wages not subject to Deductions. (See Instructions.)	Balance, Wages from which Deductions have been made.	Amount of 1% Deductions.
Totals					

Employer's Return of Deductions from Wages
pursuant to the provisions of the
"INCOME TAX ACT."
To be filed with the Provincial Collector, — NOT LATER THAN Apr. 15th 1941

	File Number.
Begg Motor Co., Ltd., 865 Yates St., Victoria, B. C.	V1 97-10-S

SEE INSTRUCTIONS TO EMPLOYERS ON THIS FORM.

This Return covers deductions made from wages for the period

from ..... to .....

Total wages, from summary of pay-rolls	$
Add value of free board, lodgings, etc. (if any)	
Total	$
Less wages not subject to deduction	$
Balance, wages from which deductions have been made	$
Amount of 1% deductions, for which remittance is attached	$

Certified a full and correct statement of wages paid, and deductions made therefrom, during the period covered by this Return.

Dated ..... 193....

(Signature) .....

PENALTY.—For not filing Return by due date 1/10 of 1%, not less than $1.

INSTRUCTIONS TO EMPLOYERS.

Employers are required to deduct 1 per cent. from the wages of every employee, earned after March 31st, 1934, if the total earnings of the employee amount to:—

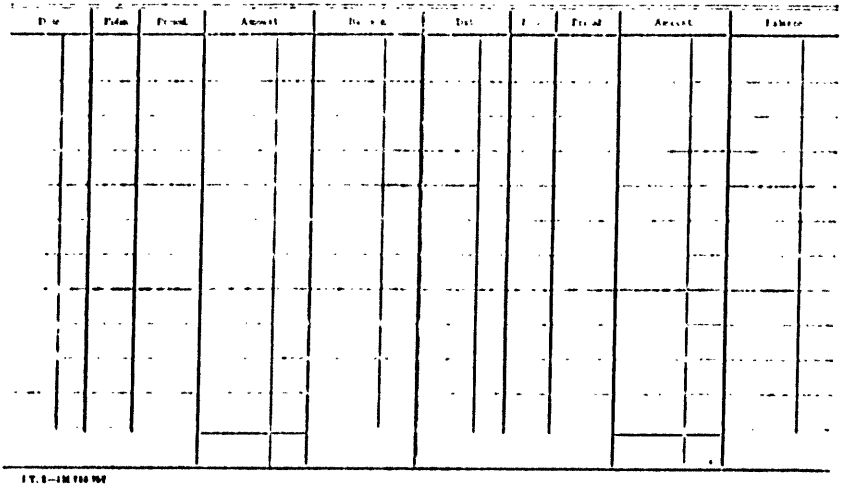
$60.00 or more on a monthly pay-roll.
$30.00 or more on a semi-monthly pay-roll.
$14.00 or more on a weekly pay-roll.

NOTE.—Only wages *below* these amounts are exempt. In all other cases the 1 per cent. deduction must be made from the full amount of the wages.

The "Summary of Pay-rolls" forming part of this Return must be completed in every case before the Return is filed. The total amount of wages paid to employees, from whom no deductions have been made by reason of the exemptions stated above, must be entered in the column provided for that purpose.

Monthly returns from employers are filed in these folders, which also serve as the ledger account.

Begg Motor Co., Ltd., VI
865 Yates St., 97-10-3
Victoria, B. C.



This card is attached to the addressograph plate, which is equipped with a tab to indicate outstandings.

Begg Motor Co., Ltd., VI
865 Yates St., 97-10-3
Victoria, B. C.

1940	Jan.	Feb.	Mar.	Apr.	May.	June.	July.	Aug.	Sept.	Oct.	Nov.	Dec.
1941	Jan.	Feb.	Mar.	Apr.	May.	June.	July.	Aug.	Sept.	Oct.	Nov.	Dec.
1942	Jan.	Feb.	Mar.	Apr.	May.	June.	July.	Aug.	Sept.	Oct.	Nov.	Dec.
1943	Jan.	Feb.	Mar.	Apr.	May.	June.	July.	Aug.	Sept.	Oct.	Nov.	Dec.

FORM 57-1.

SHEET No. .....

LIST OF EMPLOYEES

CALENDAR YEAR, 1940.

ORIGINAL—To be attached to and filed with Form 57. Read carefully the instructions on that form.

PROVINCE OF BRITISH COLUMBIA. 1940 EARNINGS.

NAME AND ADDRESS OF EMPLOYER.	M. or W.	Period employed	Total Earnings.		Total I.T. Deductions.		NAME OF EMPLOYEE.

FORM 57-1.

SHEET No. .....

LIST OF EMPLOYEES.

CALENDAR YEAR, 1940.

Copy to be retained by employer.

PROVINCE OF BRITISH COLUMBIA. 1940 EARNINGS.

NAME AND ADDRESS OF EMPLOYER.	M. or W.	Period employed	Total Earnings.		Total I.T. Deductions		NAME OF EMPLOYEE.

FORM 57-1.

SHEET No. .....

LIST OF EMPLOYEES.

CALENDAR YEAR, 1940.

Copy to be given to employee.

PROVINCE OF BRITISH COLUMBIA. 1940 EARNINGS.

NAME AND ADDRESS OF EMPLOYER.	M. or W.	Period employed	Total Earnings.		Total I.T. Deductions		NAME OF EMPLOYEE.

FORM 57-1.

SHEET No. .....

LIST OF EMPLOYEES.

CALENDAR YEAR, 1940.

Copy for Department. To be attached to original and filed with Form 57.

PROVINCE OF BRITISH COLUMBIA. 1940 EARNINGS.

NAME AND ADDRESS OF EMPLOYER.	M. or W.	Period employed	Total Earnings.		Total I.T. Deductions		NAME OF EMPLOYEE.

I.T. FORM 57.

1940

PROVINCE OF BRITISH COLUMBIA.

DATE RECEIVED.

For departmental use only.

EMPLOYER'S RETURN OF SALARIES, WAGES, COMMISSIONS, BONUSES, PERQUISITES, INTEREST, or other remuneration paid to employees during the calendar year 1940, as required under section 11 of the "Income Tax Act."

One copy of this Return, together with supplementary details on Form 57-1 *in duplicate*, must be filed with the PROVINCIAL ASSESSOR, ... VICTORIA ...., B.C., in the month of January, if possible, and NOT LATER THAN FEBRUARY 28TH, 1941, IN ANY CASE. After that date the penalty referred to below will be enforced.

Name and address of employer: Bagg Motor Co., Ltd., 865 Yates St., Victoria, B. C. — V1 97-10-8

For departmental use only.
57 Totals checked
57-1 Totals checked
Ledger

SUMMARY OF WAGES, ETC., FOR THE CALENDAR YEAR 1940.

MONTH.	Wages paid in Cash.	Value of Free Board, Lodgings, or other Perquisites.	Total Wages (from Summary of Pay Rolls)	Total Wages and Taxable Benefits.	Balance Wages from which Deductions have been made.	1% Deductions.
January						
February						
March						
April						
May						
June						
July						
August						
September						
October						
November						
December						
Totals for year						

NOTE.—Monthly summaries shown above should agree with the amounts reported each month on Form I.T. 6 (Employer's return of deductions from wages). The totals should agree with the taxpayer's records, otherwise a reconciliation must be attached.

I hereby certify that this Return, together with Form 57-1 attached hereto, constitutes a full and correct statement respecting all employees, showing the wages paid and deductions made therefrom for the calendar year 1940.

Phone No. .....

Signature .....

Date ....., 19....

INSTRUCTIONS TO EMPLOYERS.

Form 57-1, to be attached hereto, must contain a complete list of all employees, showing wages paid and deductions made, and must be completed in accordance with the following instructions:—

Particulars respecting each employee must be shown on a separate slip.

Fees and salaries paid to directors and officers of corporations must be included.

Column 1.—Show in alphabetical order full name and residential address of employees, surname first.

Column 2.—State whether employee is married, single, widow, or widower.

Column 3.—Where possible, give particulars, such as: 12 mos; 6 mos. to Oct.; casual, etc.

Column 4.—Show total wages or other remuneration for the year 1940, including the value of all perquisites, such as free board or living accommodation.

Column 5.—Show in one amount the total deducted from employee's wages for the calendar year.

Column 6.—Name of employer must appear on every slip. A rubber stamp is suggested for this purpose.

The employee's copy of each slip should be handed to the employee, as the information thereon is essential for the preparation of his individual return.

Extra copies of Form 57-1 may be obtained from any Provincial Assessor. (The information respecting employees will not be accepted on any other form.)

PENALTIES.

For failure to file this Return in the manner and within the time specified: One-tenth of 1 per cent. of the total wages paid (minimum, $1; maximum, $50).

For false Return: Upon summary conviction, a fine not exceeding $1,000.

15,500-1940-7777

I.T. Form 87D.

INCOME TAX ACT.

1940

File No. . . . . .

RETURN OF DIVIDENDS PAID BY CORPORATIONS DURING THE CALENDAR YEAR 1940.

One copy of this Return must be filed with the Commissioner of Income Tax, Parliament Buildings, Victoria, B.C., not later than February 28th, 1941.

Name of Corporation . . . . . .

Address . . . . . .

INSTRUCTIONS.—Give names and addresses of all shareholders resident in British Columbia to whom dividends or bonuses were paid in cash or shares, to the extent of $100 or more, during the calendar year 1940, showing the full amount paid to each shareholder *without any deductions whatsoever.*

If no dividends were paid during 1940, return form with a notation to that effect.

NAME. (In alphabetical order and surname first.)	FULL POSTAL ADDRESS.	Total Amount of Cash Dividends, Stock Dividends, and Bonuses (Bonuses paid during the Calendar Year 1940.	
	TOTAL, $		

CERTIFIED CORRECT.

. . . . . (Signature of official)

Date . . . . . (Rank of official)

If the above space is insufficient, use the back of this form or attach separate schedule.

INCOME TAX ACT

FORM I.T. 57B

RETURN OF INTEREST, DIVIDENDS, AND RENTS RECEIVED BY FINANCIAL AGENTS, BROKERS, AND OTHER PERSONS FOR CLIENTS DURING THE CALENDAR YEAR, 193 . .

THIS RETURN should be prepared in Duplicate. One copy must be delivered or mailed postpaid to the PROVINCIAL ASSESSOR, , B.C., not later than February 28th, in each year.

Name of Agent . . . . . .

Address . . . . . .

Indicate nature of income under Column 3 thus: Dividends (D), Interest (I), Rents (R).

(1) NAME AND ADDRESS OF CLIENT	(2) RECEIVED FROM	(3) D., INT., RENTS	(4) AMOUNT.	(5) CHARGES.	(6) BALANCE

I hereby certify that the information given above, on the back hereof, and on supplemental sheets attached hereto, if any, is true and correct and constitutes a full statement of interest, dividends, and rents received for clients by me during the calendar year ended 31st December, 193..., in accordance with the provisions of section 13 (1) of the "Income Tax Act."

Date..... (*Signature*).....

I.T. FORM 7A.
For the use of individuals whose principal income is derived from salaries or wages.

DATE RECEIVED

For departmental use only.

PROVINCE OF BRITISH COLUMBIA.

INCOME TAX

1940

File No.

1st. payment

$

Receipt No. Initials.

This Return should be prepared in duplicate. One copy must be delivered or mailed postpaid to the PROVINCIAL ASSESSOR, ..., B.C., NOT LATER THAN FEBRUARY 28TH, 1941, and one copy may be retained by the taxpayer.

Please PRINT name and address—Surname first.

Name ..... (Surname) ..... (Christian names in full) ..... Occupation .....

Residential address .....

In case of change of residence state address in 1939 .....

Last previous Return was filed with the Provincial Assessor at ....., B.C.

RETURN OF INCOME FOR THE YEAR ENDED DECEMBER 31st, 1940.

SALARIES, WAGES, COMMISSIONS, BONUSES, OR GRATUITIES. (Give name and address of employer and department in which employed, and pay-roll number, if any.) .....

Perquisites (free board, living accommodation, etc.) received from .....

OTHER INCOME. (Give full particulars in each case. Attach separate schedule if necessary.) .....

Deduct exemptions and expenses (if any):

- War disability pension .....
- One-half of income from purchased annuities .....
- Dividends of British Columbia companies .....
- Other deductions. (Specify.) (Do not claim personal exemptions here) .....

Less Personal exemptions (from page 2) .....

Balance, net taxable income .....

Tax thereon, as per table of rates on page 2 .....

Subtract the amount of 1% deductions made from wages during 1940 .....
(Particulars of earnings and 1% deductions may be obtained from employers who have been provided with forms for this purpose.)

Balance { Additional tax payable. (*See* "A" below.) ..... or Refund due. (*See* "B" below.) .....

Note.—No remittance is required where the tax payable is less than $1, nor will a refund be made for a sum less than that amount.

"A." If additional tax is payable, either the full amount or not less than one-quarter thereof must accompany this Return, and the balance may be paid in three quarterly instalments on or before May 31st, August 31st, and November 30th, 1941, with interest at the rate of 4½% per annum from February 28th, 1941, to date of payment. Additional interest at the rate of 6% per annum must be added to the amount of any instalment which is not paid by the due date.

REMITTANCE IN FAVOUR OF THE PROVINCIAL COLLECTOR FOR $ ..... IS ENCLOSED HEREWITH.

"B." If a refund is indicated, this Return will be accepted as applicable therefor.

I hereby certify that this Return, together with supplementary statements and additional schedules attached (if any), contains a true and correct statement of my total income and deductions claimed for the year 1940.

Telephone No. .....

Signature .....

Date ....., 19..

SPACE BELOW FOR DEPARTMENTAL USE ONLY.

Class	True Income	Exemptions	Total Tax Payable .....
1% Deduction	1% applied on Tax	Refund	Balance Tax Due .....
Interest and Penalty	Assessed Tax	Surtax Income	Surtax .....
Loosen		Polio	Recorded .....

I.T. FORM 7B.
For use of individuals whose principal income is derived from sources other than wages.

DATE RECEIVED.

For departmental use only.

PROVINCE OF BRITISH COLUMBIA.

INCOME TAX

1940

File No.

Int. payment

$

Receipt No. Initials.

This Return should be prepared in duplicate. One copy must be delivered or mailed postpaid to the PROVINCIAL ASSESSOR, ..., B.C., and one copy may be retained by the taxpayer.

If the taxpayer conducts any trade, business, or profession, the RETURN must be filed within three months after the end of the taxpayer's business or fiscal year.
In all other cases the Return must be filed not later than February 28th, 1941.

PLEASE PRINT name and address—Surname first.

Name ..... (Surname.) (Christian names in full.)

Residential address .....

In case of change of residence state address in 1939 .....

Occupation ..... If engaged in business or professional practice during 1940, state—

(a) Business name and address .....

(b.) Names of partners (if any) .....

Last previous Return covered the period ended ....., 19.., and was filed with the Provincial Assessor at ....., B.C.

This Return covers all income for ..... months ending ....., 1940.

PAYMENT OF TAX.

(1.) Every person liable to pay any tax under the Act shall send with the Return of the income on which the tax is payable a payment of not less than one-quarter of the amount of the tax, and he shall pay the balance (if any) of the tax in not more than three quarterly instalments thereafter, together with interest at the rate of four and one-half per centum per annum upon each instalment from the last day prescribed for making the Return to the time payment is made.

(2.) Every person liable to pay any tax who fails to pay in full any payment or instalment thereof at the time prescribed by subsection (1) for the payment of the same shall pay, in addition to the interest payable under that subsection, interest at the rate of four per centum per annum on the amount in default from the date of default to the date of payment.

RATES OF TAXATION.

On the Net Taxable Income:—
1% on the first $1,500 or any portion thereof, or
$ 10.00 on $ 1,500 and 2% on the remainder where the income does not exceed $ 2,000;
$ 20.00 on $ 2,000 and 3% on the remainder where the income does not exceed $ 3,000;
$ 50.00 on $ 3,000 and 4% on the remainder where the income does not exceed $ 4,000;
$ 100.00 on $ 4,000 and 5% on the remainder where the income does not exceed $ 5,000;
$ 150.00 on $ 5,000 and 6% on the remainder where the income does not exceed $ 6,000;
$ 210.00 on $ 6,000 and 7% on the remainder where the income does not exceed $ 7,000;
$ 280.00 on $ 7,000 and 8% on the remainder where the income does not exceed $ 8,000;
$ 360.00 on $ 8,000 and 9% on the remainder where the income does not exceed $ 9,000;
$ 450.00 on $ 9,000 and 10% on the remainder where the income does not exceed $10,000;
$ 550.00 on $10,000 and 11% on the remainder where the income does not exceed $11,000;
$ 660.00 on $11,000 and 12% on the remainder where the income does not exceed $12,000;
$ 780.00 on $12,000 and 13% on the remainder where the income does not exceed $13,000;
$ 910.00 on $13,000 and 14% on the remainder where the income does not exceed $14,000;
$1,050.00 on $14,000 and 15% on the remainder where the income does not exceed $15,000;
$1,200.00 on $15,000 and 16% on the remainder where the income does not exceed $16,000;
$1,360.00 on $16,000 and 17% on the remainder where the income does not exceed $17,000;
$1,530.00 on $17,000 and 18% on the remainder where the income does not exceed $18,000;
$1,710.00 on $18,000 and 19% on the remainder where the income does not exceed $19,000.
Where the net income exceeds $19,000 the rate is 20% on all the net income.

SURTAX ON INCOME OVER $5,000.

In the case of individuals whose net income, as ascertained by sec. 22 of the "Income Tax Act," exceeds the sum of $5,000, a surtax is imposed in addition to the tax indicated herein, in respect of which a notice of assessment will subsequently be mailed to the taxpayer fixing the date upon which the additional surtax is payable.

Remittance in favour of the Provincial Collector for the sum of $..... is enclosed herewith, being the total amount or not less than one-quarter of the amount of tax on the income for the period covered by this Return, estimated as follows:—

Net taxable income (from Summary, page 4) ..... $.....

Tax payable thereon, as per table of rates (above) ..... $.....

Less amount of 1% deductions from salary or wages (if any) ..... $.....

Balance of tax due ..... $.....

NOTE.
No remittance is required where the amount payable is less than $1.

(Claim may be submitted in respect of income tax paid to another Province on income included herein.)

I hereby certify that this Return, together with supplementary statements and additional schedules attached (if any), contains a true and correct statement of my total income and deductions claimed for the period stated.

Telephone No. .....

Signature .....

Date ....., 19....

(If requested to do so by the Commissioner, the taxpayer must verify the correctness of a Return by his statutory declaration.)

SPACE BELOW FOR DEPARTMENTAL USE ONLY.

Class	True Income	Exemptions	Total Tax Payable	
1% Deduction	1% applied on Tax	Refund	Balance Tax Due	
Interest and Penalty	Assessed Tax	Surtax Income	Surtax	
Losses		Folio	Recorded	

I.T. FORM 7B-1.
(Supplementary to Form 7B.)

DATE RECEIVED.

For departmental use only.

PROVINCE OF BRITISH COLUMBIA.

INCOME TAX

1940

File No.

Every individual who conducts any trade, business, or profession, and every member of a partnership, must complete this form and attach one copy to Form 7B. (*See* item 1, page 2, of that form.)

Name of taxpayer or partnership

Address

Trade-name (if any)

1. STATEMENT OF ASSESSABLE INCOME.

Net profit (or loss) from Profit and Loss Account (Statement 3)		
ADD: Sundry charges not allowed under the "Income Tax Act" as deductions from taxable income, viz.:—		
(a.) Salary or wages of proprietor, if charged to profit and loss (from 3 (a))		
(b.) Local improvement taxes (from 3 (g))		
(c.) Provincial income tax (from 3 (h))		
(d.) Dominion income tax (from 3 (i))		
(e.) Life insurance premiums (from 3 (m))		
(f.) Alterations, renewals, replacements, or additions (from 3 (p))		
(g.) Bad debts reserve (from 3 (r))		
(h.) Charitable donations—the excess over 5% of net taxable income (from 3 (t))		
(i.) Depreciation in excess of limits allowable in accordance with regulations		
NET TAXABLE INCOME (*see* note)		

NOTE.—If the business or profession is conducted solely by the taxpayer this amount must be transferred to item 1, page 2, of Form 7B. In the case of a partnership, the division of this amount between the partners must be shown below and the taxpayer's interest therein transferred to item 1, page 2, of Form 7B.

NAMES AND ADDRESSES OF PARTNERS.	Interest in Partnership.	Division of Net Taxable Income.
Total, as above		

I hereby certify that this Return, together with the additional schedules attached (if any), constitutes a full and correct statement of the income and expenses of the business or profession referred to herein for the period stated.

(Signature)

Date ....., 19.....

(OVER.

I.T. FORM 7B-2.
(Supplementary to Form 7B.)

DATE RECEIVED.

For departmental use only.

1940

PROVINCE OF BRITISH COLUMBIA.

INCOME TAX

File No

Every person who operates a farm, orchard, or ranch, either as sole owner or partner, must complete this form and attach one copy to Form 7B. (*See* item 1, page 2, of that form.)

Name .....

Address .....

STATEMENT OF INCOME AND EXPENDITURE FOR THE CALENDAR YEAR 1940.

GROSS INCOME FROM THE SALE OF:—Live stock		
Poultry and eggs		
Grain and hay		
Dairy products		
Fruit and vegetables		
Sundries		
Value of farm products consumed in taxpayer's household		
TOTAL INCOME		
Expenses claimed as deductions from gross income:—		
Live stock purchased		
Seed and feed purchased		
Wages paid to employees. (Give details on page 2.)		
Taxes on farm property		
Rent of farm property paid to ..... (Name and address.)		
Interest paid to ..... (Name and address.)		
Repairs to farm buildings, machinery, etc. (Do not include alterations, renewals, or replacements of a permanent nature.)		
Depreciation (*see* page 2)—		
On farm buildings (cost $ .....) at 3%		
On machinery and equipment (cost $ .....) at 10%		
On motor-vehicles (cost $ .....) at 20%		
Other expenses. (Give details. Expenses of taxpayer's household must NOT be included)		
TOTAL EXPENSES		
TOTAL INCOME, as above		
TOTAL EXPENSES, as above		
BALANCE		
Less exemption under section 4 (*c*) of the "Income Tax Act"		1,000.00
NET TAXABLE INCOME (*see* note)		

NOTE.—If the farm, orchard, or ranch is conducted solely by the taxpayer this amount must be transferred to item 1, page 2, of Form 7B. In the case of a partnership, the division of this amount between the partners must be shown below and the taxpayer's interest therein transferred to item 1, page 2, of Form 7B.

NAMES AND ADDRESSES OF PARTNERS	Interest in Partnership.	Division of Net Taxable Income.
TOTAL, as above		

I hereby certify that this Return, together with the additional schedules attached (if any), constitutes a full and correct statement of the income and expenses of the business referred to herein for the period stated.

(Signature) .....

Date....., 19....

(OVER.)

DATE RECEIVED.

For departmental use only.

FORM IT. 7C.

PROVINCE OF BRITISH COLUMBIA

File No.

INCOME TAX

RETURN OF INCOME TO BE MADE BY EXECUTORS AND TRUSTEES

This Return should be prepared in duplicate. One copy must be delivered or mailed postpaid to the COMMISSIONER OF INCOME TAX, PARLIAMENT BUILDINGS, VICTORIA, B.C., not later than February 28th, ..., and one copy may be retained by the person making the Return.

PENALTY.—For failure to file Return within the time specified, five per centum of the tax payable, with a maximum penalty of five hundred dollars.

Name of Estate or Trust.....

Return filed by.....

Address.....

Acting in the capacity of.....

Date of origin of trust or executorship.....

Last previous Return covered the period ended ....., 19..., and was filed at ....., B.C.	This Return covers all income for ..... months ending ....., 19....

I (We) hereby certify that this Return, together with the supplementary statements and additional schedules attached (if any), constitute a full and correct statement of the total income and expenses claimed as a deduction on behalf of the above-named Estate or Trust for the period covered by this Return.

(Signature).....

Date....., 19.....

EXTRACTS FROM THE "INCOME TAX ACT."

On or before the last day of February in each year, every person, in whatever capacity acting, who is in receipt of any income of or belonging to any other person shall furnish to the Commissioner a Return with respect thereto.

Every trustee shall retain, from time to time, out of any moneys or credits which come to him in his representative capacity, so much as is sufficient to pay the amount of all taxes accrued due or in arrears and payable under this Act in respect of the person or estate represented by him; and he is hereby indemnified for all amounts so retained and paid over to the Commissioner pursuant to this Act.

Every trustee, before distributing any moneys or assets under his control in his representative capacity, shall obtain a certificate from the Commissioner certifying that no unpaid assessment of income tax properly chargeable against the person or estate represented by him remains outstanding; and if the agent or trustee distributes the money or assets without obtaining the certificate he shall, in addition to all other penalties to which he may be liable, be personally liable for the payment of the income tax so remaining unpaid, but otherwise he shall not be liable personally for the income tax.

For departmental use only.

Income and distribution checked by..... Extracted by.....

Class..... T.I. $..... N.T.I. $..... T. $..... Recorded.....

(Whereupon, at 5:45 p. m., the committee adjourned until 10 a. m., Thursday, August 14, 1941.)

REVENUE ACT OF 1941

THURSDAY, AUGUST 14, 1941

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

The committee met, pursuant to adjournment, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order. The first witness is Mr. J. B. Stewart.

STATEMENT OF J. B. STEWART, CLINTON, IOWA, SECRETARY-TREASURER, OUTDOOR ADVERTISING ASSOCIATION OF AMERICA, INC.

Mr. STEWART. Mr. Chairman, and gentlemen of the Senate Finance Committee, I am J. B. Stewart, of Clinton, Iowa, representing the Outdoor Advertising Association of America, of which I am secretary and treasurer. I am also an operator in the outdoor-advertising business in Clinton, Iowa, where I have operated for some 40 years, so I probably know something about the business that I am to speak on.

The CHAIRMAN. Mr. Stewart, I see quite a number of witnesses here listed on this same general subject matter. Is it possible for you to combine your statements so that the committee may make as much progress as possible?

Mr. STEWART. Mr. Chairman, as far as the outdoor advertising industry is concerned, I will be the only speaker. I prepared a brief statement and argument on it. It has been placed in the hands of each member of the committee, and I would like to present that.

Mr. Abernathy, whose name appears right below mine, and who was to follow me, has given his time to me. Also, the American Highway Sign Association, who are the small-sign people, have asked me to speak for them as well.

The CHAIRMAN. Mr. Stewart, we would be glad to hear from any of the taxpayers. Of course, we find it necessary to shorten the hearings as much as we possibly can.

Mr. STEWART. I appreciate that, Mr. Chairman.

The CHAIRMAN. You may proceed.

Mr. STEWART. First, I might say, our association and our industry is more than grateful to the Senate Finance Committee for giving us this opportunity to present our views on this subject, because it is the first opportunity that we have had at any time to express our views before a congressional committee on it. As you probably know, when the outdoor-advertising tax was introduced into the revenue bill, it

was placed there at the last hour of the last day, and we had no hearing and no opportunity to be heard. We believe if the gag rule had not been imposed over there, and we had an opportunity to present the facts which I want to lay before you, that the bill would not have come over in that shape for your consideration. With that brief statement, I would like to state my point.

The Outdoor Advertising Association of America, whose members operate 90 percent of all standard outdoor-advertising facilities in the United States, protests against the enactment of section 3269, part XI, of H. R. 5417, for the following reasons:

1. A tax upon advertising, or any single medium of advertising, is mistaken in principle, because, instead of taxing industry's profits, it taxes the machinery which produces the profits.

2. It proposes to tax only outdoor advertising maintained by concerns engaged in the business, thereby exempting 80 percent of the total number of outdoor-advertising signs and structures from taxation, and accomplishing ultimate destruction of the business of outdoor advertising.

3. It would result in confiscation of all the net income or profits of small operators and take at least 30 percent of the present profits of the entire industry, in addition to all the other taxes which we now pay.

4. The proposed tax would reduce income-tax collections by an amount far greater than any new revenue it could possibly yield.

5. By crippling the facilities of those engaged in the outdoor advertising business, it would lessen their ability to serve the Government in the present emergency, as they have consistently done in the past emergencies.

6. It would create an unfair competitive advantage in favor of other untaxed advertising media.

7. The proposed tax would not produce sufficient revenue to justify its adoption.

On behalf of the organized outdoor-advertising industry, we offer for the consideration of your committee the following objections to the enactment of those sections of H. R. 5417, which levy a discriminatory tax upon outdoor advertising, radio, and electric signs:

It is unthinkable that the outdoor-advertising industry which has, in the past 50 years, contributed millions of dollars' worth of space to the Government should be crippled through discriminatory taxation. During the World War the members of the organized industry rendered such outstanding service, by displaying, without charge for labor, materials, and space, Nation-wide showings of posters for all the Government activities, that on July 9, 1919, President Woodrow Wilson wrote:

> The members of the association lent invaluable aid to the Liberty Loan, fuel, food, Red Cross, and other campaigns, by constantly reminding patriotic Americans of their duties to their country during the war. The value of such a service cannot be overestimated.

Similar letters of commendation were received from Secretaries of the Treasury McAdoo and Glass, United States Food Administrator Herbert Hoover, United States Fuel Administrator Harry A. Garfield, the heads of the American Red Cross, the United War Work Fund-Raising Campaign, and many others.

From the information of the committee, we submit a copy of the War Souvenir Edition of the Poster, published in 1919, which contains the record of the organized outdoor advertising industry during the World War, with facsimile reproductions of the letters from President Wilson and other Government officials, above cited, as well as reproductions of many of the posters used during that period.

In the present emergency, the members of the outdoor-advertising industry have already shown their willingness to lend their aid by contributing space, labor, and materials for the display of Army enlistment 24-sheet posters and those of the United Service Organizations for national defense.

Certainly, to cripple or make ineffective, through unwise and discriminatory taxation, a fundamental means of disseminating information to the public, such as outdoor advertising, through which a message may be delivered simultaneously in over 16,000 markets, cities, and towns in every State in the Union, would be detrimental to the national-defense program and the national morale and welfare.

The organized outdoor-advertising industry, represented by the Outdoor Advertising Association of America, has an invested capital of approximately $100,000,000. Its annual sales total from $40,000,000 to $45,000,000. Its combined net profit amounts to from $3,500,000 to $4,000,000. On this basis, the proposed tax is exorbitant and, as applied to a majority of those engaged in the industry, would be confiscatory.

Of the 1,200 taxable operators, over 1,000 have a relatively small volume of net income per unit operated, and as applied to them the tax would amount to from 50 percent to more than 100 percent of the profit realized annually.

The measure of the tax does not take into account the differences in unit revenue as between structures of the same size placed in relatively more or less advantageous locations. An advertising structure in a big market would pay the same tax as a similar unit in a small town. Similarly, one located, for example, in a recreational resort and productive for a limited season in each year, would pay as much as a structure having advertising value the year round. Examples of such inequalities could be multiplied.

It is worthy of mention that there are approximately 200,000 lessors of locations who derive revenue from rents paid by persons engaged in the outdoor-advertising business. Many of such lessors are farmers. These lessors would ultimately participate in the losses of the members of the industry who might be compelled to abandon locations which this tax would render unprofitable.

The outdoor-advertising industry has no intention of resisting its fair share of taxation, but asks for equality of treatment, and holds that a revenue bill should have no other purpose than to raise revenue. The idea of regulation or undue restriction has no proper place in a tax measure and an occupational tax is not a proper excise tax.

We believe that advertising plants, whether radio, newspaper, or magazine buildings and equipment, or outdoor-advertising structures, are legitimately subject to a normal personal-property tax by the States; and the members of this association already pay such taxes, as well as income tax and all other taxes which are uniformly levied

upon this and other businesses. But a tax levied upon the column inches appearing in a publication, the number of square feet of surface of an outdoor-advertising structure, the time sales of radio stations, or the sales price of neon tube and electric signs, is clearly a tax upon advertising itself, and is mistaken in principle.

Advertising is a mass salesman and a tax placed upon it tends to discourage its use and is, to say the least, inexpedient and absolutely unsound in economics. Such a tax would be similar to a tax on the tools of a workman or the services of a salesman.

The value of any tax from the standpoint of revenue is doubtful if it tends to discourage production.

To tax any medium of advertising, or to tax all advertising, would retard the process of distribution and thereby discourage production, thus lowering the national income, which is the proper source of taxes.

A tax on advertising, unless it is to be levied on all sales agencies, including salesmen themselves, cannot be equitable, as advertising operates to reduce other costs of distribution out of all proportion to its own cost. To tax advertising would be to offer an incentive to the backward manufacturer to cling to less efficient and more costly methods of selling and put a premium on inefficiency, to the detriment of the ultimate consumer.

Each medium has its own particular place in the advertising business and there is no justice in singling out one or more media for taxation, thereby leading to an unfair competitive advantage in favor of other media.

Any tax law should produce revenue and should have no other function. Furthermore, it should produce enough revenue to justify its adoption. In the revenue bill as it passed the House, the tax proposed on outdoor advertising is to be applied only to persons who display outdoor advertising matter for another person. In other words, it is an occupational tax on those in the outdoor-advertising business and would leave untaxed at least 80 percent of all outdoor advertising, because it levies no tax whatever upon outdoor advertising placed or maintained by those who are not in the outdoor-advertising business.

Under this provision, a manufacturer, merchant, or anyone else can maintain his own outdoor signs and pay no tax on them, but if he contracts with an outdoor-advertising company for identical signs, the outdoor-advertising operator must pay a tax on every one of them and naturally the cost of the sign is increased to the extent of the tax, thereby placing him at a marked disadvantage.

Senator BAILEY. That would be just as if we should tax advertising agencies but not the advertising that is given out by individuals.

Mr. STEWART. Exactly.

Senator BAILEY. And that we should tax advertisers, not by the value of the advertising, but by the square yard of advertising space.

Mr. STEWART. The point here is, Senator, that 95 percent of the small signs—what we call small signs—which the members of the Outdoor Advertising Association do not operate, but the members of the small-sign associations do—the manufacturers or someone else who wants to can go out and put up their individual signs, and, therefore, 95 percent of the total number would go untaxed entirely.

Senator BAILEY. What would the newspapers say if we took such a shot at their advertising and taxed them by the page?

Mr. STEWART. Well, I maintain that if outdoor advertising is to be taxed by the square foot, naturally the newspapers should be taxed by the column inch.

Senator BARKLEY. It is a fact that they all charge by the space they use; is it not?

Mr. STEWART. What is that?

Senator BARKLEY. Whether it is a newspaper or advertising billboard, they charge for their services according to the space they use?

Mr. STEWART. Exactly.

Senator BARKLEY. So the theory of the tax is that it is according to the space used.

Mr. STEWART. The space you use.

Senator BARKLEY. Theoretically, the more space you use, the more valuable the advertising is.

Senator TAFT. However, the New York Times charges more per inch than the Podunk Herald.

Mr. STEWART. If a fellow got $3,000 a year for an advertisement in the big city he would pay the same tax as the fellow getting $25 a year for the same advertisement in the small city.

Senator BARKLEY. In all probability the New York Times reaches more people than the Podunk Herald. The advertising rates are based on circulation, are they not, of the newspaper?

Mr. STEWART. No question about that, just as outdoor advertising is.

Senator VANDENBERG. Speaking frankly, the theory of the tax was to get billboards out of the way entirely; was it not?

Mr. STEWART. I am afraid so, Senator Vandenberg. That is why I am making the point that outdoor advertising has no place in the revenue measure, that an occupational tax is not properly an excise tax.

Senator BARKLEY. What interest has the Treasury in taxing billboards on the highways?

Mr. STEWART. As far as I am informed, the Treasury has no interest whatever in this particular section of the revenue bill and does not feel it would produce sufficient revenue to justify its adoption. In fact, that is borne out, I think, by what Senator Brown said the other day as to the additional money that was raised in the collection of the income tax when you lower the exemption. According to the papers Sunday morning, he made the statement here Saturday that lowering the exemptions produced $19,000,000 additional revenue and it cost $15,000,000 to collect it. If it costs $15 out of every $19 to collect an additional income tax where the machinery was all set up for collection, how much would it cost per dollar of revenue to collect a tax like this, where entirely new machinery would have to be set up, where you would go out and measure hundreds of thousands of signs, or at least, set up some kind of way to get the money in, after you levy the tax?

My own opinion is the cost of the administration of the measure would be more than the gross revenue.

Senator BARKLEY. Senator Brown is not here but I doubt whether he was quoted correctly, as it is claimed he stated, that by lowering the exemptions, it cost $15 out of every $19.

Mr. STEWART. Here is what he is quoted as saying, Senator, in the New York Times, Sunday, August 10. He says:

> When the exemptions were cut from $2,500 to $2,000 for married persons and from $1,000 to $800 for single individuals, the new group of lower taxpayers provided only $19,000,000 in revenue. Furthermore, he said it cost $15,000,000 to collect that revenue.

That is where I got my authority.

Senator BARKLEY. I do not know whether he said it or not. The mere fact that he is quoted as having said it is not prima facie evidence of having said it.

Mr. STEWART. That is very true. I agree with you there. I merely tell you what was my authority for making that statement.

Senator TAFT. May I ask one more question?

A good many of these taxes are on the theory that you could pass them on to the consumer. Could you do that in your industry?

Mr. STEWART. I think that is entirely impossible, Senator Taft, for this reason: Most contracts are made over a considerable period of time and, naturally you could not pass on the tax for any contracts that are in effect. Furthermore, in the organized outdoor advertising industry the association, its members, publish their rates for the succeeding year on July 1 of the preceding year and on July 1 of this year the 1942 rates were published and are in the hands of every advertising agency that places outdoor advertising. Quotations are made on those published figures. Certainly, they could not raise them that year. It is better, in my opinion, to levy a tax on the revenue that would be produced by the use of that money in advertising, which is many times the initial amount, than to dry it up at the source.

Senator TAFT. Could you pass it on while the newspapers are not taxed?

Mr. STEWART. Certainly not. If we did, it would certainly create an unfair competitive advantage for all other media, because the smart advertiser would naturally want to get $1 worth of advertising for every dollar he placed. Certainly, it would be no secret to him that out of every dollar he placed in outdoor advertising, a certain proportion of that must go to a tax, whereas, he could spend his whole dollar in the newspaper or direct mail, or magazine, or various other forms of advertising without being subject to that tax.

If we pass it on to the advertiser, you destroy our medium just as effectively as if we absorb it ourselves.

Senator VANDENBERG. I do not see why any argument is necessary to prove that this is completely discriminatory, unfair, unprofitable, and indefensible. I would like to save a day's time by taking it out of the bill now.

Mr. STEWART. I would be very glad to stop if you did that, gentlemen.

Senator LA FOLLETTE. You will settle for that; will you not?

Mr. STEWART. I will settle for that, Senator La Follette.

The CHAIRMAN. You are proceeding at your own risk now. You may convince Senator Vandenberg that he is wrong.

Mr. STEWART. I am not afraid of that. Do you advise me to quit, Senator?

The CHAIRMAN. I am simply making the suggestion to you.

Mr. STEWART. I do want to bring this one point out. Any tax that discriminates between persons or things in the same classification has never been tolerated in this country and to tax 20 percent of outdoor advertising and leave 80 percent untaxed because the 20 percent is maintained by one set of people and the 80 percent by another set, is obvious discrimination and cannot be defended as a proper revenue measure.

I will not take the time. I see you gentlemen are a little impatient, and I believe you have those points before you. I have a figure here as to our estimate on what the possible gross revenue would be. We place it at $1,191,000.

The CHAIRMAN. Would it not be the tendency of the user of the board to put up his own boards?

Mr. STEWART. That is what we think, and therefore, our revenue would be reduced because they would keep coming down. Here is the point that the American Highway Sign Association handed me this morning that I do not have in my brief, but it represents their view. These gentlemen have a lot of service companies that put up little bits of signs that we do not have in our standard business. They make this point: In addition to the fact that the tax on these smaller signs would not raise any appreciable amount of revenue, this tax would amount to more than 20 percent of the gross annual rental received from these small signs which would bankrupt the companies erecting them. There are nearly 30,000 small signs on blackboards in farmers' front yards on which the farmers advertise their farm products and which also state the mileage to the store of some nearby merchant who pays a few cents a month rental. The proposed minimum tax of $1 per year would mean the elimination of these signs and would put out of business the companies which erect them.

Senator BARKLEY. Have you got any suggestion for a tax that anybody will pay that will raise this $1,191,000 that will be lost if this tax is eliminated?

Mr. STEWART. Senator, I am not a tax expert. I think I can well leave that to the Treasury Department to make an appropriate suggestion to you.

Senator BAILEY. That is the gross revenue, the $1,191,000. You would have to deduct from that the expenses; would you not?

Mr. STEWART. My contention is, it would not raise any revenue whatever. My further contention is because of the fact that all the people in the outdoor advertising business who are making any money are paying income taxes at this time, that if you lower their revenue you are going to get less income taxes in addition to what you would lose on the other thing. Furthermore, there is the impediment to business.

Furthermore, such a tax will not produce any appreciable amount of revenue, because of the cost of its administration.

According to the best figures available, there are in the United States approximately 275,000 standard poster panels, which have an

advertising surface of about 210 square feet each and would therefore be taxed $3 each under the proposed tax, or a total of $825,000.

There are approximately 50,000 standard painted bulletins of various types with advertising surfaces ranging from less than 300 to 546 square feet which are operated by outdoor advertising companies. These are about equally divided between the larger and smaller signs so the average tax would be $6 each, producing another $300,000 gross revenue.

Outdoor advertising structures having an advertising surface of more than 600 square feet and which are maintained by those engaged in the business of outdoor advertising are relatively few, but assuming that there are 1,000 which is an outside figure, the gross revenue from them would be $11,000.

The number of structures not over 100 square feet in size (which would carry a tax of $1 each), and from 100 to 200 square feet in size (which would carry a tax of $2 each), maintained by outdoor advertising companies, is negligible, as 95 percent of such signs are owned by those who maintain them to advertise their own business. As the result of a survey made by our association in 1940, we estimate that the taxable revenue from these smaller structures would aggregate but $55,000.

Therefore, the total estimated possible gross revenue from the proposed tax is but $1,191,000.

The cost of collecting and administering any tax of this nature would be so great that the net return to the Treasury would be, if any, so small as not to justify the imposition of the tax.

On the other hand, although the Treasury would not benefit, the result to the outdoor advertising industry, as a whole, would be disastrous. Based upon the published financial statements of the more important concerns engaged in the outdoor advertising business, the net profits of all the outdoor advertising concerns in the membership of the Outdoor Advertising Association of America, which maintain at least 90 percent of all standard outdoor advertising facilities in the United States, aggregated approximately $3,436,000 which would indicate that the combined net profits of all those engaged in the outdoor advertising business did not reach $4,000,000 in 1940.

An additional tax of $1,191,000 would, therefore, absorb about 30 percent of the total net profit of the entire industry based on 1940 volume and in the case of the small operator would inevitably absorb his entire profit.

Because of the diversion of materials and manufacturing facilities to defense industries and the consequent reduction of advertising by the producers of automobiles, tires, gasoline, refrigerators, radios, and other classifications of consumer goods which have provided a large percentage of the total volume of outdoor advertising, it is logical to assume that the volume for 1942 will be considerably below that of 1940 and that net profit from the operation of an outdoor advertising plant ordinarily producing a reasonable profit, it only requires a drop of from 20 to 25 percent in volume to eliminate all profit. Therefore, the imposition of an additional tax of even $1,191,000, would result in the confiscation, at least for the immediate future of all possible profits of the outdoor advertising business in the United States.

If the profits of those engaged in the outdoor advertising industry are taken through such a tax, the Treasury will lose the revenue now obtained from them through income taxes and, together with the reduction in surtaxes for which the larger companies are now liable, less revenue to the Treasury will be obtained than if the proposed excise tax was not imposed.

The unfairness of a tax on outdoor advertising on the basis proposed in the revenue bill is apparent when you consider that even the smallest outdoor advertising operator would be taxed on every structure he maintained, whether or not it was being utilized and producing any revenue and even if the advertising space thereon was being donated by him in furtherance of the defense program.

We believe, for the reasons above given, that the Senate Finance Committee will serve the best interests of the Government, the public, and of business generally by deleting from the revenue bill the sections which levy a tax on radio and outdoor advertising, as well as the provisions for a tax on neon-tube signs, electric signs, and electric advertising devices.

Now, gentlemen, that is my argument. I have with me here today, other associates in our industry.

Mr. Kerwin H. Fulton, who is president of Outdoor Advertising, Inc., our selling agency; Mr. Herbert E. Fisk, of Chicago, who is executive vice president and general manager of the Outdoor Advertising Association of America; Mr. Edward C. Donnelly, the president of the Outdoor Advertising Association of America, and Mr. Leonard Trester, our Washington representative.

If you have questions that I cannot answer, I would like to have the privilege of asking one or more of these gentlemen to attempt to answer.

Senator GUFFEY. Is Mr. Abernathy here today?

Mr. STEWART. Senator Guffey, Mr. Abernathy, although he expected to appear, did not feel it necessary to make a statement, because he seemed to feel, after he read the brief, that it was unnecessary to present further arguments on behalf of organized labor.

Senator HERRING. Stewart is all right. He is from Iowa.

Mr. STEWART. Senator Herring ought to know. I have argued before him many times.

Now, Mr. Chairman, I would like the privilege of presenting a statement on behalf of the American Highway Sign Association, which I would like to have incorporated in the record.

The CHAIRMAN. You may present it to the clerk.

(The statement referred to is as follows:)

STATEMENT PRESENTED ON BEHALF OF THE AMERICAN HIGHWAY SIGN ASSOCIATION

Hon. Walter F. George, chairman, and members of the Finance Committee of the United States Senate: This brief is presented on behalf of companies engaged in erecting and maintaining the smaller type of advertising signs on private property adjoining highways, which signs are leased to advertisers on a monthly rental basis.

We realize full well the enormous task which confronts the Congress in attempting to raise the funds which are so vitally needed to finance our defense activity. We do not want to dodge our share of this burden. We stand ready to pay any tax on our profits which Congress may see fit to levy, but we feel that the proposed tax imposed by section 3269, part XI of H. R. 5417, on those leasing outdoor advertising structures to others is economically unsound, discriminatory, and unwise. We urge its complete elimination, and that

the necessary funds raised by some general tax which applies equally to all business and which does not discriminate against one industry and act as a business deterrent. We urge this for the following reasons:

1. WE BELIEVE THAT ANY TAX ON ADVERTISING IS ECONOMICALLY UNSOUND

The function of all advertising is to increase consumption and keep goods moving in large volume so that prices may be reduced and the luxuries of yesterday may become the necessities of today. Advertising is an important cog in the American business machine. It is the indispensable key to mass production. If you produce any article on a small scale, the price of that article will confine its use to a few wealthy people. But if you advertise the same article and build up its use to a point where mass production is possible, it will then be possible to reduce its retail cost so that everyone can buy it. This has been true of many articles now in common use which formerly were luxuries, such as electric lights, automobiles, radios, and numerous electrical appliances. To tax advertising is to slow down the American industrial machine, as it would mean that just that much less money would be available to produce sales. A tax on advertising is a tax on the machinery which is used to produce sales and profits. It is perfectly sound to tax the profits after they are earned, but we believe it is unsound to tax the medium which produces these profits. It would be just as reasonable to levy a poll tax on a company's salesmen at so much per head. You must not kill the goose that lays the golden egg.

2. WE BELIEVE IT IS UNFAIR TO TAX OUTDOOR ADVERTISING WHEN OTHER COMPETING ADVERTISING MEDIA ARE NOT SIMILARLY TAXED

Levying a tax on outdoor advertising without at the same time equally taxing other competing advertising media, such as newspapers, magazines, window displays, car cards, etc., would tend to make advertisers use these other advertising media, and would therefore be an unfair and unwise discrimination against one form of advertising. Outdoor advertising reaches a portion of the public which is not equally reached by any other advertising medium, and does it at a cost which is less than any other form of advertising. Any medium which promotes business at a small cost should be encouraged in these critical times, rather than being penalized by a discriminatory tax.

3. THE PROPOSED TAX WOULD PUT OUT OF BUSINESS THE MANY COMPANIES ENGAGED IN ERECTING AND SERVICING SMALL SIGNS WHICH ARE LEASED TO ADVERTISERS

These companies (generally known as "service companies") make contracts with advertisers to erect signs for them for periods generally ranging from 3 to 5 years for a small monthly rental, which usually ranges from 40 to 50 cents per month. Then the service company erects the signs for the advertiser at a cost which is usually over 60 percent of the amount which it expects to get back in rental during the life of the contract. If all goes well, by the end of the contract period the service company will have a fair profit for its efforts.

The proposed tax could not be absorbed by the service company without bankrupting it. Nor could it be passed on to the advertiser because his contract does not require him to pay it. These small sign service companies would, therefore, be legally liable for this tax, which they could not pass on to the advertiser and could not pay themselves. The inevitable result would be bankruptcy and the loss of the many hundreds of thousands of dollars which these companies have invested in their signs. It would also mean the throwing out of work of the thousands of highly skilled men who are now employed by this industry and the loss to the Government of the many Federal taxes which are now being paid by this industry. So instead of raising additional revenue, the levying of this tax would mean a loss of the revenue now received from this industry.

Let us give one concrete example of the effect of this tax: There are nearly 30,000 farmers throughout the United States who have blackboards in their front yards on which they advertise their farm products and which also state the mileage to the store of some merchant in a nearby city. Theses signs are erected by service companies and the merchants pay a few cents a month

rental. The proposed tax of $1 per year on these signs would eliminate them entirely and force out of business the companies which now erect them, because the amount of the rental cannot be raised and there is not a sufficient margin of profit to pay this proposed additional tax.

4. THE PROPOSED TAX WOULD RESULT IN ELIMINATION OF THE ONLY EFFECTIVE FORM OF ADVERTISING AVAILABLE TO MANY MERCHANTS IN SMALL TOWNS WHERE THERE IS NO OTHER ADVERTISING MEDIUM

A very considerable portion of the outdoor advertising structures used by American business to advertise its products are the smaller type of signs erected on farmers' land along highways. Some of these signs are used to advertise nationally advertised products, but the big majority of them are used by local merchants in small towns to advertise their goods and services and to bring to their places of business those who drive into or through the town. The small town hotel and restaurant, the local garage man, the local filling station, and the small town general store all use these small signs extensively to build up and maintain their patronage. In many smaller towns throughout the country this is the only form of advertising available. Thousands of these towns have no daily and often no weekly newspaper. They have no local radio station. The only means these merchants have of getting an advertising message to the public which will bring purchasers to their place of business is by signs erected on farm lands along roads leading into the town.

Many of these small signs advertising the services or goods of the small-town merchant are erected and maintained by some local sign company or some larger outdoor advertising company on a monthly rental basis, and would be included in the proposed tax on the business of leasing outdoor advertising space. The rental charged for these small signs is usually small—often ranging from 30 to 40 cents a month. The tax of $1 per year which each of these signs would have to pay under the proposed law would, therefore, amount to around 20 or 25 percent of the gross annual rentals from such signs. Obviously, most of these signs could not stand a tax at this rate and would therefore, have to be taken down. The result would be the cutting off of the only available form of advertising for many small merchants and the ruination of the business of those which erect this type of signs—and all without accomplishing the avowed purpose of this bill—namely, the raising of any substantial amount of revenue.

5. THE ELIMINATION OF THESE SMALL SIGNS BY THE PROPOSED TAX WOULD MEAN THE LOSS OF RENTALS WHICH ARE NOW PAID TO FARMERS ALONG HIGHWAYS BY MOST OF THESE SIGNS

This revenue does not amount to a large sum in any individual case, but in the aggregate it represents a cash income which the farmers who receive it are mighty glad to get. It's a little added income which, as one Illinois farm woman wrote her legislator, "may be the difference of putting oranges in little Molly's and Johnny's dinner pail."

CONCLUSION

For the reason therefore that we believe this tax to be economically unsound, discriminatory, and unfair, and because it would ruin the business of many outdoor advertising-service companies, destroy the only available advertising medium of many small-town merchants, take away some of the cash income now received by farmers for outdoor advertising on their property, and would not raise any substantial amount of revenue, our group urges this committee to eliminate any tax on outdoor advertising from the 1941 Revenue Act.

STATEMENT OF JOHN BENSON, NEW YORK, N. Y., PRESIDENT, AMERICAN ASSOCIATION OF ADVERTISING AGENCIES

The CHAIRMAN. Mr. Benson. Your name is John Benson, and you are president of the American Association of Advertising Agencies?

Mr. BENSON. Yes, sir.

The CHAIRMAN. Do you want to speak on the same matter that Mr. Stewart has just spoken on?

Mr. BENSON. From quite a different angle, Mr. Chairman, and in a broader way, because we are broadly interested in advertising, not in any single medium. I think I can cover the ground in about 7 minutes.

The CHAIRMAN. Make it as brief as you can, because we do not want to unnecessarily duplicate the testimony, of course.

Mr. BENSON. Yes; I understand it. Well, on behalf of that professional body that I represent, practitioners of advertising, I would like to protest against the levying of a tax on advertising or advertising media as provided in this bill now before the Finance Committee.

Advertising agencies have no direct financial interest in this tax, as it is not imposed upon them; nor do they have any bias in favor of any one advertising medium or group of media, using them all impartially when and as required to solve a given advertising or marketing problem for a client. Having any ownership interest in a medium of advertising would be a breach of our ethical code.

Hence we hold no brief for either the outdoor or radio broadcasting media as such. What we deplore about the proposed tax on them is the burden it imposes upon advertising itself and the cost of distributing goods. Advertising is but one of several forms of selling and is often used to facilitate or economize sales effort. If such a tax were imposed, manufacturers would either do less advertising and hence sell less goods, or they would continue to do the same amount of advertising at increased cost, which would tend to raise prices to consumers—to the extent, of course, that the tax is not absorbed by the medium, which may be done in part and for a limited period of time. We are more opposed to the principle than we are to the burden.

Now, if advertisers sell less goods, they employ fewer people to make them, and the tax would contribute to unemployment. If the manufacturer raises his prices, it would contribute toward inflation.

In addition to the above, a tax on advertising would be discriminatory between manufacturers who use advertising as a means of selling and those who use other forms of selling but do not use advertising.

One of the most important services that advertising renders to distribution is to save time, effort, and money in moving goods from producer to consumer. Cost of the media is a big factor, of course, in this economy of the advertising operation. It does not matter how effective the advertising appeal may be, to increase the cost of the channel used to reach a market will lower the efficiency just that much, with one or more of the following results:

1. Slow down civilian production and nondefense employment of labor. Printers and pressmen are not benefited by an offensive tax of this sort. Their employment depends on successful advertising, as a whole, which breeds more advertising and more printing, whatever the media used. One medium feeds into another.

2. Lessen volume of business done and reduce available net profit, from which more taxes could be derived.

3. Reduce the margin between selling price and cost of distribution, which might be used in raising wages or in improving product.

4. By raising the cost of selling, add to the upward spiral of prices with its trend toward inflation.

The plea has been made that this special radio tax is not imposed upon advertising, but on entertainment. In our opinion, this is not true. Only the commercial revenues are to be taxed. Commercial radio advertising is not entertainment, it merely uses entertainment as an aid in selling. Therefore, the tax is on a method of selling, not on entertainment.

May I say a word in conclusion, about the timely public service which can be rendered by advertising during the defense emergency and why it should not be handicapped or burdened in rendering that service.

Senator CONNALLY. You mean free advertising for the defense emergency?

Mr. BENSON. Well, some of it sometimes is free, Senator Connally, but I am talking about regular commercial advertising.

Senator CONNALLY. All right.

Mr. BENSON. This is an economic discussion of advertising. Advertising is a definite brake on inflation and high prices. It does not stimulate desire for more civilian goods than can be produced. It does not encourage indiscriminate demand by the public. It promotes good will for a specific product or service and does not stimulate immediate sale unless the product is available or can be adequately produced. Arousing desire for goods which conflict with defense production would not result in sufficient sales to pay for the advertising, and would also cause ill will instead of good will among customers.

Advertising thus renders an indispensable service by diverting public attention and desire away from such goods and toward those which can be made in abundance. This satisfies popular demand and builds up volume to absorb the expanded purchasing power of the masses employed in national defense. And is there any better hedge against inflation?

As the President has pointed out, the Nation needs all the economic activity it is possible to produce, for the welfare of its people and for financing the war effort. Advertising is the effective spur. How much better to tax wealth and net income than the means of producing them. To do the latter is like consuming seed corn instead of planting it and producing abundant crops for consumption. It would be killing the goose that lays the golden egg.

And the spur must be vigorous and effective to move an adequate volume of unrestricted production into consumers' hands, with so many lines being restricted by defense.

In times like these we should operate, it seems to us, our processes of making and selling goods as efficiently and inexpensively as possible. The proposed tax would impair that efficiency, and thus produce, we believe, much less total taxes.

Senator BARKLEY. Do you care to say that all the goods advertised will do what the advertiser says they will do?

Mr. BENSON. No, sir; Senator Barkley; but I can say to date, the advertising fraternity have done much to improve that situation, have done much to secure legislation which will improve it in the Wheeler-Lee law. Today there is very little advertising that is deceptive. There is more or less that is——

Senator BARKLEY (interposing). Exaggerated?

Mr. BENSON. Exaggerated. Some of it is nonsensical, that is, it plays on motives that are not very substantial. We are all aware of that. We are constantly trying to improve the situation.

Senator BAILEY. At the worst, you can compare it with political advertising, can you not?

Mr. BENSON. I do not feel free, Mr. Senator, to comment on that.

Senator CONNALLY. If we tax one form of advertising, do you favor taxing them all?

Mr. BENSON. I would rather put it the other way around, Senator, and tax none of them, because you are taxing the processes of distribution.

Senator CONNALLY. You are taxing something every time there is any sort of tax increase. You do not think the advertisers ought to contribute anything toward national defense? They ought to be left alone and just advertise and the rest of us pay by our sweat and blood?

Mr. BENSON. I think, Senator, we will have plenty of taxes to pay and plenty of losses to sustain due to the war, the priorities, and other things which might restrict advertising on a large scale, and much reduce the revenues of all advertising media.

Senator CONNALLY. Has not this business, the advertising business, been flourishing for many years? I see full-page ads all about this, that, and the other thing. In the last 2 or 3 years, have not they been doing a big business?

Mr. BENSON. No, sir. Quite a subnormal business for the last 10 years.

Senator CONNALLY. Do not go back that far. I am talking about the past 2 years. Have not they come right on up? Made a lot of money?

Mr. BENSON. I would say "no"; advertising has not made a lot of money.

Senator CONNALLY. You made some?

Mr. BENSON. We made some money; yes.

Senator CONNALLY. All right.

Mr. BENSON. Our figures show a net profit that is little more than half of what it was 7 or 8 years ago, in spite of the fact that the volume has grown.

Senator BARKLEY. Are you speaking for the advertising industry generally, or for the radio?

Mr. BENSON. I am speaking for the advertising practitioner. We do the professional job of making the plans and executing them for the client.

Senator BARKLEY. How many national advertising agencies are there?

Mr. BENSON. Oh, we have only about 125 members. They do about two-thirds of the national business, or a little more, I think.

Senator BARKLEY. The Outdoor Advertising, however, is one of the largest in the advertising business?

Mr. BENSON. That is a medium, pure and simple.

Senator CONNALLY. You are brokers, are you not?

Mr. BENSON. No; we are not brokers.

Senator CONNALLY. You get a rake-off if you handle the advertising?

Mr. BENSON. Well, we get paid a commission, Senator, just like an architect would, you know, or an engineer, on the volume of expenditures in the structure or in the advertising campaign.

Senator BARKLEY. All these billboards that you see all over the country, some of them marked above the picture "Outdoor Advertising Co."; some of them marked "Cusack." There used to be a firm named Cusack in certain parts of the country.

Mr. BENSON. There was.

Senator BARKLEY. Those cover a very large territory. There are some local billboard advertisers. I used to know a man in my own town who had probably a dozen billboards scattered over the county, and about once a week, he would go out and change the scenery. Of course, he was paid for it. It may have been an outdoor advertiser, it may have been a local advertiser. I do not know about how much profit he made, but he continued in that business for a long time, and was a good man.

All right, there is no complaint about that. I was wondering whether this outdoor advertising business is controlled largely by a few companies that have rented, or at least built in various sections of the country, their own billboards by getting the consent of some farmer to build one over in his field. To what extent is it controlled largely by a few companies?

Mr. BENSON. Well, Senator, that is something that the outdoor advertising industry is better qualified to answer. I am sure, from contact with the industry, every plant owner can rent or withhold renting his property.

Senator BARKLEY. Every plant owner? What do you mean by "plant owner"?

Mr. BENSON. The owner of the plant, the one who owns the poster panels, you know.

Senator BARKLEY. Is it a right that has to be purchased?

Mr. BENSON. He rents the locations from property owners, or residents.

Senator BARKLEY. Does he have to buy from anybody the right to go into a community and advertise in that way?

Mr. BENSON. Not that I know of.

The CHAIRMAN. Are there any further questions?

Senator LA FOLLETTE. Mr. Benson, I want to ask you a question. It is a fact, is it not, that when an advertiser allocates a certain amount of money for a campaign, that the competition, so to speak, between the various media is pretty keen?

Mr. BENSON. It is very keen.

Senator LA FOLLETTE. So would, or would not, this tax have the effect, not of decreasing advertising, in all probability, but simply discriminating against various media?

Mr. BENSON. I think it would definitely decrease advertising, because you cannot use advertising media indiscriminately.

Senator LA FOLLETTE. Suppose a man came to you and said, "I have got a million dollars I want to put in an advertising campaign." He might decide not to use certain media because it was paying taxes, but he probably would not cut his whole program, would he?

Mr. BENSON. What it might do, it would weaken the effect of it, because the campaign is built up of different messages to different

markets for different purposes, and each medium lends itself particularly well to a definite problem. Our job is like the job of a doctor who specifies certain pills. We would be as much handicapped if we could not use outdoor advertising as the doctor would if he could not use quinine or something else that was needed in a given situation. Our job is purely professional, that of analyzing the problem and applying the remedy, and using the medium which covers a certain market most effectively.

Senator CONNALLY. Let me ask you right there, when a man comes in to you for an advertising campaign, do not you advise him what kind of advertising is best to do?

Mr. BENSON. We do.

Senator CONNALLY. And sometimes you use a little of all of them?

Mr BENSON. Sometimes we can and sometimes we cannot. The plan that we develop, for instance, may lend itself to outdoor or radio, or to newspapers or mail follow-up.

Senator CONNALLY. Depending on the character of the product?

Mr. BENSON. Yes; or the aim of the advertiser, what he wants to accomplish in his market. He might want more distribution or he might want better distribution. He may want more sales, or he may have one problem or another that is solved more or less by appealing to the consumer or to the trade. You know, advertising is used for many purposes besides stimulating the sale of goods, especially in a time like this when it will be used very vigorously to render service to the customers, as to how to use the products they have now and cannot replace, how to extend the life of them; how to get the most value out of them. It is a great opportunity for the producer to build goodwill. He may not have the product to sell, but he wants to keep open his lines and he wants to establish all the goodwill he can.

Senator CONNALLY. This outdoor advertising tax is graded from $1 a year to $11 a year, and it goes from 100 square feet to more than 600 square feet, which is a billboard 20 by 30. A billboard that is 20 by 30 is big enough to blot a whole wheat field, if you get close enough to it.

Mr. BENSON. We use the standard billboard.

Senator CONNALLY. The maximum is $11 a year. How much would a billboard 20 by 30 earn in a year in the way of income, do you know?

Mr. BENSON. Well, I think it is probably $6 or $7 a month for the use of the board. The standard board is the one we utilize which we call a 24-sheet poster.

Senator CONNALLY. Does not that depend on the location, though, where it is, sometimes?

Mr. BENSON. Yes.

Senator CONNALLY. You would charge more for a billboard close to New York where more people can see it than you would for a billboard near Podunk where nobody can see it?

Mr. BENSON. That is right.

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

Mr. Charles E. Murphy.

STATEMENT OF CHARLES E. MURPHY, NEW YORK, N. Y., GENERAL COUNSEL, ADVERTISING FEDERATION OF AMERICA

The CHAIRMAN. Mr. Murphy, are you speaking on this same general subject?

Mr. MURPHY. I am, sir; and I think you will be relieved to know I can do it in less than 3 minutes.

The CHAIRMAN. Thank you.

Mr. MURPHY. My name is Charles E. Murphy. I am general counsel of the Advertising Federation of America.

The Advertising Federation of America is the only national organization representing both sellers and buyers of advertising. Among its members are 61 advertising clubs located in key cities in every section of the Nation. Our organization, therefore, is a horizontal one which reaches across the industry, and we are able today to bring you, very briefly, the viewpoint of the industry as a whole regarding these proposed taxes on radio as well as outdoor advertising.

I have just submitted my statement for the record, Senator. The gist or my statement is this: We subscribe to the premise that income must be taxed in order to meet the national emergency; but we maintain that to tax the processes which produce income is an economic fallacy, that advertising is one of the prime processes by which income is produced and that to tax it would defeat its own purposes.

Just one additional observation, because the argument in support of that premise is in my statement submitted for the record.

The CHAIRMAN. Yes; it will be entered in the record.

Mr. MURPHY. Right after the war, after I got out of the Army, sir, and before I became a lawyer, I wrote and planned advertising, with the help of others in my home town of Trenton, N. J. I did that for small firms and small factories in that city, and I saw them grow and prosper by the judicious use of advertising to promote their worthy products. From a few employees they grew until today they are fine, large, stable, formidable organizations.

A few years later I went to New York to engage in the larger advertising fields and there I saw and witnessed the bigger companies produce new products from time to time, practically every year, and promote those new products which were useful and beneficial to the public as a whole, again through the judicious use of advertising, and I saw many, many employees added to each company as those new products were promoted. To me, and to us, it was the American system of distribution working in its perfect cycle. Whether in the small town or the larger town, every advertising dollar that I ever saw spent was considered with great care and with great consideration.

The question always asked by the man investing his money in advertising is: "What good will this advertising dollar do my business? What sales will this advertising dollar produce for my business?"

A tax on advertising to us means this, that Congress would say to the businessmen and merchants of this country, "We are going to collect a tax on the wages that you are going to pay your salesmen," for advertising is nothing more nor less than mass selling. It is the cheapest, the best and only way to distribute the products of our mass production to 130,000,000 people.

Thank you very much.

Senator CONNALLY. Wait a minute. I want to ask you one question.

Mr. MURPHY. Yes, sir.

Senator CONNALLY. Of course, we are going to cut down on civilian consumption in many lines, automobiles, and I hope radios, and different things of that kind, the civilian goods. The result is there is probably going to be a bigger demand in some lines without advertising than there would be otherwise. Mr. Henderson is allocating, reducing, and fixing prices, and all that. Do not you think that advertising is really not as necessary in the present situation as it would be in normal times? When times are hard you are anxious to increase your sales. Would this be a good time for a tax on advertising?

Mr. MURPHY. On the contrary, sir.

Senator CONNALLY. I want to get your views.

Mr. MURPHY. Yes; I would be delighted to give them to you.

Advertising does not and did not in the last war urge or promote the indiscriminate use of consumer goods. What it did, and what it does today, is to regulate and control the proper flow of goods which are available for consumer markets. Advertising would be a help rather than a hindrance in the ordinary economic distribution of goods which we do not need for defense purposes. In fact, it is an essential, in our opinion, in that regard.

Senator VANDENBERG. For example, the great oil companies are now spending their own money to tell gasoline consumers how to most profitably use gasoline.

Mr. MURPHY. Yes.

Senator DANAHER. Moreover, Mr. Murphy, would it not be true, if you are going to tax outdoor advertising on that theory, you ought to tax newspaper and magazine advertising as well?

Mr. MURPHY. We, of course, hope you will not tax any, sir.

Senator BARKLEY. If the purpose is to stop people from buying, it does not make any difference whether they do advertise or not.

The CHAIRMAN. Thank you very much.

(The statement submitted by Mr. Murphy is as follows:)

STATEMENT OF CHARLES E. MURPHY, ESQ., OF NEW YORK CITY, GENERAL COUNSEL FOR THE ADVERTISING FEDERATION OF AMERICA, RELATIVE TO PROPOSED TAXES ON RADIO AND OUTDOOR ADVERTISING

The Advertising Federation of America is the only national organization representing both sellers and buyers of advertising. Among its members are 61 advertising clubs located in key cities in every section of the Nation. It, therefore, reaches horizontally across the entire advertising industry and presents here today the cross-sectional viewpoint of the advertising fraternity regarding the proposed taxes on outdoor and radio advertising.

We consider any tax on advertising, regardless of the media affected, as harmful to the economy of our Nation and detrimental to our well-established system of distributing consumer goods.

The power of advertising, as the selling force of industry and as the stimulator and stabilizer of commodity distribution, must be protected. This is necessary in supporting the base for emergency taxes, for any impairment in the use of advertising by taxation will in turn affect distribution and the revenues derived therefrom. In our opinion, a tax on advertising will defeat its own purpose.

We are mindful that vast sums of money must be raised by our Government for national defense. This involves the greatest merchandising effort in the history of our country. Hence it is that our merchandising machinery must be keyed up to the highest notch of efficiency.

Business uses advertising to maintain and increase its outlets for goods. Unless such outlets are maintained and increased during the coming years, the expanded income on which taxes are based will not be forthcoming. Nothing should be done, therefore, to cripple the merchandising machine that produces income, and a tax on advertising will bring that very result. Income must be taxed, but to tax the process which creates income is an economic fallacy.

Advertising does not encourage indiscriminate expenditure for civilian goods during the period of national defense. On the contrary, it is used to regulate and stimulate the proper flow of consumer goods based on the products available for nondefense purposes. Advertising will divert public demand to merchandise that can be supplied without harming our defense production and thus keep employment and distribution in nondefense industries at its highest possible level.

As late as May 20, 1941, President Roosevelt in a letter to our organization, said:

"Advertising has been responsible for many of the good things which citizens of the United States enjoy. It has been a potent force in making available to our citizens the products of American skill and ingenuity. Without it, many present day necessities would still be luxuries.

"That force needs now to be applied toward the maintenance of our accustomed standards of living and further progress. This may require adjustment but it should mean increased effort."

The advertising business in America is wholeheartedly behind our Government's monumental efforts for national defense. In common with other businesses, it is paying today, and will continue to pay, huge sums in taxes into our National Treasury.

We have offered our services to the Government and will continue to give them willingly, as it is our duty to do.

We strongly urge, however, that a tax on advertising, regardless of its nature, will be a grave economic mistake and harmful to the laudable and patriotic cause to which you, your colleagues, and all other good Americans are firmly dedicated.

May I, sirs, in just a few seconds, add a personal observation? Before becoming a lawyer, I planned and wrote advertising for small stores and small industries in my home town of Trenton, N. J. I saw these small firms grow and prosper by promoting worthy products through the judicious use of advertising. From a few employees I saw them grow to employ many people. I later went to New York to engage in advertising in its larger fields, and there I saw companies place on the market many new, fine, and useful products of real benefit and utility to the American people. I saw advertising used to promote and distribute these products. I saw employees added in great numbers as consumption grew. It was the American system of mass distribution working in its perfect cycle.

Whether it was in the smaller city or the metropolis, I never saw a dollar spent for advertising except with the greatest care and consideration. Always the question asked was: "What sales is this advertising dollar going to produce?" A tax on advertising is no different than Congress saying to a merchant or manufacturer: "We're going to collect from you a tax on the wages you pay your salesmen." For advertising, gentlemen, is mass selling and nothing else. It is the best, cheapest, and only system through which the products of our mass production may reach the consuming public.

The CHAIRMAN. Mr. McMillan.

STATEMENT OF G. S. McMILLAN, NEW YORK, N. Y., SECRETARY, ASSOCIATION OF NATIONAL ADVERTISERS, INC.

Mr. McMILLAN. Mr. Chairman, and gentlemen of the committee, my name is G. S. McMillan. I am secretary of the Association of National Advertisers, Inc., appearing against the imposition of taxes on advertising in both sections of the bill, having to do with radio and outdoor advertising.

I would like to explain that the Association of National Advertisers, Inc., is a nonprofit membership corporation incorporated under the laws of New York State. It is composed of some 300 manufacturers,

all of whom use advertising as an aid to selling. Its membership is Nation-wide and includes companies from almost every industry—steel, shoes, grocery products, drug products, textiles, and so forth. Represented are both large and small companies, with advertising appropriations ranging from the largest to well under $50,000 a year, a true cross-section of American business.

Membership in the association is open only to corporations selling goods or services other than advertising. Publishers, advertising agencies, outdoor plant owners, radio-station operators, and others engaged in selling advertising are not eligible for membership.

As an association composed solely of manufacturers who are all buyers of advertising, with no financial or controlling interest in any advertising medium, we hold no brief for radio, outdoor, newspapers, or other advertising medium per se. An essential part of the business of such media is the sale of advertising: The principal business of the members of the Association of National Advertisers is manufacturing.

But while we have no particular interest in any one medium, we are vitally concerned with the preservation of the American advertising system and hence in the welfare of all media. We are concerned in the maintenance of free and open competition between media.

We believe the taxes proposed in title V, section 557, and title VI, section 601 of H. R. 5417 are unsound, unfair, and discriminatory, and that therefore they should be eliminated.

We have seen no argument whatever in favor of the tax on outdoor advertising. We have seen no argument in favor of the tax on radio advertising except one which proposed such a tax principally as a punitive matter designed to correct alleged unfair competition. If there has been unfair competition—which we do not admit—there are adequate laws dealing with that subject and existing Government agencies whom Congress has designated to administer them.

Senator BARKLEY. What sort of unfair competition is it?

Mr. MCMILLAN. The only argument I have seen in favor of a radio tax bill came from an organization, I believe, in the printing-trade unions who said it was an unfair competition between the newspapers and radio. It did not mention outdoor at all. I have forgotten just what arguments they used, but the gist of the argument was unfair competition.

We do not believe a revenue measure should be used to confer police power. Further, we believe it is significant that there has been, to our knowledge, no proposal of such taxes on outdoor and radio advertising by publishers of magazines or newspapers nor any testimony favoring the taxes from them.

It has also been argued that the proposed tax on radio advertising is an amusement tax. This hardly seems plausible. Amusement taxes in the United States are imposed upon and paid by those enjoying the amusement. Taxes on admissions to theaters, athletic games, and the like are paid by those who purchase tickets, not by the motion-picture companies or the promoters of the amusement. Such is not the case with the proposed tax on radio advertising. Again, the tax would be imposed on radio time sales. That means on sponsored programs only, in other words, on advertising.

No tax is proposed on sustaining programs, on the broadcasting of special events, speeches, and so forth, which are just as surely entertainment as is sponsored material.

Senator VANDENBERG. That is theoretical.

Mr. MCMILLAN. No tax is proposed on magazines, nor should there be—and magazines are designed as and purchased for entertainment. No tax is proposed on newspapers, nor should there be—and yet sponsored news broadcasts are to be taxed.

Senator VANDENBERG. Huey Long tried that once, did he not?

Mr. MCMILLAN. He tried it in Louisiana; yes.

In view of the above, we cannot view the proposed levies on outdoor and radio in any other light than as a direct tax on advertising. Further, as practical businessmen, we know that tax will be passed on to the manufacturer, the buyer of advertising.

We believe it is unwise and unsound to tax advertising. We in this country are engaged in mass production. In order to have mass production we must have mass distribution, and in order to have mass distribution we must have advertising. It is a vital part of selling and by far the most economical way to move the goods made by the men in our factories.

Advertising is not a finished product. It is a business process—just as important and essential a business process as is engineering or production. It is a function not a product. Taxing one function of business, isolating that function and imposing a tax upon it is, to our mind, unsound.

There is nothing mysterious, there is nothing impractical about advertising. On the contrary it is one of the most practical processes in our whole system of free competitive enterprises. It is the means of telling the public what there is for sale and where it can be obtained.

More than any other force in business, advertising has a stabilizing effect, not only on business but on our economy generally. Aside from its benefits to consumers, it has enabled business to expand and grow. That expansion and growth has made for stability for the future, not only for business, but also for all of those engaged in business. The effect of that stability has been to contribute to a feeling of security for the future on the part of all employees of business and to enable business to operate on a sound basis. When business is conducted along lines that are sound and stable, it can be depended upon to make a reasonable profit. Unless it does make a reasonable profit it cannot continue and if it cannot continue, it not only makes for unemployment but dries up the principal source of revenue for the Government and defense.

It is to the profits of business that Government must look for a large part of the revenue that is to be raised through taxation. To discourage advertising through taxation or to make it impossible for business to advertise will be to strike at the very source of the income the Government now needs so badly.

A tax on advertising would not only seriously cripple one of the most vital tools of business, but it would also cripple the media concerned, all of which are substantial taxpayers and employers of labor. Incidentally, we see no way in which the proposed taxes could possibly benefit labor. The effect would be quite to the contrary.

The proposed taxes would also have a bad effect upon the hundreds of thousands of retailers in all lines of business. Advertising by the manufacturer creates demand for products, moves goods from the retailers' shelves. To cripple advertising would be to slow down that demand, to make for slow turn-over and hence lower the profits of the retailer.

The function of advertising, now of all times, is to strengthen the national economy to meet its burden. As President Roosevelt has said:

> It has been a potent force in making available to our citizens the products of American skill and ingenuity—that force needs now to be applied toward the maintenance of our accustomed standards of living and further progress.

It is from the Nation's nondefense business that the sinews of war must finally come. To hamper that business is to weaken those sinews.

Advertising is needed now as never before. Let us take a hypothetical example. There has been a wave of hysterical buying on the part of the public of silk stockings. The United States Department of Agriculture has been working for some time, we understand, on the development of stockings made from other fibers. If, as, and when, it becomes necessary to tell the women of America of these new fibers and of the stockings made therefrom, what force can be substituted for advertising to do that job? What other means will there be to spread the knowledge of this new discovery, to convince women that their beauty will be enhanced rather than impaired by the use of the new products made from articles of American manufacture? If there is a better way, manufacturers would certainly like to know about it.

In addition to this at-the-moment viewpoint, there is also involved the matter of the future. When we find ourselves out of the present emergency, what force at our command could be utilized to better advantage than advertising to maintain the greatly increased productive capacity with which we will undoubtedly find ourselves, to make for stability of employment?

The National Resources Planning Board on August 12—only 2 days ago—released an interesting report made at the suggestion of President Roosevelt in which it warned the Nation that the United States can win the war and still—

> lose everything we are arming to defend if, in the transition to peace we slip back to a low national income with its inevitable unemployment, suffering chaos, and loss of freedom.

We do not feel that it would be sound or wise to cripple a force that may be so much needed later to enable us to carry on. There will come a time when it will be highly desirable to stimulate nondefense industry. Advertising, which has been called the dynamo of business, is the force to accomplish that purpose.

We are entirely aware of the necessity which lies upon all of us to bear increased taxes. We are entirely willing to carry our share of the load. All manufacturers are willingly meeting the increased burden of taxation which has necessarily been thrown upon them, which has arisen from a situation which is neither of their own making nor to their liking. To tax advertising, however, would be to impose a burden on a business function which helps to make sales and thus helps to make taxes.

The money to be derived from the taxes proposed in the bill on radio and outdoor advertising, even if the estimates are correct, would not seem to be vital to the success of the tax measure. Further, we believe that the American public would pay a far greater price for the tax and its collection than any benefits that might be derived therefrom.

In view of the above, the Association of National Advertisers respectfully urges that the committee eliminate the taxes proposed in sections 557 and 601.

That is the statement. I would like to add one thing in answer to a question which was raised. Advertising expenditures as percent of national income declined from a high of 3.75 in 1914 to a low of 2.31 in 1940; from a high of $19.62 per capital of our population in 1926 to $12.61 in 1940. There was spent in 1940 in the United States an estimated total of $1,660,000,000 in advertising, a loss of $450,000,000 over 1929.

The amount of money spent for advertising has not increased in ratio to the national income. The national-income curve has been going up and the advertising-expenditure curve down.

The CHAIRMAN. On the question of radio, it may not justify any tax placed upon advertising over the radio. I am not making the suggestion for that purpose, but since radio is a facility that must be regulated, and since it is costly to regulate a system of that kind, would not there have to be some form of franchise tax to pay for the cost of regulating that?

Mr. MCMILLAN. That would be something that has to do with the radio industry, which I am not prepared to answer for.

The CHAIRMAN. That has nothing to do with advertising?

Mr. MCMILLAN. Nothing to do with advertising.

The CHAIRMAN. But it does have to do with the whole business?

Mr. MCMILLAN. It might, perhaps. But such a matter belongs in the Federal Communications Commission Act and not in a revenue bill.

The CHAIRMAN. Thank you, Mr. McMillan.

Mr. Warren.

STATEMENT OF WILLIAM C. WARREN, NEW YORK, N. Y., REPRESENTING TRANSIT ADVERTISERS, INC.; CHICAGO CAR ADVERTISINT CO.; AND TRANSPORTATION DISPLAYS, INC.

Mr. WARREN. Mr. Chairman, and gentlemen of the committee, my name is William C. Warren. I represent the Chicago Car Advertising Co., 333 North Michigan Avenue, Chicago, Ill.; Transit Advertisers, Inc., North Station, Boston, Mass., and 30 Rockefeller Plaza, New York City; and Transportation Displays, Inc., 9 Rockefeller Plaza, New York City. These companies represent three out of a total of five companies engaged in the business of displaying advertising material on properties of common carriers.

I want to address my remarks to section 3269 of the revenue bill of 1941, as passed by the House of Representatives, which section imposes a graduated tax on every person engaged in business as a lessor of billboards for outdoor advertising.

Because these companies are in somewhat of a different position, it is felt desirable to acquaint you with their peculiar problems, and we do not feel we are more or less duplicating this information that has been furnished you.

It is not clear that this excise tax is applicable to advertising displays located on properties of common carriers; however, if it is applicable it will force these three companies to discontinue and, hence, cause a complete destruction of this advertising-display business. The advertising displays of these companies are commonly referred to as one-, two-, and three-sheet displays, consisting of 8, 18, and 24½ square feet, respectively. These advertising displays are located on properties of subways, elevated trains, and railroads, principally in and around the areas of Boston, Chicago, Philadelphia, New York City, and New England generally. Chart A gives you in detail the States in which the advertising displays of these companies are located and on whose properties. You will notice that there are 12 States in which they have their advertising displays.

CHART A

State, Common Carrier, and Advertising Organizations

Connecticut:
  Transit Advertisers, Inc.:
    New York, New Haven & Hartford Railroad.
    The Connecticut Co.
Illinois:
  Chicago Car Advertising Co.:
    Chicago Rapid Transit.
    Illinois Central Railroad.
Indiana:
  Transportation Displays:
    Erie Railroad.
Maine:
  Transit Advertisers, Inc.:
    Maine Central Railroad.
    Boston & Maine Railroad.
Massachusetts:
  Transit Advertisers, Inc.:
    Boston & Maine Railroad.
    New York, New Haven & Hartford Railroad.
    Boston Terminal Co.
  National Transitads:
    Boston Elevated Railway.
New Hampshire:
  Transit Advertisers, Inc.:
    Boston & Maine Railroad.
    Maine Central Railroad.
New Jersey:
  Transportation Displays:
    Lackawanna Railroad.
    Erie Railroad.
    Central Railroad Co. of New Jersey.
    New York, Susquehanna & Western Railroad.
  Transit Advertisers, Inc.:
    New Jersey-Cortlandt Street Ferry Co.
New York:
  Transit Advertisers, Inc.:
    New York, New Haven & Hartford Railroad.
    The County Transportation Co.
    Long Island Railroad.
    Pennsylvania Railroad.
    New Jerrey-Cortlandt Street Ferry Co.

New York—Continued.
Transportation Displays:
New York Central Railroad.
Lackawanna Railroad.
Erie Railroad.
Central Railroad Co. of New Jersey.
New York Subways Advertising Co.:
New York City Subways.
Ohio:
Transportation Displays:
Erie Railroad.
Pennsylvania:
Transportation Displays:
Lackawanna Railroad.
Erie Railroad.
National Transitads:
Philadelphia Rapid Transit.
Transit Advertisers, Inc.:
Pennsylvania Railroad.
Pennsylvania-Reading Seashore Lines.
Camden-New Jersey Ferry Co.
National Transitads:
Philadelphia Rapid Transit.
Rhode Island:
Transit Advertisers, Inc.:
New York, New Haven & Hartford Railroad.
Vermont:
Transit Advertisers, Inc.:
Boston & Maine Railroad.
Maine Central Railroad.

These companies, in reality, are merely agents of the common carriers because of the constant close control exercised by the carriers and the degree with which they scrutinize the advertising to be displayed on their properties.

Senator VANDENBERG. Where is that in the tax bill?

Mr. WARREN. On page 78, sir. These advertising companies do not own their own display structures as do the outdoor companies. Displays are placed, changed, relocated, and removed at the request of the common carriers. The number of displays on any particular location is also determined by the common carrier. In actual practice the common carriers frequently require displays to be changed due to the alteration of a station, the improvement of a station, or for other reasons, and all such changes have to be made at the expense of the advertising-display companies. Even in respect to the advertising material to be displayed, the common carriers exercise control, and from time to time will not allow certain advertising displays on their properties. Thus, it is evident that these companies are in effect merely agents of the common carriers.

All of the five companies displaying advertising material on properties of common carriers were recently organized, with the exception of one of the companies, and each of the five companies is owned by several individuals, none of whom is affiliated in any way. These companies have taken over to a degree the advertising displays on properties of common carriers of those companies which formerly were operated by the late Baron Collier.

The CHAIRMAN. Let me ask you——

Mr. WARREN. Yes, sir.

The CHAIRMAN. Do your companies own the board?

Mr. WARREN. My understanding is that with one exception these display boards are not owned by these companies but that the common carriers own them. One company, however, does own the small steel frames which are placed on the side of the station.

The CHAIRMAN. You own that?

Mr. WARREN. Yes; one company owns that.

The CHAIRMAN. You own the space.

Mr. WARREN. Yes. In the case of one company, it simply owns a steel frame that is placed on the side of the station, wherever the common carrier says we can place it.

The CHAIRMAN. Yes.

Mr. WARREN. Senator, in the case of all companies, we may want to place one display on a station but the railroad says, "No, no; you will ruin the symmetry of this station if you do not place another here [indicating] or two here [indicating]," so we may have to place three there instead of one. We have that difficult problem to face constantly.

This excise tax contained in section 3269 of the House bill should not be applicable to advertising displays on properties of common carriers for the following reasons:

1. Any excise tax on companies handling advertising displays on properties of common carriers would be confiscatory and ruinous to every company now engaged in such business.

2. The 40 to 60 percent of gross revenue demanded and obtained by common carriers under long-term contracts with these companies makes any excise tax such a burden as to constitute a death penalty.

3. An excise tax on only outdoor advertising is highly discriminatory and unfair.

4. The graduated rates proposed in section 3269 of the House bill are discriminatory and unfair.

5. State legislation taxing outdoor advertising has always recognized and exempted as a class, outdoor advertising on properties of common carriers.

Senator VANDENBERG. Let me ask you at that point, to what point do the States tax outdoor advertising?

Mr. WARREN. Senator, there are probably 14 States, I think, that tax outdoor advertising in some way. In most instances, it is regulatory rather than as a source of revenue.

6. This excise tax, if applicable to advertising displays on properties of common carriers, will yield approximately $75,000 annually from those companies having advertising displays on properties of common carriers; the obvious small net receipts to the United States Treasury after deducting the cost of administering the tax and the inherent discrimination and unfairness of this excise tax should militate against its application to advertising displays on properties of common carriers; hence either this excise tax on outdoor advertising should not be retained as a part of the revenue bill of 1941 or an amendment should be incorporated whereunder advertising displays on properties of common carriers are expressly exempted.

I. Any excise tax on companies handling advertising displays on properties of common carriers would be confiscatory and ruinous to every company now engaged in such business

If the graduated excise tax rates imposed by section 3269 of the House bill are applicable to the advertising displays on properties of common carriers, these three companies will not be able to continue this medium because the added burden cannot be assumed with the present small annual net profit per each advertising display nor can this excise tax be passed on because of long-term contractual arrangements with the common carriers and advertisers. No tax law should be designed to destroy legitimate businesses, but if this tax on outdoor advertising is applicable to the advertising displays of these companies, it will have that very effect in that it will be confiscatory and ruinous to the companies.

At the time this excise tax was considered by the Committee on Ways and Means of the House of Representatives, no public hearing was held on the merits or demerits of the tax. For that reason, that committee was not familiar with the problems of such companies nor with the financial difficulties of those advertising companies selling the use of this medium. Each of the three petitioning companies has had its auditors prepare a careful study of the number of advertising displays and the net annual profit for each display for the first 6 months of 1941 plus the estimated net profit for the last 6 months of 1941.

You will notice from this chart (see chart B) that the estimated 1941 annual profit per one-sheet display before deduction for Federal income tax for Chicago Car Advertising Co., is $0.106, for Transit Advertisers, Inc., is $0.124 and for Transportation Displays, Inc., is $1.02. If you will then examine the computed annual profit per foot and the computed tax rate per foot you must conclude that such an excise tax would be ruinous to these companies. You will also note that if this excise tax is applicable to the one-sheet displays that the proposed rate would be $0.125 per square foot while on an outdoor billboard of 100 square feet the proposed rate would be $0.01 per square foot.

CHART B

Chicago Car Advertising Co.

Number of displays [1]	Size of frame	Square feet per unit	Annual net [2] profit per display	Total square feet	Computed [3] annual profit per foot	Computed tax rate per foot	Allowable [3] tax rate per foot
7,126	1 sheet	8	$0.106	57,008	$0.01325	$0.125	$0.01
2,784	2 sheets	18	.249	22,272	.0138	.0555	.01
3,729	3 sheets	24½	.318	91,360	.0130	.0408	.01

[1] Over 65 percent not rented.
[2] Before deduction for Federal income tax.
[3] Based on proposed tax, if applicable, of $1 per 100 square feet.

CHART B—Continued

Transit Advertisers, Inc.

Number of displays [1]	Size of frame	Square feet per unit	Annual net [2] profit per display	Total square feet	Computed [3] annual profit per foot	Computed tax rate per foot	Allowable [3] tax rate per foot
2,759	1 sheet	8	$0.124	22,072	$0.0154	$0.125	$0.01
1,879	2 sheets	18	.252	33,822	.3148	.0555	.01
5,287	3 sheets	24½	.266	129,531.5	.0108	.0108	.01

[1] Over 40 percent not rented.
[2] Before deduction for Federal income tax.
[3] Based on proposed tax, if applicable, of $1 per 100 square feet.

Transportation Displays, Inc.

Number of displays [1]	Size of frame	Square feet per unit	Annual net [2] profit per display	Total square feet	Computed [3] annual profit per foot	Computed tax rate per foot	Allowable [3] tax rate per foot
489	1 sheet	8	$1.02	3,912	$0.1275	$0.125	$0.01
492	2 sheets	18	.73	4,336	.0105	.0555	.01
1,127	3 sheets	24½	1.94	27,615	.0791	.0108	.01

[1] Over 20 percent not rented.
[2] Before deduction for Federal income tax.
[3] Based on proposed tax, if applicable, of $1 per 100 square feet.

Senator DAVIS. Is that a rate for a year?

Mr. WARREN. Yes; that is the rate for a year. That is 12½ cents per square foot on the 1-sheet displays, as contrasted with 1 cent as allowable under the act.

This is so patently discriminatory that no further comment will be made.

By examining the figures compiled by each company as to 2-sheet and 3-sheet displays you can obtain a complete picture of the disastrous effect of such an excise tax on 1-, 2-, and 3-sheet displays on properties of common carriers.

Some comments should be made as to the reasons for these low annual profits per display.

In the first place, in every instance but one, these companies were recently organized as has been previously pointed out and furthermore advertising display companies always have considerable display space that is not sold. You will note on the chart as to each company that the amount of space as unsold is indicated in a footnote. Over 65 percent of the display space of the Chicago Car Advertising Co. is not sold, over 40 percent of the Transit Advertisers, Inc., is not sold and over 20 percent of Transportation Displays, Inc., is not sold.

Senator DANAHER. A question there, please.

Mr. WARREN. Yes.

Senator DANAHER. You do not say, Mr. Warren, that you would be compelled to pay a tax on space that is not sold, do you?

Mr. WARREN. We would, for this reason, sir; we may have a display in one space only for a week where there is compensation derived. In other words, over the period of a year, every space will be filled for a short time, a week, maybe 3 months, maybe the whole year. In other words, as you will recall, from chart B, the Chicago Car Advertising Co. has 7,000 1-sheet displays. During the course of the year,

every one of those displays will have some kind of advertising for compensation. It may be only for a week, or maybe for more time, but we would fall under the act because of that reason.

The act says "for compensation."

Senator DANAHER. Your argument is, if the board were rented for 1 month out of 12, it would still have to pay a tax?

Mr. WARREN. For 1 day, sir. Even though the display space may not be sold the common carriers require that every space have an advertising display in order that the blank space will not make their properties less attractive. These blank display spaces of necessity, being always filled with nonrevenue displays, such as supplied by civic, national organizations, Navy and Army, and gratuitous displays from advertisers already purchasing space, create the impression with many unfamiliar with the business, that it is highly profitable and can easily, without any financial difficulty, pay the proposed graduated excise taxes.

Any depressed business such as the representatives of the sale of advertising displays on properties of common carriers should not be subjected to excise taxes as proposed in section 3269 of the revenue bill of 1941. Within the past few months additional hope has been manifested for the future of these small and independent companies operating these advertising displays. However, any tax such as that proposed in section 3269 would destroy every possibility of any profit to be derived from their activities, even though the advertising display business was now functioning at the peak of activity which it formerly operated.

II. The 40 to 60 percent of gross revenue demanded and obtained by common carriers under long-term contracts with these companies makes any excise tax such a burden as to constitute a death penalty

Any common carrier which has space available for advertising displays exacts a high percentage of gross revenue from the advertising company because the common carrier brings together a private audience composed of its fare-paying passengers.

Being directly responsible for bringing together the private audience and also having complete control of the advertising material which is visible in and about their stations, platforms, and other structures, these common carriers have always demanded as a minimum 40 percent of the gross revenue derived by advertising display companies and, in many cases, as high as 60 percent of the gross revenue. In all cases, the advertising display companies enter into long-term contracts with the common carriers whereunder during the period of the contract these percentages of gross revenue are to be paid irrespective of any additional costs which the advertising companies might encounter. This high percentage of gross revenues taken by the common carriers must be contrasted with the percentages taken by those other than common carriers. The minimum required by them is 5 percent of gross revenues with a maximum of possibly 20 percent.

Upon analysis, the reason is evident for this great disparity between the percentages of gross revenue taken by the common carrier and one not a common carrier. One who is not a common carrier does not assemble a private audience nor do they provide the facil-

ities for such an assembly, but must rely wholly upon the whims and fancies of the public to pass the location or upon the fact that the location is on some strategic highway, constructed and maintained by public funds. Obviously, one depending upon a public audience cannot exact the same percentage of gross revenue that one can who assembles a private audience within the confines of private property. For that reason, common carriers have always demanded and have justly obtained high percentages of gross revenues from advertising companies displaying advertising on their properties. Under such conditions, those companies displaying advertising on properties of common carriers are not in a similar position to those advertising companies displaying advertising along public thoroughfares. Any excise tax such as that proposed in section 3269 would only serve to increase the competitive disadvantages of those companies having advertising displays on properties of common carriers.

III. This excise tax on outdoor advertising is highly discriminatory and unfair

The revenue bill of 1941 as passed by the House of Representatives does not propose to levy an excise tax on all classes of advertising, but only on certain classes. Such taxation violates a fundamental principle of an excise tax, that it should be uniform and apply equally to all classes affected. By far the greatest amount of advertising is through the use of 2 other media—the newspapers and magazines. To tax the use of the medium of outdoor advertising displays and not the use of the other media obviously is highly discriminatory and unfair. Such discrimination places the taxable medium at an economic disadvantage and will result in the untaxed media continually making inroads on the taxed medium because of the competitive advantages created and maintained by such apparent unfair taxation. This result is inevitable in a field of business activity which is as highly competitive as the advertising business.

IV. The graduated rates proposed in section 3269 of the House bill are discriminatory and unfair

The very language of section 3269 of the House bill excludes more outdoor billboards than have been included for taxation. The only billboards that would be subject to this excise tax would be those which were owned and controlled by one "who engaged in business as a lessor of billboards."

Congressman Martin J. Kennedy, of the Eighteenth District of New York stated in a speech before the House of Representatives that there were five times as many billboards outside this classification as there were within the classification. Not only is this proposed excise tax discriminatory as to this exclusion, but also the rates graduated from $1 to $11 are also highly discriminatory and unfair.

Senator DANAHER. Another question. Will you break down a little better, not in terms of what Mr. Kennedy said in the House, but what you said here, as to why so large a percentage of boards do exclusive advertising of one product?

Mr. WARREN. If an advertiser, instead of going to the Outdoor

Advertising Co., or some company that is a lessor of billboards, simply erects his own board, then it is not subject to a tax under this act. The result is that most of the boards are under that classification, and you have most of them excluded. Furthermore, if you do enact this kind of tax, those people who are going now to the advertising agencies to have it done, are going to start doing it themselves and avoid the tax. So it is one of the things that is going to have a very definite economic effect on this business.

Senator DANAHER. For instance, as we drive along the highway, we see a sign advertising Burma-Shave. Does the agency maintain that, or does some company do it?

Mr. WARREN. I am not certain about Burma-Shave, but I know quite a number of companies who do maintain their own signs and put up their own signs, particularly in the smaller localities.

Senator DANAHER. If that particular company actually does put up the signs, it does meet the point you make?

Mr. WARREN. That is right. It is not subject to the tax, while those boards of an agency are subject to the tax.

Senator DAVIS. Some of the signs do not contain a complete sentence.

Mr. WARREN. Yes.

Senator DAVIS. There is a series of boards running along with a word or two on each.

Mr. WARREN. Yes.

Senator DAVIS. Will each one of those be taxed on the billboard rate?

Mr. WARREN. Oh, yes; no question about that, if they are for compensation.

If the excise tax is applicable to 1-, 2-, and 3-sheet displays on properties of common carriers, a 1-sheet display of only 8 square feet which obviously would carry a very nominal annual rental, is taxed at $1, whereas the same rate of tax applies to a billboard of 100 square feet which would have a considerably larger annual rental.

Not only would there be a great disparity in the annual rent in these instances, but also as it has been pointed out before, the percentages of gross revenue demanded and paid by the companies maintaining advertising displays on properties of common carriers is considerably higher. Obviously, less of the gross revenue is retained by those companies having advertising displays on properties of common carriers and therefore the application of this rate to the 1-, 2-, and 3-sheet advertising displays on properties of common carriers is doubly discriminatory and inequitable.

V. State legislation taxing outdoor advertising has always recognized and exempted as a class, outdoor advertising on properties of common carriers

Several States have already had a history in the taxation of outdoor advertising. This is particularly true of the New England States. In the States of Maine, New Hampshire, and Vermont, legislation has been enacted taxing billboards, but such legislation expressly contains an exemption for advertising displays on properties of common carriers. The exemption provision of the Vermont taxing statute is as follows:

This chapter * * * shall not apply to signs and other devices on or in the rolling stock, station, subways, or structures of or used by common carriers * * * (Sec. 8349, Public Laws, 1939).

The exemption provision of the Massachusetts taxing statute is as follows:

Certain signs, etc., exempted—sections 29 to 31, inclusive, and 33, shall not apply to signs or other devices on or in the rolling stock, stations, subways, or structures of or used by common carriers, except advertising signs or other advertising devices on bridges or viaducts or abutments thereof (Annotated Laws of Massachusetts, ch. 93, sec. 32).

Senator WALSH. Are those cards that are on streetcars and elevated railroad cars included in this bill?

Mr. WARREN. No, sir. They would not be included in the bill, because they are not outdoor advertising.

It has previously been indicated that the advertising displays on properties of common carriers were the 1-, 2-, and 3-sheet displays, which were only 8, 18, and 24½ square feet respectively. Undoubtedly, the size of these displays and the high percentage of gross revenues commanded by the common carriers have been extremely important to the State legislatures in granting this exemption. Considerable importance should be attached to the fact that the various States which have enacted State legislation on billboards have expressly exempted advertising displays on properties of common carriers. It seems clear that this State legislative history should be followed and that a similar exemption should be included in the revenue bill of 1941 if the proposed excise tax contained in section 3269 is to become part of the Revenue Act of 1941.

VI. This excise tax, if applicable to advertising displays on properties of common carriers, will yield approximately $75,000 annually from those companies having advertising displays on properties of common carriers; the obvious small net receipts to the United States Treasury after deducting the cost of administering the tax and the inherent discrimination and unfairness of this excise tax should militate against its application to advertising displays on properties of common carriers; hence either this excise tax on outdoor advertising should not be retained as a part of the revenue bill of 1941 or an amendment should be incorporated whereunder advertising displays on properties of common carriers are expressly exempted

Accurate estimates show that there are approximately 75,000 1-, 2-, and 3-sheet displays on properties of common carriers. If the proposed excise tax on outdoor advertising is applicable to these displays on properties of common carriers, the total annual gross receipts derived from such advertising displays would, therefore, not exceed $75,000 in the aggregate. After deducting the necessary expenses of administering such an excise tax, the total net receipts to the United States Treasury would be an extremely negligible amount. It is contended that any excise tax not yielding in excess of the amount herein set forth should not be enacted into law as a part of the Federal revenue system. Particularly is this true where such an excise tax is highly discriminatory and unfair and the economic effect of the tax would be such that the properties of those affected would be confiscated and their business ruined.

We therefore respectfully submit that the revenue bill of 1941, as passed by the House of Representatives, should be amended, striking from it section 3269 which contains the excise tax on outdoor advertising or an amendment should be adopted whereunder the 1-, 2-, and 3-sheet displays on properties of common carriers are expressly exempted from the excise tax proposed by section 3269.

The CHAIRMAN. All right, sir.

Mr. WARREN. Thank you, sir.

Senator DANAHER. There is one question I would like to ask of this witness.

The CHAIRMAN. All right, Senator.

Senator DANAHER. If we have the right to say, by way of regulation, that we should have an imposition of a tax on a franchise, the doing of business by outdoor advertising companies, why cannot we also say where gasoline stations will be located, or anything else on the highway, by levying a tax on the ground they are obnoxiously situated?

Mr. WARREN. I do not see why you cannot, as long as they are lessors, following out the theory of this bill.

Senator DAVIS. Would some of the signs on the gasoline stations be classed as outdoor advertising?

Mr. WARREN. They would be so classed under section 3269 unless they are owned and maintained by the proprietors of the gasoline filling stations rather than by someone else as a lessor.

Senator DANAHER. If I have a corner lot and on my building I put a billboard and put some advertising on it, I would be exempt from this bill?

Mr. WARREN. That is right, Senator. Whereas if one of the advertising companies acted as a lessor, they would be required to pay the tax.

Senator DANAHER. If you would like to submit a memorandum on the question I have put to you, as to the right of the Federal Government to set up this kind of a tax, I would be glad to have you do so.

Mr. WARREN. We will furnish that to you in the next couple of days. Would that be plenty of time?

Senator DANAHER. Yes.

Mr. WARREN. Thank you.

(The memorandum referred to appears on p. 1524.)

The CHAIRMAN. There will be inserted in the record a brief statement by Mr. Myles Standish, of Providence, R. I.

(The statement by Mr. Standish is as follows:)

To the average American, the meaning of democracy as a definition of the American way of life is essentially economic rather than political.

Of all the freedoms which make up the American way of life, that which is most highly prized and will be most fiercely defended, is the freedom of the individual to shape his own destiny by exercising his initiative and enterprise to sell his services to society for the purpose of earning a living.

The right of the individual to freely communicate to the public information concerning the goods or services he produces or sells is an integral and inseparable part of that freedom, for without it, economic independence, which is the very essence of our liberty, would be impossible of achievement.

All other civil liberties are essentially safeguards to this one fundamental right—the right to live as a free man economically as well as politically.

Advertising, as we know it today, is simply the old right of word-of-mouth communication streamlined, amplified and mechanized to match the needs and

techniques of a mechanized mass production and mass distribution economy. It is universally used by large and small, in one form or another, and universally depended upon as a vital and irreplaceable means of communication between producer and consumer. Without the services of advertising, mass production—distribution and selling could not continue to exist.

Therefore, the proposal of the Congress to tax advertising is, in fact, for the first time, an assertion by the peoples' elected representatives of the right to control, restrict, or eventually even abolish, through increasingly onerous application of the principle inherent in the right to tax, that freedom of speech or communication upon which their constituents depend for their very existence as a free people.

To assert that the constitutional guaranty of freedom of speech is confined to the expression or dissemination of political, religious, or social information, conviction and opinion, and does not extend to the right to disseminate commercial information essential to economic survival, is to assert that the outward forms and appearances of freedom are more important than freedom itself. It is an obvious observation that the four freedoms are empty figures of speech to those economically dependent upon favor or patronage.

If, as John Marshall laid down, the right to tax is the right to destroy, the establishment of the principle of imposing taxation upon certain methods of advertising, and the exception of other methods of advertising from the effects and burdens of such taxation, upon no apparent basis of reason whatever, is plainly discriminatory and constitutes a denial to great numbers of citizens of the equal protection of the law.

Legislation which discriminates against one class or body of citizens and confers privileges and advantages upon another can hardly be seriously defended as just.

Obviously, the problem resolves itself into a question of the advisability of taxing either all advertising or none, unless we are to embark upon a system of legislation by whim and caprice.

Regardless of the justice or legality of the proposed tax, we submit it is practically inadvisable and undesirable for two fundamental reasons.

1. As a revenue measure, it defeats its own purpose, because it will decrease rather than increase tax revenue. Advertising, like a tree which recurrently bears fruit, is a productive force or process which cannot itself be crippled or destroyed without reducing or destroying its products. National income, which is the product of advertising, is the sole source of defense revenue. Unnecessary restriction upon nondefense industry and business will decrease taxable income and profits and reduce revenue for defense efforts.

2. As social legislation it is in itself an attack upon and not a defense of democracy, and destroys the system it purports to defend.

The very essence of the morale of our national defense is the determination of the American people to protect, maintain, and perpetuate the American way of life as it is expressed in our system of free enterprise and guaranteed by freedom of speech and freedom of the press. The proposed establishment of the right to deny to American citizens free access to customary means of communication adequate and necessary to the preservation of that system constitutes in itself an abridgement and opens the way for the destruction of those very rights and institutions for the supposed defense of which the tax is levied.

The argument that the best way to defend our institutions and rights is to surrender them without a struggle, is like maintaining that the best way to preserve life is to commit suicide.

The advertising industry neither claims nor wishes any exemption from carrying its full and equitable share of the tax burden. It is only when it is singled out for special discriminatory and perilous legislative action that threatens, not its profits, but its very right to existence, that it feels compelled to vigorously protest.

The CHAIRMAN. Mr. Peters.

Mr. NIEMEYER. I would like to take Mr. Peters' place.

STATEMENT OF G. H. NIEMEYER, NEW YORK, N. Y., CHAIRMAN, JEWELERS TAX COMMITTEE

The CHAIRMAN. What is your name?

Mr. NIEMEYER. My name is Niemeyer. I am the following witness. Mr. Peters has asked me to take his place.

The CHAIRMAN. He is not here?

Mr. NIEMEYER. He is here, but he has asked me to take his place.

The CHAIRMAN. I see several witnesses here on the jewelry tax.

Mr. NIEMEYER. Yes.

The CHAIRMAN. How many will be consolidated?

Mr. NIEMEYER. I really do not know. Some of them represent other organizations which are independent of this group.

Senator WALSH. You are Mr. Niemeyer?

Mr. NIEMEYER. That is my name, Senator.

The CHAIRMAN. How long will you use?

Mr. NIEMEYER. Less than 5 minutes, sir.

The CHAIRMAN. You may proceed.

Mr. NIEMEYER. Thank you. Mr. Chairman, my name is G. H. Niemeyer. My address is 82 Fulton Street, New York City, and I am in the precious-metal business. It was my pleasure to have been a member of the Jewelers Tax Committee under the Revenue Act of 1918. I served as chairman of the Jewelers Tax Committee under the act of 1932, and I am serving in a similar capacity at the present time. My appearance is voluntary, without compensation, nor have I any direct personal interest in the outcome. It is my privilege to speak for the following trade organizations:

American National Retail Jewelers Association, which has over 3,200 members and 35 State retail jewelers associations.
American Jeweled Watch Association.
American Jewelers Protective Association.
American Watch Assemblers Association.
Chicago Jewelers Association.
Gem & Pearl Dealers Association.
Jewelry Crafts Association.
Jewelers Vigilance Committee.
National Wholesale Jewelers Association.
New England Manufacturing Jewelers & Silversmiths Association.
Platinumsmiths' Association.
Sterling Silversmiths Guild of America.

This industry is made up of patriotic citizens who are willing and ready to bear their fair share of any tax obligation.

We endorse the principle of a retail excise tax applied to our specific industry as proposed by the United States Treasury Department and passed by the House of Representatives. The fundamental reasons for our support of this principle are well expressed in the report of Hon Robert. L. Doughton, chairman of the House Ways and Means Committee, which accompanied the Revenue Act of 1941 and reads as follows:

Retailers' excise taxes.—The bill imposes a tax of 10 percent upon the retail sale of jewelry, furs, and toilet preparations. The tax is placed upon the retail sale rather than the manufacturer's or importer's sale because of administrative and equitable considerations. Manufacturers' excise taxes upon these articles have been imposed by the Federal Government in the past. Such a tax upon toilet preparations is, in fact, imposed by existing law. Experience has proven, however, that under such taxes evasion is substantial and inequitable competitive situations are created.

In view of these considerations, the House Committee on Ways and Means is convinced of the desirability of placing these taxes upon the retail sale.

We do, however, strongly protest against the proposed tax rate of 10 percent. We believe this rate to be grossly discriminatory. A 10-percent tax at the point of retail sale is equivalent to about a 20-percent tax on the manufacturer, importer, and producer. The products against which our industry must compete, such as automobiles, radios, electrical appliances musical instruments, and so forth, are called upon to pay 10 percent or less on the manufacturer's price, and certain other comparable items are not taxed at all. We feel sure that the Congress does not intend to discriminate so unfairly against our industry.

It is our belief that a tax rate of 10 percent will seriously affect sales volume to a point where very little more revenue would be raised than if the rate were 5 percent.

Income taxes and social changes have affected our business most seriously during the past 10 years. The Revenue Act of 1941 will still further restrict our economic opportunity.

A 10-percent tax on jewelry is so high that, in our opinion, it will encourage avoidance and even evasion of the tax liability, particularly in the sale of higher-priced items.

During the World War we paid a retail excise tax of 5 percent under the Revenue Act of 1918. This raised between $20,000,000 and $25,000,000 a year in revenue. Under present conditions the proposed bill should, in our opinion, raise $30,000,000 a year or more at a 5-percent rate.

We do not believe that this relatively small industry which has had to struggle so hard to meet the social and economic changes which are taking place and which, as an industry, interferes to such a very limited extent with defense production, should be asked to contribute so disproportionately and unfairly.

We offer to patriotically bear our share of any tax burden. All we ask is your consideration in a spirit of fairness and justice.

Senator VANDENBERG. How would you feel about substituting a small manufacturers' sales tax for all of these excise taxes?

Mr. NIEMEYER. We prefer not to have a manufacturers' excise tax on the jewelry trade, because there are certain industries, like the jewelry industry, which permit further manufacture; and, under the 1932 law—which is a manufacturers' tax law—every retail jeweler, almost every retail jeweler in the country was a manufacturer, and had a tax obligation which was paid sometimes, and sometimes not, I am sorry to say.

The CHAIRMAN. Well, you are speaking now, Mr. Niemeyer, as a manufacturer, rather than a retailer?

Mr. NIEMEYER. I am not a manufacturer, nor a retailer, I am one of those fellows in the trade who sticks his neck out, if you know what I mean. I have been in this business as chairman of the vigilance committee, which seeks to maintain fair competition within the trade and keep the jewelers and their reputation safe from those who would violate it by violating the law and regulations of the Government.

The CHAIRMAN. Are you equally concerned on behalf of the retailer as on behalf of the manufacturer?

Mr. NIEMEYER. I am appearing for both, sir.

The CHAIRMAN. You appeared before the House Ways and Means Committee?

Mr. NIEMEYER. I did, sir.

The CHAIRMAN. I read your testimony there, and I noted in your testimony before the Ways and Means Committee the statement that you thought quite a number of the retailers preferred this retail tax.

Mr. NIEMEYER. They certainly do, Mr. Chairman. The very fact that I represent 35 of the State retail-jewelers' organizations, I should say was ample evidence of that fact.

Senator WALSH. But they do not want more than 5 percent.

Mr. NIEMEYER. They do not want more than 5 percent, as you have possibly heard.

Senator WALSH. Has there ever been a tax of more than 5 percent on jewelry?

Mr. NIEMEYER. There was a 10-percent manufacturers' tax under the 1932 law; yes.

Senator WALSH. How long was that in operation?

Mr. NIEMEYER. That was in operation from 1932 to 1936, and the largest amount that was raised by that tax—which is very important in the consideration of this matter—was $4,000,000 in 1933.

Senator WALSH. On 10 percent?

Mr. NIEMEYER. On a 10-percent manufacturers' excise tax; and the industry is presumed to have done a business of between $225,000,000 and $250,000,000.

The CHAIRMAN. Has the retailer ever been taxed?

Mr. NIEMEYER. The retailer was taxed during the World War.

The CHAIRMAN. How did he come out there?

Mr. NIEMEYER. The tax was 5 percent; and, as I have indicated in my testimony, that raised between $20,000,000 and $25,000,000 year after year until they began to make some exemptions, and then it was lessened.

Senator LA FOLLETTE. Mr. Niemeyer, why has it proven so difficult to collect this tax in this particular industry?

Mr. NIEMEYER. Because the retailer becomes a manufacturer, and the importing situation is very difficult. For example, diamonds are very difficult for any man to identify as taxable goods. An importer's diamond was taxable and a man who did not import a diamond, who got it second-hand, if you please, his diamond was not taxable. You would have a diamond that might be worth $500 in one case, that was taxable, that had a 10-percent tax on it, and a diamond competing with it that was not taxable. It was very difficult for the Internal Revenue Department to put their fingers on the tax obligation and on the value.

Senator WALSH. That is because of smuggling?

Mr. NIEMEYER. No; not because of smuggling. Smuggling has nothing to do with it, sir. Here is a dealer who has two kinds of diamonds in his place, one that he imported himself and another that he bought in the trade. In that connection I might say, also, that at the moment this diamond situation is more chaotic than ever, because we have literally millions and tens of millions of dollars' worth of refugee diamonds in New York now, held by people that the industry does not even know about, and they are being sold in the regular markets.

Senator WALSH. There is no way of checking up on them?

Mr. NIEMEYER. There is no way of checking up on them. We have tried to help the Department, but it is pretty difficult.

We also protest against the effect of the retroactive provision of section 2405, line 25 and 26, which proposes a tax on conditional or installment sales made since July 1, 1941, when charge-account sales collectible at some indefinite future date are not affected. It certainly does not seem fair or reasonable to penalize the buyer or seller concerned in such installment transactions when no penalty of this character or extent was contemplated or provided for at the time the sale was made.

We respectfully suggest the elimination of the words in lines 12 and 13 of section 2400 on page 76 of H. R. 5417 reading "gold, gold-plated, silver, silver-plated, or sterling flatware or hollow ware." It is our impression that these words have the effect of limiting rather than extending the coverage intended, as we believe the items stipulated separately are already covered by the previously stated provisions in lines 9, 10, and 11 of section 2400 which read "articles made of, or ornamented, mounted, or fitted with precious metals or imitations thereof."

Thank you, sir.

The CHAIRMAN. The committee will be obliged to recess at this time, because it is desired to fix a closing date for public hearings on this bill, if we can do so this morning; and, since the Senate will be in session this afternoon, we will ask the witnesses, who were scheduled, to appear before the committee in the Military Affairs Committee room on the floor of the Senate Chamber in the Capitol at 1:30.

You may be excused until 1:30 and we will ask you to appear in the Capitol, in the Military Affairs Committee room, this afternoon.

(Whereupon, at the hour of 11:45 a. m. the committee recessed until 1:30 p. m. of the same day.)

AFTERNOON SESSION

(Pursuant to adjournment for the noon recess, the committee reconvened at 1:30 p. m.)

The CHAIRMAN. The hour set for the opening of the hearing this afternoon having arrived, we will proceed. From time to time the Senators will come in when it is possible for them to do so.

Mr. Wagner, you say you are substituting for Mr. Peters?

Mr. WAGNER. Yes.

The CHAIRMAN. And Mr. Peters gave way for Mr. Neimeyer this morning, that is, agreed for Mr. Neimeyer to precede him?

Mr. WAGNER. Yes.

The CHAIRMAN. You may proceed. You appear on behalf of the retail trade?

Mr. WAGNER. Yes; I am addressing myself from the standpoint of the retailer.

The CHAIRMAN. Proceed.

STATEMENT OF WILLIAM WAGNER, NEW YORK, N. Y., EXECUTIVE SECRETARY, ASSOCIATED CREDIT JEWELERS OF NEW YORK AND NEW JERSEY, INC.

Mr. WAGNER. My name is William Wagner. I am executive secretary, Associated Credit Jewelers of New York and New Jersey, Inc. I want to read first a very brief statement on behalf of Mr. Phineas Peters, chairman, executive board of Retail Jewelers Associations of Greater New York, Inc., a group which covers all of cash jewelers' associations in New York, or a large portion of them.

STATEMENT OF PHINEAS PETERS, CHAIRMAN, EXECUTIVE BOARD OF RETAIL JEWELERS ASSOCIATIONS OF GREATER NEW YORK, INC.

This statement is submitted to you in behalf of 265 small retail jewelry store owners in Greater New York, who comprise the membership of the incorporated association of which I am chairman.

We have feared from the very inception that the defense program would hit small business harder than any other type of free enterprise prevalent in the United States. While none of the retail merchants for whom I speak has welcomed this idea, all of us realized that some sacrifice of the old order of things would have to be undergone in a period of national emergency. We realized, too, that some small businesses would not survive.

It is, however, fair and appropriate that this committee should have a full and complete understanding of the effect that the proposed Revenue Revision Act of 1941, as passed by the House of Representatives, will have upon small retail jewelry merchants. The 10 percent tax on retail jewelry sales and related items, compared with the rates imposed on radios, phonographs, automobiles, cameras, and other items that compete with jewelry for the consumer dollar, is out of proportion. It can readily be seen that the taxes on these other items are considerably less, thus making the purchase of jewelry less attractive. In addition, the industries enumerated consume materials needed for defense production, whereas the manufacture of jewelry uses mainly precious metals which are not needed for defense.

High living costs and the already increased income tax to be paid by the small taxpayer will reduce the consumer's power to buy jewelry in any shape or form or at any price. The consumer's dollar, therefore, will fall to lines other than jewelry—lines that will conflict probably with the material and manpower needed for defense production. Less consumer money spent in jewelry stores is sure to cause a wave of jewelry failures to sweep the country, a natural result of which will be to substantially reduce the Treasury's anticipated tax yield from the jewelry industry.

In addition, this will make the unemployment situation more acute, both as to business owners, their families and employees. This unemployment also will reach back and be reflected in factories and other sources supplying jewelers.

We do not seek an advantage over any other industry. On the contrary, we reiterate with considerable force the jewelry industry's desire to do its share. What we do feel, though, is that if the proposed tax on jewelry sold at retail were reduced from 10 to 5 percent, that part of the industry now faced with disaster would be able to survive and contribute its full share to the national defense, both financially, and spiritually.

Respectfully submitted.

PHINEAS PETERS.

Now, gentlemen, I would like to present my statement to you, as the executive secretary, Associated Credit Jewelers of New York and New Jersey, Inc., on behalf of the members of the association, who sell about one-tenth of all jewelry and allied merchandise sold by all retail jewelry stores of the United States and about one-fourth of all jewelry and allied merchandise sold by jewelry stores on installments.

1. A 10-percent tax on retail jewelry sales will decrease sales volume and cause business dislocations and unemployment. It likely will produce less revenue than would a lower rate.

2. Taxing retail jewelry sales 10 percent is out of all proportions to levies laid on other lines, some of which are material needed for defense and compete actively with jewelry for the same consumer dollar.

3. We urge a 5-percent tax on jewelry sales for consumption and use. We believe the jewelry business can manage such a levy without too much hardship and that it will do away with the injustice and unfairness inherent in the proposed 10-percent levy. A 5-percent levy can be collected without the complications that are bound to result from a tax on sales by manufacturers and importers which would cause tax avoidance and bring undesirable changes in the distribution of jewelry products.

4. Section 2405 of the pending revenue bill of 1941 provides for a 10-percent retroactive tax on additional jewelry sales. Such a levy, in practice, amount to a tax on jewelers' working capital. Jewelers have made no provision whatever for payment of a tax on conditional sales made from July 1, 1941, to date and are at a loss to find a practicable way to make provision for such a levy before the tax law actually goes into effect.

5. A retroactive tax on conditional jewelry sales would take several million dollars out of retail jewelers' businesses—from the smallest to the largest. Most assuredly your committee knows that nowadays virtually all retail jewelers sell on installments, and, therefore, the whole jewelry structure would be harmed by a retroactive levy on installment sales or, as has been said already, a tax on jewelers' working capital.

6. Taking several million dollars from the working capital of the retailers of an industry that has been none too prosperous for a number of years could and undoubtedly would result in nonpayment of debts owed jewelry manufacturers and wholesalers and thus result in far-reaching business dislocations and more unemployment, which, in turn, would result in decreases in revenues for defense purposes.

7. The revenue that could be derived from a retroactive tax on conditional jewelry sales unquestionably would be offset, probably several times over, by the losses that would result from depriving the jewelry industry of a substantial part of its necessary working capital.

Now, in addition to that, I have filed with the clerk a very brief statement on behalf of the Retail Jewelers of Westechester County, which I will not take the time to read because it is repetitious; however, I should like to have it in the record.

The CHAIRMAN. The reporter will put it in the record.

(The statement referred to is as follows:)

EXCISE TAX ON RETAIL JEWELRY SALES

This statement is presented by Victor Ross, retail jeweler, of 324 North Avenue, New Rochelle, N. Y., on behalf of the members of the Westchester Jewelers' Association. The membership is comprised of about 90 retail jewelers, all of them, comparatively speaking, small business men. I am presenting this statement as the vice president and acting president of the association.

The jewelers for whom I speak do a limited volume of business annually. Most of their jewelry sales are to the residents of their respective communities who are salaried persons working in New York City.

If retail jewelers of Westchester County must assume responsibility for a 10-percent tax on their retail sales, they will have their businesses hurt in two ways. First, the tax will discourage jewelry buying, because as a rule neither the jewelers nor their customers can afford to pay the extra money called for by such a high tax.

Second, a 10-percent tax will cause the residents of Westchester County to look for jewelry bargains elsewhere and even though they will have to pay the tax, no matter where they buy, many will not buy from Westchester County jewelers as a result of their shopping around.

We also fear that the money that Westchester County residents have been spending with retail jewelers will go into other lines of goods on which the tax is not so high. The 10-percent levy places jewelers at an unfair disadvantage in competing for the patronage of our own people. It will penalize jewelry buyers unduly.

Jewelers of Westchester County favor a reasonable tax on retail jewelry sales. They are opposed to a tax on sales by manufacturers and importers because collection of such a tax is impracticable and a levy of that kind will prove against the best interests of the Government and the jewelry industry.

We favor a tax at the point of retail sale with no exemptions of any kind.

Respectfully submitted.

VICTOR ROSS,
Vice President and Acting President.

The CHAIRMAN. Is it your view that the tax is all right, imposed on the retailer rather than the manufacturer?

Mr. WAGNER. We favor a 5-percent levy. We would like a lower than a 10-percent levy, but are entirely satisfied with a 5-percent levy on retail sales, and feel a tax levied in any other way is not practicable.

The CHAIRMAN. Those are your views?

Mr. WAGNER. Those are my views, and also the views of the Westchester Association, which I represent.

The CHAIRMAN. Thank you, Mr. Wagner.

Mr. Roessler.

STATEMENT OF RALPH ROESSLER, MARION, IND., PRESIDENT OF THE NATIONAL ASSOCIATION OF CREDIT JEWELERS

The CHAIRMAN. Will you give your full name to the reporter?

Mr. ROESSLER. My name is Ralph Roessler, of Marion, Ind.

The CHAIRMAN. And you are appearing here on the jewelry tax?

Mr. ROESSLER. I am appearing on the jewelry tax.

The CHAIRMAN. Yes. You may proceed.

Mr. ROESSLER. Mr. Chairman, and gentlemen of the committee: My name is Ralph Roessler, of Marion, Ind. I am engaged in the retail jewelry business, and have been so engaged during my entire business career. I am president of the National Association of Credit Jewelers, 31 North State Street, Chicago, Ill. This association has a paying membership of over 700 retail jewelers engaged in the installment and credit sale of jewelry in the United States. It is estimated that this membership sells approximately 55 percent of all jewelry sold in this country on a credit basis.

I believe from the evidence which I shall offer to the committee that it is fair to state that the views which I am about to express are those of the overwhelming majority of retail jewelers of this country.

We are not here to oppose a tax on jewelry. It is our desire to offer our cooperation to the Government in these days. We regard it a duty to our industry to bear its fair share of taxes to aid in the national defense.

Senator DAVIS. When you say they are not here to oppose the tax, you mean the excise tax?

Mr. ROESSLER. I am speaking of the excise tax; yes. With that thought in mind, I wish to present our views as to the most practical and economical method of imposing and collecting an excise tax if you, in your wisdom, find it necessary to impose that tax. We regret that it has become necessary for us to part company with the manufacturers and those whom they represented before this committee. We are, however, doing so with the firm conviction that our plan is to the best interest of the Government, the consumer, the retailer, and the industry generally. There can be no question but that sacrifices must be made, and we are willing to make them. However, in the imposition of an excise tax on a special commodity it is of primary importance that it be considered in connection with the many other taxes which the industry must bear as well as those which the consumer must also bear.

In the Revenue Act of 1932, section 605, the Congress imposed a 10-percent tax on the manufacturer, producer, and importer of jewelry. The administration of that section became complicated and difficult by reason of the fact that the Treasury Department promulgated regulations under which it was determined that any jeweler, retailer, or otherwise, who assembled two or more completely finished component parts of jewelry was a manufacturer or producer and was consequently subjected to the payment of the tax. That ruling resulted in great confusion in the industry and imposed heavy administrative cost in the collection of the tax as well as heavy burdens upon retailers in attempting to comply with that ruling. The difficulties which arose are only too well known to the Treasury Department as

well as to the industry. Finally, in 1936, the Congress repealed section 605 of the 1932 act.

And I may inject there that the reason for making that statement is the many difficulties which developed when the Government was forced to go into retail stores to make their collections.

It would not be possible for us to even approximate the overhead cost to the Government of properly administering and enforcing an excise tax on the retail sales of jewelry. We do believe that it would be exorbitant and entirely out of line with the amount to be collected. In that connection, may we suggest to you the many outlets for the sale of jewelry at retail that may be classified somewhat as follows:

1. Jewelry stores.
2. Department stores.
3. Specialty and novelty stores.
4. Millinery stores.
5. Dress shops and manufacturers of dresses.
6. Drug stores.
7. 5- and 10-cent stores.
8. Itinerant jewelers.
9. Company stores.
10. Army and Navy post exchanges.
11. Country stores.
12. Purchasing agents in industrial plants.
13. Clothing and haberdashery stores.
14. Catalog and mail-order houses.
15. Antique stores.
16. Shoe stores.
17. Watch-repair shops.

And, I might add, many others.

According to a release from the Department of Commerce, dated February 14, 1941, there were 14,559 jewelry stores; 4,074 department stores; 57,903 drug stores; 16,946 variety stores, or a total of 93,482 stores in this group in the United States, all of which most likely sell some class of jewelry. It is of course known to this committee that the other retail outlets which I have mentioned number many, many thousands, most all of which sell jewelry of some description at retail.

Since I appeared before the Ways and Means Committee we have had further investigation, and find that there are over 300,000 outlets for jewelry at retail.

If this tax is imposed on the retail sales price it will be necessary for that entire number to make monthly returns and pay the tax. Assuming that our figure of 300,000 outlets for retail jewelry is correct, that means there will be 3,600,000 returns annually. It will also be necessary for all of them to be checked and investigated, and after the returns are in their accuracy must be determined by the Government. Assuming that the cost of examining and auditing such returns is approximately $1.50, we arrive at a figure of approximately $5,400,000 annually as an overhead expenditure in that regard. Obviously it would take an army of employees to properly and effectively administer and enforce such a tax provision.

As against this picture, we have, according to a release from the Department of Commerce dated December 28, 1940, 968 jewelry manufacturers of precious metals, and 289 manufacturers of costume and novelty jewelry, or a total of 1,257 jewelry manufacturers.

This number represents approximately the sources from which the Government would collect the tax if it is placed upon the manufacturer, producer, or importer. It admits of no doubt that it is easier and by comparison far more economical to collect the tax from manufacturers, most of whom are located in a given area, than to collect it from the same number of retailers scattered in most every city, town, and hamlet in the country.

These figures show that there are 1,257 manufacturers of jewelry, well known and definitely located, as against at least 300,000 retail outlets for jewelry scattered throughout the country. It is therefore needless to add that under such a state of facts, it is far more feasible to impose and collect the tax from the manufacturers.

It is our considered opinion that a tax on the retailers of jewelry will substantially reduce their volume of business. In many instances the burden would be so heavy upon small jewelers as to very likely put them out of business. A fact to support this argument arises by virtue of a situation where a large retail jeweler is in competition with a smaller retail jeweler. The large retail jeweler may absorb a portion or all of this tax, whereas if a small retail jeweler should attempt to thus absorb the tax it would be ruinous to him. Therefore, a tax which is optional of passing on the consumer rather than mandatorially collectible from the consumer becomes a serious competitive weapon. This unfair and inequitable situation cannot arise if you impose the tax upon the manufacturer, producer, or importer. Every retailer who purchases from such manufacturer, producer, or importer is then on an equal competitive basis.

Volume of business.—The figures which we are giving you do not accurately reflect the sale of jewelry at retail by jewelry stores or other retail outlets of jewelry for the reason that such retailers sell much merchandise other than jewelry. In a release by the Department of Commerce, dated February 14, 1941, it is reported that the volume of business done by retail jewelry stores amounted to $361,595,000 for the year 1939. From this volume must be deducted other items sold by retail jewelers, such as radios, china dinnerware, gift novelties, and so forth, the volume of which we do not have.

In the same release from the Department of Commerce, it is reported that for the year 1939 variety stores did a volume of business of $976,801,000; drug stores, $1,562,502,000; and department stores, $3,974,998,000. There is no break-down, and of course it is impossible to determine from these figures the amount of jewelry sold by these stores. Nevertheless, if the tax is imposed upon retailers, it is necessary that some method be devised by which all these outlets for jewelry must make returns, pay the tax, and be properly supervised by the Government. That makes obvious to you the great problem which would confront the Government in properly administering and enforcing such a tax.

Amount of tax.—It has been suggested that a 10-percent tax on the retail sales price of jewelry will result in twice as much revenue to the Government as a 10-percent tax on the manufacturers sales price of jewelry. We submit that such a statement cannot be supported by facts. This statement does not take into consideration

the huge overhead cost of collection by the Government from approximately 300,000 retail sources scattered throughout the United States as compared with approximately 1,300 manufacturers, producers, and importers located in a fairly well-defined area. As heretofore stated, the cost to the Government of collecting from 300,000 sources would be approximately $1.50 per return, or approximately $5,400,000. As against this huge cost we find that there would be approximately 15,600 returns from manufacturers at an overhead cost of approximately $23,400 annually. Again, it is not possible for me to estimate the percentage of retail outets for jewelry which would never be reached by the Government. You may rest assured that it would have quite some bearing upon the revenue. However, there would be no reason whatever for the Government not collecting from 100 percent of the manufacturers, producers, and importers.

By adding to these facts the recognized view of the retail jewelers that their volume of business would be substantially reduced, we cannot but arrive at the conclusion that the 10-percent tax on the manufacturers would, in the long run, result in a net return to the Government approximating that which would result by a 10-percent tax on the retail sale of jewelry. We also direct your attention to the fact that many outlets for sale of jewelry at retail have no accurate bookkeeping system, and although we make no charge or allegations, experience has proven to the Government as well as to us that a very considerable amount of taxes would not and could not be collected from retailers because of the lack of proper records as well as deliberate evasions by the unscrupulous. These facts alone should be convincing to you that by placing this tax upon the manufacturer the Government will receive its revenue expeditiously, economically, and in full. It would not disrupt the industry and we believe that it is a burden which should be borne by us during this period of emergency. We, of course, pay the tax even though it is imposed on the manufacturer. We believe that the manufacturers, as well as every other part of our industry, should assume its fair and proportionate obligation to our Government. If this tax is imposed on the manufacturers they are, in reality, only acting as a collecting agency for the Government. They should at least be willing to do that much, and frankly I do not have much patience with those who are not willing to bear this slight burden at this time.

It has been represented to the Ways and Means Committee, as well as to this committee, that the jewelers' tax committee, which has just appeared before you, represents the sentiment of the retail jewelers in presenting their argument to you. The fact is that I have in my possession, and would like to present to your committee, a great volume of letters, telegrams, and resolutions from retail jewelers, both cash and credit, throughout the United States who have taken a directly opposite position from that presented to you by the jewelers' tax committee. You have undoubtedly received such communications yourselves, and are well able to judge whether the statement I am making is correct.

We share the belief that, if you decide to impose this tax on the retailer, you should reduce it to 5 percent. A 10-percent tax would be a tremendous burden for retailers to bear. Many may be forced

to go out of business, others would barely make both ends meet, and no one would be able to make a reasonable profit on investment. The tax on jewelry during the last World War was 5 percent and we submit that such a percentage would now be fair and equitable. However, the many administrative difficulties, among our other reasons, persuade us to the firm and unshakable view that this tax should be imposed upon the manufacturer, producer, or importer.

Conclusion.—I am submitting herewith a suggested amendment to the proposed tax bill which, in my opinion, removes the difficulties of administering which prevailed under section 605 of the 1932 Revenue Act. And just there, gentlemen, in explanation of the difficulties that arose, was the fact that by the ruling of the Treasury the retail jeweler, if he moved a watch movement from one case to another, he came under that ruling a manufacturer or producer of the watch movement or watch case; also that if he set a diamond which he had in his possession for years, he became a manufacturer of the mounting, and importer and producer of the diamond. Now, we believe that that situation can be clarified in the following amendment which I will propose. You will observe that it is our suggestion that a retailer of jewelry who assembles two or more completely finished component parts of jewelry upon which a tax has been paid shall not be considered a manufacturere or producer. I believe that if you adopt such an amendment it will go a long way toward making the administration of this provision of the act comparatively easy and simple. Naturally some difficulties will arise but they will be insignificant as compared with those which will arise if the tax is imposed upon the retailer.

Our suggested amendment is as follows:

There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold: All articles commonly or commercial known as jewelry, whether real or imitation; pearls, precious and semiprecious stones, and imitations thereof; articles made of or ornamented, mounted or fitted with, precious metals or imitations thereof, ivory (not including surgical instruments or eyeglasses); watches, clocks, parts for watches or clocks sold for more than 9 cents each; opera glasses; lorgnettes; marine glasses; field glasses; and binoculars. No tax shall be imposed under this section on any article used for religious purposes. A sale of any two or more of the above articles shall be considered a sale of each separately. For the purpose of this section, a retail jeweler who assembles two or more completely finished component parts of jewelry upon which the tax has been paid shall not be considered a manufacturer or producer.

In addition to this statement, gentlemen, I want to clarify one statement made by Mr. Niemeyer this morning in stating that the manufacturers' tax from 1932 to 1936 produced in the neighborhood of $4,000,000. Mr. Niemeyer forgot to state that at that time there was an exemption of $25, meaning that so far as the general retail store was concerned, practically all their merchandise was exempted from the operation of the tax. We are asking for no exemptions. We think the broader the base the better it would be.

Another thing I would like to say is that I have received some communications which I would be glad to have this committee, if they desire so to do, examine at leisure. I might indicate, from one or two of them, generally what they are.

Here is one from Paul E. Morrison, president, Retail Jewelers Association of Michigan:

Greetings to your meeting from Michigan; 850 retail jewelers who recently sat in special 1-day convention and passed resolution going on record as favoring newly proposed jewelry tax to be placed at source of manufacture. It is well recognized here that demoralization of our industry would result from any tax being placed at point of retail sale resulting in unfair competition as well as the immense cost of collection to the Government to police all retail stores.

That, gentlemen, is a State association affiliated with the American National Retail Jewelers Association.

I have another telegram, and I will only impose two or three of these on you because of the shortness of time. This is from Savannah, Ga.:

At meeting in Atlanta, Ga., jewelers expressed themselves unanimously for tax at source. Will so wire A. N. R. J. A. and copy of telegram is to be sent you. Think South Carolina will do likewise, according to Mr. Cochran.

B. I. FRIEDMAN.

And here is another:

You have unqualified support of rank and file California jewelers, for whom I am authorized to speak. Wire from Senator Downey states he will appear before committee asking change; contact him if you think advisable; supporting letters from all over State. Regards.

That is from Arthur H. Dibbern, managing director, California Retailers Jewelers Association.

Here is a resolution from the Virginia Retail Jewelers Association:

Resolved, That we, the president and the executive committee of the Virginia Retail Jewelers Association, representing the retail jewelers of Virginia, do hereby recommend that this tax be levied on the manufacturer or on the jeweler's source of supply; and be it

Resolved further, That this association is definitely opposed to a tax on retail sales, feeling that such a tax will jeopardize the volume of sales materially, thereby reducing the tax which would otherwise accrue to the Government from our industry.

Now, I could continue, but I don't wish to take any more time. I would like, however, if you care to have me do so, to file with the clerk these additional communications.

The CHAIRMAN. File them with the clerk. We will be very glad to give them consideration.

Any questions, gentlemen?

(No response.)

The CHAIRMAN. And thank you for your appearance.

And the next witness is Mr. Shipe.

STATEMENT OF A. K. SHIPE, WASHINGTON, D. C., REPRESENTING NATIONAL ASSOCIATION OF CREDIT JEWELERS

Mr. SHIPE. Mr. Chairman, I believe this matter has been covered sufficiently; and, in view of the fact that you have pronounced the policy that you do not desire to hear too many witnesses on the same subject, and in order to conserve the time of the committee, I shall decline to make any further statement.

Senator VANDENBERG. Which side of this controversy are you on?

Mr. SHIPE. I am in favor of the tax on the manufacturer. I am counsel for the National Association of Credit Jewelers.

(The following letter was ordered printed in the record:)

NATIONAL ASSOCIATION OF CREDIT JEWELERS,
CHICAGO, ILL., *August 21, 1941.*

HON. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: During the hearing accorded representatives of the jewelry industry, several statements were made by representatives of the jewelers tax committee, Mr. G. H. Niemeyer, chairman, that need clarification, and in some instances, correction. In your deliberations on the jewelry excise tax we very respectfully ask that you present this letter to your committee and, if desirable, have it made a part of your committee record.

In July 1940, in anticipation of an excise tax on the jewelry industry, a group of men met and formed what is known as the jewelers tax committee. As chairman of this committee Mr. Niemeyer appeared before the Senate Finance Committee. This committee is responsible for all the effort that has been put forth in opposition to collecting this tax from manufacturer, producer, or importer. In order that you may know exactly for whom Mr. Niemeyer was testifying we submit for your consideration the membership of his committee and who they actually represent.

A. Blustein, wholesaler, representing National Wholesale Jewelers Association, Washington, D. C.

James B. Dickey, representing Tiffany & Co., Fifth Avenue, New York, claims to be the largest manufacturer of jewelry operating a retail store.

George P. Engelhard, representing Chicago Jewelers Association, wholesale jewelers. Publisher of trade journal, N. J., distributed free to retailers, sole revenue derived from advertising obtained from manufacturers and wholesalers.

P. M. Fahrendorf, jewelers vigilance committee. The membership of the vigilance committee is made up largely from the manufacturing and wholesale groups. Also publisher of Jewelers Circular-Keystone. Dependent upon manufacturers and wholesalers for advertising support.

Royal J. Gregg, representing New England Manufacturing Jewelers and Silversmiths Association. Also, Osty & Barton Co., jewelry manufacturers, Providence, R. I.

Walter N. Kahn, representing American Jewelers Protective Association, also L. & M. Kahn Co., wholesalers in New York.

C. M. Kendig, representing American Jeweled Watch Manufacturing Association. Also, Hamilton Watch Co., makers of watches, Lancaster, Pa

Clifford F. Lamont, representing Gem and Pearl Dealers Association, importers and wholesalers of pearls. John Lamont & Son, New York.

Oscar M. Lazrus, representing American Watch Assemblers Association. Importers of watch movements. Also Benrus Watch Co.

William F. McChesney, representing Sterling Silver Guild of America, silverware manufacturers. Also Gorham Manufacturing Co., makers of sterling and plated silverware.

J. Mehrlust, representing Platinumsmiths Association, manufacturers of platinum jewelry. Also J. Mehrlust, New York, manufacturer.

G. H. Niemeyer, chairman, representing jewelers vigilance committee. Also Handy & Harmon, gold and silver refiners, whose product is sold largely to manufacturers, New York.

Wilson A. Streeter, representing American National Retail Jewelers Association. Also, Bailey, Banks & Biddle, large retail store in Philadelphia with manufacturing interests.

Kenneth I. Van Cott, representing jewelry publicity board. Also, exclusive Fifth Avenue Diamond Shop.

Henry W. von Unruh, representing American National Retail Jewelers Association. Retail jeweler in Cincinnati, Ohio.

Rawson L. Wood, representing Jewelry Crafts Association, manufacturers' association. Also, J. R. Wood & Sons, jewelry manufacturers and diamond importers, New York.

In a careful analysis of this committee you will note there is but one individual who actually represents the average retail jeweler, Mr. von Unruh, of Cincinnati. It was the decision of this group of outstanding manufacturers' representatives that the tax should be collected from the retail jeweler. This decision was made without referendum and without consulting the retailers' wishes.

You heard Mr. Niemeyer present the industry's patriotic desire to do its share in contributing to the defense fund through taxation. I quote from his testimony, "We offer to patriotically bear our share of any tax burden." He failed to tell you that it is the program of the jewelers tax committee to see that that patriotic share is borne wholly by the retailers and that his committee is now rasing an enormous sum of money throughout the country to spend in an effort to influence Congress to keep the tax on the retailer for the sole purpose of totally exempting the manufacturer, producer, and importer from any participation whatsoever in the collection of this tax.

No matter where this tax is collected, the retailed must in some manner raise the money and at best the only burden placed upon the manufacturer would be that of acting as the collecting agency for the Government. We submit the manufacturer is as much a part of the industry as the retailer, and he has an equal responsibility to the Government.

Mr. Niemeyer, in his testimony to the Finance Committee, pleaded for a reduction of the tax on the retailer from 10 to 5 percent, showing to the committee that a 10-percent tax at retail would be ruinous to the retailer, yet he has made the positive statement he would oppose a tax at source even though it meant a tax of 10 percent at retail, or, as he testified, the destruction of many retailers. Obviously, Mr. Neimeyer has but one objective, to exempt the manufacturer from having any part of this tax by placing it in its entirety upon the retailer. If this is not true, they why is the jeweyers tax committee raising such an enormous fund of money to promote their efforts? Each State has been given a quota of funds to raise, and judging from the $1,000 quota given Indiana, the total amount expected must be a very large sum. As an example I will quote from a letter received from the secretary of a State jewelers association:

"The A. N. R. J. A. tax committee at the insistence of Mr. Niemeyer has raided California in regard to the special fund you no doubt have heard about, to the extent of over $1,600. It was the worst shake-down racket I have ever heard of in the jewelry industry."

The National Association of Credit Jewelers has from the beginning represented the retail jeweler only. Many States have had special meetings on this subject at which resolutions have been drawn and sent on to your committee. This has all been voluntary work, each individual financing his own efforts, and many letters and wires you have received testify to their earnestness. We are not concerned about the large retail establishments, they can take care of themselves, but we are deeply concerned over the preservation of the smaller store which cannot successfully compete with the large institution if the payment of a tax in the retail store becomes a weapon of unfair competition.

Mr. Niemeyer made the statement that in 1932 to 1936 the largest amount raised by a manufacturers' tax was $4,000,000. He failed to state that at first every article costing $3 or less was exempted from taxation, and later everything under wholesale cost of $25 was exempted. This eliminated thousands of outlets from paying any tax, and thousands of smaller stores from paying on any but a small portion of their sales. Many manufacturers produced items around $25 cost to retailer and billed them at $24.99 to avoid payment of tax to the Government. Again, the sales volume in 1932 to 1936 was materially lower than it is now. His testimony can be completely nullified in this respect by taking Government figures as to the amount of sales by manufacturers, producers, and importers in the past 2 years and resolving that into tax production.

Mr. Niemeyer claims there will be avoidance of the tax by refugees who bring in diamonds. If it is true at the source, it will be equally true at the outlet. If such a situation prevails it could more easily be controlled by the Government at the source than at the outlet.

There has been great confusion among the retail jewelers caused largely by propaganda sent out by the jewelers' tax committee. A few days before the jewelers' excise tax was considered by the House committee, the jewelers' tax committee sent out a broadside that if a manufacturers' tax was levied, there would be a 10-percent floor tax levied upon all merchandise in stock to be paid within 30 days. The intent of this propaganda was to frighten the retailer (for a floor tax as suggested would ruin the industry) in asking for a retail tax in preference to a floor tax.

This same confusion has been evident to your committee. After its success in having this tax imposed on the retailer in the House of Representatives, the jewelers' tax committee assumed the role of championing the cause of the retailer by asking your committee to reduce the tax from 10 to 5 percent. They then

broadcast a request for retailers to telegraph or write to you gentlemen in support of their sham effort as a supporter of the retailer. Naturally retail jewelers will wire you to that effect and many have done so. Their reason for so doing is because that very committee has been assuring them that the tax will be imposed upon them and that they very obviously would prefer the 5-percent tax rather than the 10-percent tax. But that is no indication whatever that these same jewelers do not prefer a tax collected at source.

We believe there are three patriotic duties involved in this matter:

1. The retailer's duty to raise the tax for the Government, whether jeweler, druggist, clothier, department store, dime store, or peddler.

2. The manufacturer's duty to see that the money comes from all retailers selling taxable items by issuing merchandise only to those who pay the tax.

3. The duty of Congress to see that the revenue is raised as economically and expeditiously as possible, and that the tax does not become destructive of the business which produces the revenue, thus defeating its own purpose.

We believe that the following figures will give you a substantially accurate picture of the net revenue to be derived from a 10-percent excise tax on jewelry, whether on the retailer, or the manufacturer, producer, or importer:

	Retailer	Manufacturer, producer, or importer
Volume of business	$500,000,000	$280,000,000
10 percent tax	$50,000,000	$28,000,000
Number of outlets	300,000	1,257
Number of returns annually	3,000,000	15,084
Cost of collection at $1.50 per return	$5,400,000	$22,626
Estimated loss by inability to collect, or by evasion, 15 percent	7,500,000	None
Reduction in volume of business by virtue of tax, 15 percent	7,500,000	None
Total, last 3 items	20,400,000	22,626
Net revenue	29,600,000	27,977,374

We believe that the above figures are reasonably accurate. The committee will also bear in mind that if the tax is placed upon the manufacturer the revenue is realized immediately, whereas if it is placed upon the retailer no revenue is realized until after final sale to the consumer, and in case of installment sales, on each installment when paid, the latter consisting of a very substantial volume of the retail jewelry business. Also many items of jewelry are held by retailers for a substantial length of time before sale, and in many instances no sale can be made and the items are returned to the manufacturer. In all such latter cases no revenue would be derived if this tax is imposed upon the retailer. We submit that these figures and facts indicate quite clearly that the net revenue to the Government would be substantially the same whether the tax is imposed on the manufacturer, producer, and importer, or on the retailer. If this tax is placed on the manufacturer, producer, and importer the industry will suffer less, the public will benefit, and the Government will get the revenue promptly.

We, therefore, earnestly urge that you adopt the amendment presented to your committee by us on August 14, 1941.

Respectfully yours,

RALPH ROESSLER,
President, National Association of Credit Jewelers.
A. K. SHIPE,
Attorney for National Association of Credit Jewelers.

The CHAIRMAN. Mr. Wilson A. Streeter.

STATEMENT OF WILSON A. STREETER, PHILADELPHIA, PA., CHAIRMAN, TAX COMMITTEE, AMERICAN NATIONAL RETAIL JEWELERS ASSOCIATION

Mr. STREETER. I am appearing on behalf of the jewelers in this tax.

The CHAIRMAN. Retailers or manufacturers?

Mr. STREETER. Retailers. Mr. Chairman, my name is Wilson A. Streeter, and I am president of the Bailey, Banks & Biddle Co., Philadelphia, Pa., one of America's oldest retail jewelry stores, and I am here, representing, as chairman, the tax committee of the American National Retail Jewelers Association, an organizatinon of more than 3,200 paid members, with associations in 38 States, 90 percent of whom are in favor of the contents of this brief; vice chairman of the jewelry tax committee under the Revenue Acts 1917, 1918, and 1932, and secretary of jewelers' tax committee, 1941.

According to the last census there are some fourteen-thousand-four-hundred-odd retail jewelers of all kinds, including repairers, and so forth; both the census and the National Jewelers Board of Trade state that some 8,000 of these are repairers and minor dealers who have a general sales volume of $10,000 or less, leaving about 6,400 retail jewelers—important ones.

At the hearings before the Ways and Means Committee we collaborated with Mr. G. H. Neimeyer in presenting what we believed met the wishes of our members, thus conserving the time of those hearings.

We regret exceedingly that due to a most unfortunate situation we now find that in order to properly represent our members we must present a separate statement.

The statement presented today by Mr. Neimeyer contains the considered conclusions reached by the jewelers' tax committee after careful study and conferences, and we approve same.

The law, section 2400, as printed by the Ways and Means Committee imposes a tax of 10 percent at the point of retail sale as recommended by the United States Treasury Department, and Mr. Doughton, on page 33 of his report, clearly outlines the reasons this tax was imposed in that manner, and not as nearly all other taxes, at the point where the goods were sold by the manufacturer, importer, and producer.

I am not going to repeat that statement, because it has been read to you once today.

Senator GUFFEY. But that which you are omitting, you want to have in the record?

Mr. STREETER. Yes.

The CHAIRMAN. It will be included in the record.

(The statement submitted by Mr. Streeter is as follows:)

This bill imposes a tax of 10 percent upon the retail sale of jewelry, furs, and toilet preparations. The tax is placed on the retail sale rather than the manufacturers' or importers' sale, because of administrative and equitable considerations. Manufacturers' excise taxes upon these articles have been imposed by the Federal Government in the past. Experience has proven, however, that under such taxes evasion is substantial, and inequitable situations are created. In view of these considerations your committee is convinced of the desirability of placing these taxes on the retail sale.

Mr. STREETER. Under the tax law of 1917, a tax of 3 percent was imposed on the manufacturer, importer, and producer and as a revenue producer was a failure. This law contained a floor tax which was removed in the Senate.

Mr. STREETER. The War Revenue Tax Act of 1918, passed in February 1919, imposed a tax of 5 percent on the retail price, using much the same language as section 2400, Revenue Act, 1941.

This tax produced some $25,000,000 in the earlier years, until exemptions were passed by law.

In May 1932 a new excise-tax law imposed a tax of 10 percent on the manufacturer, importer, and producer, estimated to produce at least $15,000,000 revenue. When we appeared before your committee we stated that law would not produce $5,000,000.

The law contained an exemption of $3 and produced about $4,000,000 the first year and an increased exemption of $25 reduced the yield $2,000,000 and $3,000,000, and the law was repealed June 6, 1936.

The records of the Internal Revenue Department will indicate that this tax did not produce sufficient revenue to make it of value. Aside from this it created havoc among the various branches of the jewelry industry, creating conditions that could not be controlled because of elements which entered into all branches, such as curbstone brokers, second-hand goods, and so forth. These are conditions referred to by Mr. Doughton.

Because of the fact much confusion will be caused we suggest elimination of the following from the text of section 2400, lines 12 and 13, "Gold, gold-plated, silver, silver-plated or sterling silver flat ware and hollow ware." This is a duplication and limitation of the scope of the act as to "precious metals and imitations thereof," lines 10 and 11.

We believe that when it is necessary to secure a revenue for specific purposes the most effective and remunerative plan is a Federal sales tax.

We believe that Congress should meet the issue of the present situation by broadening the base of the income taxes rather than assess all income taxes on 5 percent of the American people. We further believe the stiff graduation in surtax rates between $2,000 and $10,000 will prove a very real hardship on this group, forcing serious financial loss and handicap, hence producing diminishing returns.

Secretary Morgenthau suggested a saving of $1,000,000,000 in ordinary Federal expenses; he also stated recently the necessity of securing $2,000,000,000 additional revenue. We commend for your attention the statement of Dr. George S. Benson, the president of a college in Arkansas, who outlined to the Ways and Means Committee in detail how a saving in excess of this amount could be accomplished. (See p. 1198, vol. 2, of House hearings.)

The man on the street today is saying, "I don't mind being taxed for defense, but why does not your Federal Government do what every sane businessman does—reduce other running expenses?"

Senator VANDENBERG. The Federal Government is only partially sane. If you sat around here very long you would not be very long either.

Mr. STREETER. While we as jewelers do not believe in the imposition of excise taxes on any specific industry, we do believe that if such taxes are imposed all industries should be taxed on the same basis.

The 1941 tax law imposes taxes at the rate of 10 percent on numerous lines on the manufacturer, importer, and producer, and then it imposes a tax of 10 percent at retail on three selected industries; as jewelers we believe this to be an unjust discrimination against these industries. It is almost double the other levies. It was first

estimated this tax would produce $29,000,000—revised, I believe, three times until it is now $56,000,000.

Gentlemen, I wish to impress you with the fact that this 10-percent rate on retail sale will defeat the law as an income producer.

Unfortunately, there are elements in our country outside the legitimate jewelry store who, like in 1932, will defeat this law, and these people have never been reached by our Federal agents. There are millions in gems in the hands of refugees, and others who will be the sellers of important jewelry to the consumer, collect no sales tax and pay no revenue to the Government. Ten percent is such a high rate it will be an incentive to take risks, risks which will deprive the retailer of an opportunity to make sizable sales; then, too, there are many millions of dollars worth of second-hand gems hanging over the market which will reach the consumer without passing through the jewelry store.

And I might add that without ever passing through a manufacturer, importer, or producer, hence, they would never be taxed.

Senator VANDENBERG. That is going to happen anyway, regardless of what kind of rate you make.

Mr. STREETER. To some extent, but not the extent under the incentive of a 10-percent rate.

We respectfully urge you to revise this law and reduce the rate to 5 percent on final sale. You gentlemen need only to look back to 1929 when after years of pleading by the jewelers you finally reduced the tariff on cut diamonds from 20 percent to 10 percent and placed the rough on the free list. From 1913 to 1929 more diamonds were being smuggled into America than arrived through the Customs, this reduction making it unprofitable to smuggle, and changed that picture overnight.

Senator DAVIS. Have you an estimate of the amount of jewelry brought in here by refugees?

Mr. STREETER. There is no way of getting it. Nobody knows who they are. We hear of them; they come in and offer their goods. We don't deal with them, because we don't do that type of business, but they do find a great many buyers among the public generally.

Please don't impose this heavy rate of 10 percent and require the legitimate jewelers of America to face competition with these forces which will destroy them. A tax of 5 percent on the resale price will produce more revenue and at the same time permit the jeweler to earn a profit which will produce income taxes for our defense expenditures.

A tax of 10 percent will act as a deterrent to the purchase of jewelry-store wares, and we believe this also will defeat your own purpose by reducing the revenue, as well as income taxes of jewelers. Why deny those who today have some money to spend for articles they have always dreamed of owning for themselves or families as long as they do not interfere with the defense production; let them buy freely without a punitive sales tax.

Five percent is the extreme rate that can be imposed without unjustly penalizing the purchaser or creating an incentive to unfair business competitive conditions.

Before I complete the last paragraph, I want to make one comment on Mr. Roessler's testimony a minute ago. The secretary of our asso-

ciation advises me we have 600 credit jewelers in our membership. A great many of them are also members of the Retail Credit Jewelers Association. The statement has been made as to the possible amount of sales. Our association has no record, except that during the N. R. A. period it represented 85 percent of the retail jewelry sales of the country. Regardless of the suggested law which has been suggested and which would make every unfinished part of jewelry taxable when it passes through the retailer, I believe the retailer would still be liable as a producer of taxable articles.

In conclusion, in view of the fact that a large number of the members of our association sell on credit terms involving leases and conditional sales, we direct attention to a most unfair provision in section 2405, lines 23 to 26, and respectfully request the last three words on line — be deleted "July 1, 1941," and the following substituted: "the effective date of this act." Obviously it is not possible to assess taxes on merchandise sales before a law is passed and made operative. This provision is apparently an error, as it follows the language of another provision referring to articles similarly taxed under the 1940 law, whereas there is no tax on jewelry and furs at present.

Senator DAVIS. May I ask a question? Mr. Roessler, in his remarks, stated that he figures there are 300,000 outlets for retail jewelry. If that is correct, it would involve 3,600,000 returns annually at a cost of approximately $1.50 for each return. To be checked and investigated, it would cost $5,400,000, an expenditure nearly as great as the tax itself.

Mr. STREETER. All I can say to that is this: This provision for placing the tax on retail sales comes from the Treasury Department, and it was the Treasury Department which struggled for 4 solid years to make a manufacturers' tax operative on jewelry, and they failed to do so. What other reasons they had besides those indicated by Mr. Doughton I do not know.

Senator DAVIS. We cannot find places here to build buildings. If these are the facts, you would have to build a couple of new buildings to put these clerks in to check this tax alone.

Mr. STREETER. No question about that; but we didn't suggest the tax.

Senator GUFFEY. How old is your firm?

Mr. STREETER. 109 years next month.

The CHAIRMAN. Well, the first 109 years are the hardest.

Mr. STREETER. Well, they may not be if this tax is levied.

(Mr. Streeter submitted the following for the record:)

THE BAILEY, BANKS & BIDDLE CO.,
Philadelphia, Pa., August 18, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: Please permit me to express my gratitude for your courtesy at the hearing on Thursday.

When I receive a copy of the rather confusing statement presented by Mr. Roessler I desire to direct attention to some, what seemed to me to be, rather glaring errors.

Mr. Roessler stated he represented the great majority of the retailers and supported the statement by telegrams, etc. I did not feel you gentlemen would care to examine a like amount of telegrams, numbers of them reversing their former ones sent in response to 10,000 letters mailed to people who do not belong

to his association whose published list contains 468 names (41 of which are dual memberships of two concerns).

Trusting you will consider this proposed statement when you study this question, I am

Very truly yours,

WILSON A. STREETER, *President.*

AMERICAN NATIONAL RETAIL JEWELERS ASSOCIATION,
New York, N. Y., August 22, 1941.

To the MEMBERS OF THE COMMITTEE ON FINANCE,
United States Senate, Senate Office Building,
Washington, D. C.

GENTLEMEN: Supplementing the statement made before your committee, on August 14, 1941, by Mr. Wilson A. Streeter, of Philadelphia, chairman of our tax committee, I am enclosing copy of telegram sent to presidents of State associations in affiliation with the American National Retail Jewelers Association on August 2, 1941, and copies of their replies.

Faithfully yours,

AMERICAN NATIONAL RETAIL JEWELERS ASSOCIATION,
CHARLES T. EVANS, *Secretary.*

Information for Mr. G. H. Niemeyer, chairman, jewelers' tax committee, and Mr. Wilson Streeter, chairman, American National Retail Jewelers Association tax committee.

The following telegram was sent to State presidents under date of August 12, 1941:

"If the retail jewelry business is to have any chance of escaping the ruinous results of a 10-percent or higher retail tax, it is imperative that a consolidated front be presented before the Senate Finance Committee on Thursday, August 14. Every effort will be made by the jewelers' tax committee to have the rate reduced to 5 percent. Please wire us collect immediately approval on behalf of your members of this position. There will be no further opportunity to make our wishes known so we cannot overemphasize the seriousness of the situation. Urge that you also contact as many of your own members as possible asking they wire their own Senators and members Senate Finance before August 14 as requested by the American National Retail Jewelers Association.

"CHARLES T. EVANS."

To the above telegram the following replies have been received:

"We urge every effort be made by our jewelers' tax committee to impress the Senate Finance Committee that a 10-percent tax is entirely too high. A 5-percent defense tax at this time would seem fair. With an Alabama 2-percent sales tax plus the proposed 10-percent Federal tax, competitive merchandise would have a great advantage. A ruinous condition for the Alabama jewelers. The Alabama Retail Jewelers are a patriotic organization and ask only fair treatment with competitive business in these trying days.

"ALABAMA RETAIL JEWELERS ASSOCIATION,
"F. W. ANDERSON, *Secretary.*"

"At a recent board meeting of the Arkansas Retail Jewelers Association it was the unanimous opinion that we approve the efforts of the tax committee to have the suggested ruinous rates of 10 percent on retail jewelry sales reduced to 5 percent. You or the tax committee chairman have our permission to represent our State association before the Senate Finance Committee.

"ARKANSAS RETAIL JEWELERS ASSOCIATION,
"H. T. PURVIS, *President.*"

"At our last convention the Arizona Retail Jewelers Association unanimously passed a resolution to the effect that we felt we should not oppose any reasonable tax upon our industry which might assist in the defense of our Nation but further resolved that any tax over 5 percent would not only be unreasonable but also discriminatory. We trust that our national association, through its tax committee can convert the Senate Finance Committee to our viewpoint at the August 4 hearing.

"ARIZONA RETAIL JEWELERS ASSOCIATION,
"ELMER E. PRESENT, *President.*"

"California jewelers favor tax at point of sale. Ten percent will be disastrous to jewelry business, must not be over 5 percent.

"CALIFORNIA RETAIL JEWELERS ASSOCIATION,
"P. H. BOYSON, *President.*"

"As president of the Maryland-Delaware and District of Columbia Jewelers Association, I and my fellow members strongly oppose a 10-percent tax on jewelry and deem a 5-percent tax wholly adequate and producer of more revenue. A 10-percent tax will certainly reduce sales to a point where it will bring in less revenue than a 5-percent tax.

"MARYLAND DELAWARE DISTRICT OF COLUMBIA RETAIL JEWELERS ASSOCIATION,
"SYDNEY W. SELINGER, *President.*"

"Majority Florida retail jewelers favorable to 5 percent or less retail tax. Have contacted all Finance Committee Senators by wire today.

"FLORIDA RETAIL JEWELERS ASSOCIATION,
"BRUCE WATTERS, *President.*"

"The jewelers of Iowa feel that a more than 5-percent tax would be ruinous to the good of the jewelry business, and I urge you to take this to the Senate Finance Committee. We want to do all we can but do not want to be put out of business with too high a tax.

"IOWA RETAIL JEWELERS ASSOCIATION,
"GRANT W. DUDGEON, *President.*"

"Accept our approval on your stand on 5-percent tax. Kansas retail jewelers back of you fully in this matter. The majority of Kansas jewelers today also wiring Senators as individual as well as our association.

"KANSAS RETAIL JEWELERS ASSOCIATION,
"W. B. BRASFIELD, *Secretary.*"

"Wired Senator Barkley yesterday calling his attention to the hardship a 10-percent excise tax on jewelry would place on both large and small retailers, We believe 5-percent tax would produce more revenue as it would discourage evasion and bootlegging. A 10-percent tax would encourage both. In one particular store a 10-percent tax would discourage sales. During the last war we suffered by the imposition of the 5-percent tax. Jewelry does not divert defense materials and should not be paralyzed.

"KENTUCKY RETAIL JEWELERS ASSOCIATION,
"NOLTE C. AMENT, *President.*"

"Have contacted prominent jewelers—all agree 10 percent would ruin our business. Five percent we would try and work out. Remind committee this city and other cities already have 2 percent sales tax. We would be selling taxes instead of merchandise. Have contacted all Senators, Finance Committee; also other jewelers here. You can depend on our cooperation.

"LOUISIANA RETAIL JEWELERS ASSOCIATION,
"LOUIS J. BERNARD, *President.*"

"Please make 5 percent contacts. All jewelers in this section.

"MAINE RETAIL JEWELERS ASSOCIATION,
"LINDSAY G. TRASK, *President.*"

"Officers and members of Massachusetts and Rhode Island Retail Jewelers Association definitely opposed to 10-percent tax as being ruinous to jewelry industry. Bankruptcies and forced closing result as both jewelry stores are operating at a loss or at a very small margin. We authorize you to represent this organization and urge you to do everything in your power to have this tax reduced to 5 percent.

"MASSACHUSETTS-RHODE ISLAND RETAIL JEWELERS ASSOCIATION,
"FRED WIDMER, *President.*"

"Imposition of 10-percent retail jewelry tax in addition to Government's program of discouragement of spending for nonessentials will be ruinous to jewelry industry. Minnesota Retail Jewelers Association heartily approves and fully supports your position for 5-percent retail tax. Will do anything in our power to assist.

"MINNESOTA RETAIL JEWELERS ASSOCIATION,
"MAURICE ADELSHEIM, *President.*"

"Missouri Retail Jewelers Association supporting your position on excise tax. A 10-percent tax would be ruinous to our industry. Imperative that you impress seriousness of this tax to the Senate Finance Committee.

"MISSOURI RETAIL JEWELERS ASSOCIATION,
"PHIL A. DALLMEYER, *President.*"

"Our executive committee expressed for all the jewelers of Nebraska their alarm at hearing of a suggested 10-percent tax on jewelry. This would be back breaking to our business and we see no reason why the necessary money to carry on our defense program should not be raised by spreading more evenly through income tax and other lines of business.

"NEBRASKA RETAIL JEWELERS ASSOCIATION,
"HARRY DIXON, *President.*"

"The retail jewelers of New Hampshire urge that if it's necessary to retain a tax on sales of jewelry that the rate not exceed 5 percent. We feel the proposed rate of 10 percent would be disastrous to our industry and that the revenue derived from tax would be no greater than from a 5-percent tax at point of sale. However, it does seem unfair to impose excise taxes on selected businesses. We feel a general sales tax at low rate would be a fair tax to all industries.

"NEW HAMPSHIRE RETAIL JEWELERS ASSOCIATION,
"LEONARD H. VANCORE, *President.*"

"The retail jewelers of New Jersey approve position taken by the American National Jewelers Association. Plead that you do everything possible to have tax fixed at 5 percent to avoid too drastic a curtailment of sales volume.

"NEW JERSEY RETAIL JEWELERS ASSOCIATION,
"L. J. RAD, *President.*"

"In the event it is decided to retain a tax on retail jewelry sales, the New Mexico Retail Jewelers Association solicits your support to the extent that it definitely not exceed 5 percent of sales. The people are now paying a 2-percent State tax on retail sales, and any tax over 5 percent would be most unfair to our industry, would discourage sales, curtail employment, thereby lowering income to the Government from such taxation. This same telegram went to our Senators, Congressmen, and Chairman George.

"NEW MEXICO RETAIL JEWELERS ASSOCIATION,
"FRANK FOGG, *President.*"

"The North Carolina Jewelers Association approves most heartily your efforts, contents of your telegram of August 12. Rest assured of our cooperation and support.

"NORTH CAROLINA RETAIL JEWELERS ASSOCIATION,
"G. D. BRUNS, *President.*"

"You have our approval, tax reduction to 5 percent.

"NORTH DAKOTA RETAIL JEWELERS ASSOCIATION,
"I. T. LARSON, *President.*"

"Protests are pouring into this office against the ruinous and unfair 10-percent retail jewelers' tax. We urge you to use all influence and arguments against this high tax to save our industry. In the firm conviction that a 5-percent tax is sufficient, we have wired the following telegram to members of the Senate committee: 'The Retail Jewelers of Ohio ask your help to secure a reduction from 10 to 5 percent on retail jewelry sales under section 2400 of the pending revenue tax bill. We believe a 10-percent tax is unfair to impose on our industry alone, and that such a high tax is an incentive for unfair competition and avoidance. We are convinced a 5-percent retail sales tax is more equitable and will bring the desired amount of revenue from this industry.'

"OHIO RETAIL JEWELERS ASSOCIATION,
"H. B. MCCAGUE, *President.*"

"Oklahoma jewelers unanimously favor reduction of tax rate to three. Not exceeding 5 percent.

"OKLAHOMA RETAIL JEWELERS ASSOCIATION,
"H. V. GRITZ, *President.*"

"Our State association heartly concurs with your tax committee to have rate reduced to 5 percent.

"OREGON STATE JEWELERS ASSOCIATION,
"A. W. MOLIN, *President.*"

"Wiring all members of Senate Finance Committee, all Senators South Carolina, contracting phone and wire members of association all over State urging seriousness of 10-percent retail tax or higher tax; 5 percent if possible will meet with hearty approval, 10 percent will cripple us. South Carolina will back American National Retail Jewelers Association; our position changed since my last wire to you. We wish you success.

"SOUTH CAROLINA RETAIL JEWELERS ASSOCIATION,
"RAYMOND E. COCHRAN, *President*."

"The Tennessee retail jewelers wish to emphasize the fact that they are in favor of the limit of 5-percent tax on jewelry.

"TENNESSEE RETAIL JEWELERS ASSOCIATION,
"C. C. BREESE, *President*."

"At a recent meeting of officers and directors of Texas association it was decided we should endorse the stand taken by American National Retail Jewelers Association and give you our full support to secure a reduction in tax rate from 10 to 5 percent on jewelry. We believe 5 percent will raise the amount expected from our industry. We oppose provision taxing installment and 'lay away sales' made between July 1 and signing of bill, because merchant has had no chance to inform customer or add tax to purchases, and believe it unfair to customer who must buy on installment plan.

"TEXAS RETAIL JEWELERS ASSOCIATION,
"MELROSE TAPPAN, *President*."

"Please represent to Senate Finance Committee on jewelers tax that Texas jewelers, in a meeting, feel that if a retail tax is imposed, that it should not exceed 5 percent of the sale price. Estimates show that this will raise more than the estimated amount jewelry should pay on the tax bill. Too, we trust that the committee will not penalize thousands of customers forced to buy on installment purchases made prior to the actual passage and signing of any tax measure.

"TEXAS RETAIL JEWELERS ASSOCIATION,
"H. E. DILL, *Secretary*."

"Had association meeting tonight, members voted that 5 percent tax is as much as they can stand and expect to hold their business. Am sending telegrams to Senators Aiken and Austin, and Representative Plumley.

"VERMONT RETAIL JEWELERS ASSOCIATION,
"W. S. BRIGHTON, *Secretary*."

"Washington State Retail Jewelers Association are 100 percent behind the efforts of your tax committees. Large number of telegrams sent Senators yesterday, many more today. Good luck.

"WASHINGTON STATE RETAIL JEWELERS ASSOCIATION,
"JERRY L. CUNDIFF, *President*."

"The efforts of the jewelers tax committee and the American National Retail Jewelers Association in seeking a reduction in the retail sales tax to 5 percent is heartily approved. We feel that only through such action by the Senate Finance Committee can the retail jewelers continue business and thus contribute to the national defense program in which they so strongly believe.

"WISCONSIN RETAIL JEWELERS ASSOCIATION,
"A. W. ANDERSON, *Secretary*."

The CHAIRMAN. I believe, by agreement, Mr. Printz is to precede the other two witnesses appearing on the fur tax.

Mr. Printz?

STATEMENT OF ALEXANDER PRINTZ, CLEVELAND, OHIO, CHAIRMAN, NATIONAL COAT AND SUIT INDUSTRY RECOVERY BOARD

Mr. PRINTZ. I am chairman of the National Coat and Suit Industry Recovery Board, a national organization representing 95 percent of the producers of women's and children's coats and suits. I am serving without compensation. I happen to be a manufacturer of

cloaks and suits. We employ 600 people; and while we have not been in business for 109 years, we are now in our forty-eighth year, and that is quite a record in our industry.

This memorandum is submitted on behalf of the National Coat and Suit Industry Recovery Board. May I say in this connection the recovery board is rather unique in this: It is governed not only by the members of the industry, but the unions have a very important part in and are represented on the national board.

The recovery board supports this tax. The tax upon the retail sale is simple to collect, will yield the largest revenue, and will insure to the consumer that the full tax she pays will inure to the benefit of the Government and does not represent pyramiding of profits on a tax placed at a prior source.

We should, however, like to recommend one amendment to this provision. The tax is now imposed upon articles made of fur and upon articles of which such fur is the component material of chief value. We seek a corrective amendment regarding the phrase "component material of chief value." It is important to point out to the members of this committee what this phrase means and how it has been interpreted in the past.

In order to determine the "component material of chief value" of a fur-trimmed garment, the value of the fur must be compared to the value of the cloth shell of the garment. That is the outside cloth only. To ascertain the value of the cloth shell the following items of cost must be computed; cloth, thread, allowance for handling cloth such as shrinkage, sponging, mill damage, freight, and so forth, direct labor including cutting, operating, finishing and pressing of the cloth shell, designing and an allowance for overhead allocated to the shell, and many other items too numerous to mention. Only after the cost of the cloth shell is determined after this process of computation, can it be compared with the cost of the fur, in order to determine the taxability of the garment. The details of those, if anyone may be interested, are included in the manual, Fur Tax Manual, which we passed out, and got the approval of the Treasury Department of the Government on, during the last fur-tax period.

It is apparent that with the current rapid fluctuations of the costs of materials entering into the garment, the incongruous and untenable condition will result whereby the same garment is taxable one day and tax-free the next. For example, a manufacturer with a large inventory of woolens at low prices will produce a taxable garment. And that is what we are going through right now with advances as high as 50 cents per yard on woolens. As the season progresses and he is compelled to replace woolens at a higher cost, the same garment will be tax-free, because the other component part now becomes more valuable than the fur. On the other hand, a manufacturer with a large inventory of furs at low cost will be able to produce a tax-free garment while the identical garment produced by a competitor will be taxable. It might be the identical garment made by the same manufacturer and delivered at different times.

Furthermore, the retailer will be offering for sale two identical garments at the identical wholesale price, one taxable and one tax-free.

Moreover, as we have demonstrated, the term "component material of chief value" is extremely difficult of ascertainment. The basis of computation is costly and subject to honest misinterpretation and

miscalculation, which may result in loss of revenue to the Government and subject innocent parties to penalties. Experience under the last fur tax demonstrated the inequities resulting from the operation of the phrase "component material of chief value."

The recovery board is seeking to eliminate these hardships and nevertheless be certain that the maximum revenue is collected under this provision. To this end we propose the following amendment:

SEC. 2401. *Tax on furs.*—There is hereby imposed upon the following articles sold at retail a tax equivalent to 10 percent of the price of such so sold. All articles made of fur of the hide or pelt. (That means that anything that is all fur is taxable.) There is hereby imposed upon the following articles sold at retail a tax equivalent to 10 percent of the price for each so sold. Articles of which fur is a component material which sell at retail for $71 or over.

We believe that this amendment if enacted will achieve the following results:

1. It will aid the Government. The gross revenue collected under this provision will remain approximately the same as the gross revenues collectible under the "component material of chief value" provision. The $71 retail price of a fur-trimmed garment represents in the vast majority of cases the line of demarcation at which the relative values of the cloth shell and the fur are approximately equal. Consequently, virtually all of the garments which would be taxable under the "component material of chief value" clause, would remain taxable under the proposed provision.

The Government would receive a greater net revenue under this amendment. The cost of the collection would be reduced to a mere fraction of the cost under the present provision. Only one simple inspection of the retailers' sales would be required under the proposed amendment, whereas under the present provision, both the retailer and the manufacturer would undergo complex inspection to ascertain whether a garment was taxable and whether the tax was collected. The basis of collection would be simplified and less costly since it is immediately determined upon the ascertainment of the selling price.

2. It will benefit the manufacturer. As has been demonstrated in an earlier section of this memorandum, the problem of determining taxability under the "component material of chief value" provision is highly complicated and involves a burdensome cost-accounting system on the part of the manufacturer. Furthermore, the merchandising and marketing structure of the industry may be dislocated because of the variability of the components and the fact that the same garment may be taxable one day and tax-free the next day.

3. It will aid the retailer by providing him with certain definite immediately ascertainable knowledge of whether or not a garment is taxable. If a fur-trimmed garment sells for more than $71, it is immediately taxable without reference to the question of "component material of chief value."

4. It will benefit the consumer because the present provision necessitates a costly cost-accounting system, the expense of which must be ultimately borne by the consumer. Moreover, the consumer will not be confronted with the dilemma of identical or nearly identical garments—one taxable and one nontaxable. The consumer will know that all fur-trimmed garments selling about $71 retail are taxable. Furthermore, this simple method will eliminate any possibility of fraud by imposing and keeping a tax upon a nontaxable garment.

For all of the above reasons it is respectfully urged that the amendment proposed by the recovery board be adopted.

I will be glad to answer any questions.

Senator DAVIS. Do I understand you to say you want the tax collected at the time the garment is sold to the consumer?

Mr. PRINTZ. Yes.

Senator TAFT. You prefer the retail to the wholesale tax?

Mr. PRINTZ. We do.

Senator TAFT. Representing whom?

Mr. PRINTZ. Representing 95 percent of the manufacturers in our industry, as chairman of the recovery board, which I have the honor to be.

Senator TAFT. But you don't represent any retailers?

Mr. PRINTZ. None; only wholesalers and the union.

Senator TAFT. We have had a representative of the National Dry Goods Association protesting against the retailers' end of it.

Mr. PRINTZ. I know; yes.

Senator DAVIS. You want the tax collected when the retailer sells to the customers?

Mr. PRINTZ. Yes; because that does away with all this bookkeeping and accounting on the component material of chief value. The payment of any such tax as this by the manufacturer is a very easy thing to evade and it is too often evaded. It is a simple thing for a manufacturer, if he wants to do so, to say a garment takes 3 yards of cloth, whereas it takes 2½ yards; whereupon, the picture immediately changes. There are a great many tricks in the trade; there is no point of going into that phase of it, but this is a clean proposition. You haven't to do any bookkeeping or accounting, and the Treasury Department is not confronted with almost insurmountable difficulties in the collection of the tax. For instance, a spool of thread costs 5 cents, and you have to allocate how much of that goes on the inside, in the lining, and how much on the outside. It is burdensome and impracticable. We don't care where the tax comes from but we do not want that provision as it is here. It is just absurd, and our experience with it has been far from satisfactory.

The CHAIRMAN. We had a great deal of trouble with that fur tax.

Mr. PRINTZ. Yes.

The CHAIRMAN. And never were able to get it satisfactorily adjusted.

Mr. PRINTZ. Understand, I am not speaking officially, but I have been told that the Treasury Department found the cost of collecting the tax under that chief component material rule very burdensome.

The CHAIRMAN. Mr. Beldock.

STATEMENT OF GEORGE J. BELDOCK, NEW YORK, N. Y., REPRESENTING THE FUR INDUSTRY ASSOCIATION

Mr. BELDOCK. My name is George J. Beldock. I am an attorney from New York.

May I be permitted to rise?

The CHAIRMAN. You may rise; I will sit.

Mr. BELDOCK. Thank you. Gentlemen of the committee, I appear in behalf of five fur associations of New York City, namely, American Fur Merchants Associations, 363 Seventh Avenue, New York

City; American Rabbit Dealers Association, 363 Seventh Avenue, New York City; Fur Dressers Guild, Inc., 205 West Thirty-fourth Street, New York City; Fur Dyers Trade Council, 363 Seventh Avenue, New York City; and Rabbit Dyers Institute, 276 Fifth Avenue, New York City.

I appear for the sole purpose of discussing the proposed retailers' excise tax on furs. The associations which I represent have been active trade associations for many years, and in one instance over 25 years in the fur industry. We represent the importers, the dealers, and the processors; the processors and the dyers of fur skin. I am here in support of the tax at the retail end. I may take a moment to explain the nature of the business of our membership.

As you gentlemen know the furs are trapped and imported from abroad by dealers known as importers. They own the skins. Those skins require processing and are sent to the processers who are the dressers.

After an operation similar to a tanning operation many of the skins are then dyed to suit the demands of the trade. The skins, after they have been dressed and dyed are then sold to the manufacturers to be put into the finished garment. In some cases they are sold to the cloak and suit industry who make of them a trimming for a cloth coat; and the last witness had reference to that trade. They make cloth garments fitted with fur collars and fur cuffs. The associations that I represent are not engaged in the retail business or in the manufacturing business. We are purely and simply the owners of the fur skins, the dealers and the importers of the skins, and the processers who dress and dye these skins.

Under the provisions of section 2401 of the bill, approved by the House, the tax of 10 percent would be fixed at retail. Now, the fur industry is divided on this subject. I was present and heard the representative of the National Dry Goods Association who spoke before this committee the other day, and I am mindful of his recommendation that the tax be placed on the manufacturer. I know of the activities of another group known as the fur tax committee. They are scheduled to speak here next week. They favor the tax on the dresser, upon the point of processing, and I am aware of the concerted efforts of the retailers and jobbers groups who advocate the placing of the tax not at retail, not on the manufacturer, but on the dresser. I may say that the experience of the Treasury Department and this administration in the past with the tax on the point of manufacture was very miserable and not practical. We have had no experience in this country with a tax on dressing. There has been a somewhat similar tax in Canada. This is the first time in my experience that there has been proposed a tax at the point of the processing.

Now, before I speak of the merits of our position, I should like to call your attention to what I know to be the fact, namely, that you gentlemen have been receiving a great many telegrams in connection with this matter. These are the result of a concerted drive on the part of this retailers' committee to raise a substantial fund, the purpose of which I am not aware of, to have write-ins sent to this committee by way of telegrams, letters, and so forth, forms of which have been distributed throughout the country. They have retained

a national agency to promote their interest. They have had numerous meetings in New York City and elsewhere and raised various sums of money for a fund of somewhat, between $40,000 and $50,000. They have stated that it is necessary to interest members of the Treasury Department, and that they have—and I am reading from a newspaper account—received favorable reactions from members of the Finance Committee, this committee. My purpose in referring to this is that I don't want this committee to feel that by the number of the telegrams you have received you may judge the wishes of those engaged in the fur industry. My association has sent no telegrams and we have not met other than in our membership meetings. We have raised no funds. We are here for one purpose, to ask this committee to approve the proposed tax at retail, and we do it because we think it is the only workable way the tax can be collected. A tax on manufacturers has been tried by the Treasury Department, and failed. And we say that a tax on processing will likewise be a failure. The purpose of this campaign of the retail group is a recognizable one. It is merely the old story of shifting the tax to someone else; that "the fur tax is a good tax; the industry favors it; we realize that we must pay more and make our contribution to national defense, but let the next man pay and collect the tax. It is only a good tax if I don't have the burden of collecting it." That seems to be the argument advanced by the various people who oppose the tax at retail.

We maintain that we must not overlook the fact that the consumer pays the tax. Under the proposed plan, the retailer will be simply the collector of the tax. If placed at the point of dressing, it will be passed on; to place it at the point of manufacture, it will be passed on. I wish to call to your attention the answer which you received from the representative of the National Dry Goods Association the other day, when he was asked a question by one of the Senators as to whether he felt like saying for his organization whether the tax would be absorbed. He said, "No," that in his opinion it would be passed on in any event; and he was asked whether there would be sales resistance on the part of the public if the tax be placed at retail rather than at the point of manufacture, and he said, "No,"—and he is a retailer. He said there would be no difference in sales resistance; in fact he felt there wouldn't be any resistance in either event.

In determining how the tax is to be collected, I ask you to consider the recommendations of the Treasury Department, recommendations for the collection of the tax at retail. This was approved by the House Ways and Means Committee in their report, stating that the retail tax was best by the test of administrative and equitable considerations. We favor this tax in preference to a tax on processing for a number of reasons. At the point of manufacture and dressing, there is the preparation of millions of individual fur skins, whereas at the point of retail we have a fixed selling price, and it is a simple matter for the tax to be computed on retail. Were the tax to be levied at the processing point, we would have the problem of determining the value of the merchandise.

Fur skins, although looking alike, have different values, depending on the various elements that make up such value. The seasons of the catch, whether the first or second lot of the catch, whether

purchased by a dealer who can make substantial purchases by reason of his financial standing; and, consequently, can get a different price on his purchases. The merchandise is graded according to a certain quality, and I have been identified with the fur trade for many years representing dealers, and I know there are no two dealers who pay the same price for the same skin, although they may be of the same grade; many elements are involved—elements of purchase, time of purchase particularly. I have known in one instance of a certain class of skins that sold for $1.50 a few months ago, and because of the demand in the market for that type of coat, which was a muskrat, the price of the identical skin, the same grade, the same quality, had risen to a point of $2. That was raised because of the demand and shortage and requirements of the trade for that particular skin; so, there, too, is another element; the element of style and popular demand. If the consumer, women, takes a fancy to a particular type of garment, like a beaver or muskrat, there is immediately a great demand and the price fluctuates. Now, what we say is that if you try to fix the tax at the point of dressing and try to determine then the cost of the skin, you will have to set up another agency of experts to examine every skin and determine the value of it.

Query: If I bought these skins 3 months previously at $1.50, shall I be taxed at $2, the present market value, or if the price declines to $1.60 and I still have the skins, shall I pay the tax on that value, having purchased them at the higher figure?

Senator TAFT. Do you have the title?

Mr. BELDOCK. We have the title to those skins, and we buy those skins, and frequently put them in warehouses.

Senator TAFT. Sooner or later, you sell them, do you not?

Mr. BELDOCK. Yes; and the proposed tax is to be fixed at the time the skins are processed.

Senator TAFT. That would not be practicable. What is the objection to taxing them at the time of sale?

Mr. BELDOCK. You may sell the same fur today for $2 and tomorrow or next week at some other different price.

Senator TAFT. That would make no difference. Your gross would be so much and your tax so much. After all, a retailer may sell a dress at different prices during the season.

Mr. BELDOCK. That may be true, but the reason they argued for the tax at the point of dressing was that there were only a hundred such points of processing whereas there were forty-thousand-and-some-odd retailers; that whereas the tax at retail will involve collection from many thousands and therefore require collection of the tax from many thousands of individuals, in the case of the processors there are only 110 of them; and, secondly, it is argued that is where the tax should be because it would then be confined to a group of 110 processors who could assist the Government in collecting the tax, whereas if we permitted the dealer to hold on to the furs and when he sells the lot we would have the same problem as with the old manufacturers' tax.

Senator TAFT. Why is it you couldn't compute the figures in a sale by the processors?

Mr. BELDOCK. He doesn't sell; he just performs a service.

Senator TAFT. I thought you said he had title.

Mr. BELDOCK. No; the dealer has title. He sends the fur to the dresser or dyer, the processor gets a fixed charge for his labor. He is just a servant; he performs that service and returns it to the owner upon completion; title always remains in the dealer. If we were trying to have a tax at the point of sale of the dealer you would have the same situation. He sells hundreds of thousands of furs.

One other argument here advanced is this: There are 20 to 60 to 80 skins going into a fur garment, depending on the type of garment. If we were to tax the skins at the inception, point of dressing, we have to place a value on every skin, whereas if we tax it at the point of retail there is a tax on the finished garment. There is no question about that. Whether the retailer pays $100 and makes a profit of $10 or pays considerably more and makes a profit of $200 doesn't matter. Whatever the retail price is that is used, it is and always will be the base of the computation for the tax.

I might mention that when we speak of fur skins that there are many hundreds of different types of fur skins, some of them of the variety generally known as muskrats, beavers, and Persian skins; hundreds of others are less known, such as the rabbit, the civet cat, Manchurian dog skins, all of which become a part of the fur garment, either in the coat or trimming.

Secondly, on the question of revenue, I submit that the tax on dressing will fail, in that it will fall far short of the estimated yield of $20,700,000.

As expressed by Mr. Sullivan of the Treasury Department, a 10-percent tax at retail would yield that sum, which means that if the tax were to be placed on the initial skin it would have to be not 10 percent but possibly 20 percent of the value of the skin. As you know, the finished garment includes not only the cost of the skin but the cost of the manufacturing, the trimming, the lining, the middleman's profit, and the mark-up of the retailer; and, secondly, if the present estimate of the yield of $20,700,000 from the retail sales, based on 10 percent, is correct—and I take it it is—in order to receive a similar sum by taxing the skins themselves you would have to have a much greater tax than 10 percent, the value of the skins being roughly 50 percent value of the completed garment.

Furthermore, from the point of view of raising of revenue, a tax on skins at dressing at the present time will exclude from this tax the majority of the skins already processed and manufactured into garments and in stock in various stores throughout the country, whereas a tax at retail will impose the tax on the garments regardless of when manufactured. I say that the processing from January 1 to this time has covered about 60 or 65 percent of all the skins normally to be processed this year. Those skins are in the market. They have been completed—have been manufactured into garments and are on the market for sale. If the tax were placed at the dressing the revenue from those skins, more than 50 or 60 percent, would be lost unless, of course, a floor tax were imposed, something which the entire industry, we believe, is opposed to—that is, a floor tax.

I might, in closing, refer to a comment which recently appeared in a trade paper, Women's Wear Daily, a national publication. They were trying to obtain a point of view of representative retailers as

to whether this proposed retail tax would deter sales when there was considerable talk about the resistance created by the retail tax. This has reference to an article of August 6, 1941, when the public was advised of the approval by the House of this measure, and reading from this, I quote:

> All those interviewed agree that the less said about the tax the better, and that when it comes it will be accepted just as other taxes have been. Now, that the fur coat is no longer mainly for women of wealth, the tax may cause women to wrestle with their budget, but these buyers feel the fur coat will win in sales, since buying has been simplified and payments handled on an investment basis instead of just buying another coat suitable perhaps for one season.

This covers the area of Houston, Tex., where the inquiries were made.

The CHAIRMAN. What do you have to say about the suggestion of the previous witness, Mr. Printz, that the fur is the component part of chief value? Is Mr. Printz still in the room? He doesn't appear to be.

Mr. BELDOCK. I heard his statement. He proposed that there be an exemption for those garments made of fur and otherwise where the selling price was under $71. Now, there was an exemption when the manufacturers' tax was in effect. I believe it was $75, and I am in favor of such an exemption, but I submit if, in the wisdom of your committee, it is decided——

The CHAIRMAN (interposing). It was reduced from $75 to $25, if I am not mistaken. But that is not important at this time.

Mr. BELDOCK. I believe so—I am sorry. I say, if, in the wisdom of your committee, this proposal of Mr. Printz' be adopted, then I submit to you that you consider the plight of those manufacturers who make for sale fur coats made entirely of fur that sells for $71 and under There is a very substantial branch of the industry known as the rabbit trade, which I represent and for which association I am also appearing today. There are some twenty-five to thirty million skins processed annually in that industry. Those skins are converted into cheaper, lower-priced garments. You gentlemen may have seen them in the market. They sell at wholesale for $59, $49, $39.50; they are complete fur coats, made entirely of rabbit skin with no trimmings, of course. They retail for $59, $69, and some $89, depending on the quality of the skin, but the great majority retail under $71. That branch of the industry is directly in competition with the better-grade cloth coat that is trimmed and sells for $70, $80, or $90. If we are trying to do an equitable job, and if the cloth coat industry is to receive an exemption for garments under $71—and I see the logic of the argument of Mr. Printz—I say that in order to prevent a great deal of inequality that all the manufacturers of fur coats, principally rabbit skins that sell in the same price range, likewise receive that exception. You can readily see what would happen if cloth coats selling for $60 were free of tax and a fur coat selling for $60 was taxable.

The CHAIRMAN. Yes. I would like to ask you about the witness representing the National Retail Dry Goods Association. It occurred to me that there was a good deal of force in his objection to the imposition of this tax at the point of retail sale for the reason that the retailer with a garment not made entirely of fur, but having only

a component part of it, that the retailer would not be in any position to know what the relative value or actual value of the component parts of the materials in the garment was and, while that might not be a valid objection all the way through, undoubtedly there must be a line where it would be difficult for the retailer to say that this garment has fur on it; that this fur is not the material of chief value; but since he didn't make the garment and he hasn't any separate invoices on everything that is in the garment, he has a pretty difficult job; doesn't he?

Mr. BELDOCK. Yes; he has, Mr. Chairman. However, isn't that a matter of the mechanics of the collection of the tax?

We are bound to find some difficulties.

Now, doesn't the Government compel those engaged in selling or manufacturing of woolens, under the Wool Labeling Act, to go to a great deal of inconvenience to identify the content of the wool in percentages, and would it be so farfetched to recommend to the Treasury Department that when the retailer buys his garments that he obtain from the manufacturer, together with his invoice or by certification on the invoice, some reference to the value of the fur as compared to the value of the cloth?

The CHAIRMAN. I suppose he could do that, but it appeals to me as being a rather forcible objection.

Mr. BELDOCK. It is, sir; but I don't believe that objection goes to the kernel of the whole tax question; that is only one portion of it. Then, we have a great part of the industry which hasn't the component-part problem.

The CHAIRMAN. Yes; that is not so difficult.

Mr. BELDOCK. I realize the problem confronting the committee. I feel that the Treasury Department has thoroughly investigated the matter, and I know they recommend this tax at retail, after a great deal of deliberation. I say that the Treasury Department believes in the collectibility of this tax. It has had the experience with the manufacturers' tax, and I think their judgment is better than mine and better than those who propose the tax on dressing who have had no experience with that at all.

Senator TAFT. If you had reduced Mr. Printz' exemption, $50, then there would be no such objection that you have raised to the $70?

Mr. BELDOCK. That depends on whether the $50 was at retail or wholesale.

Senator TAFT. Retail.

Mr. BELDOCK. Yes; that would cover a good portion of the rabbit coats; but still there is a close line, and it would be very hard to divide—that is, the man who sells the rabbit coat at $50 or $60 from the man who sells the cloth coat at $50 or $60.

Senator TAFT. Only if they sold it under $50.

Mr. BELDOCK. Yes; there are a great many sold under that figure. There are a great many cheaper garments sold at $50, average.

(Mr. Beldock submitted the following letter for the record:)

SILBERMAN FUR CORPORATION,
New York, August 19, 1941.

Mr. GEORGE J. BELDOCK,
Ambassador Hotel, Washington, D. C.

DEAR MR. BELDOCK: I have read a newspaper account of the arguments presented before the Senate Finance Committee by Mr. Charles Gold, counsel

for the Retail Manufacturing Furriers of America, Inc., who was arguing that the proposed Federal tax on furs be placed at the point of dressing. I know that you are in Washington to appear before the committee and present your arguments in support of the tax to be placed at the point of retail sales.

I would like you to point out to the committee the following argument against placing the tax at the point of dressing:

Since the outbreak of the war, the American fur trade has lost most of its export business and has been trying very hard to increase its exports to the South American countries, which is the only export market we have available to us at the present time. It so happens that the dressing and dyeing industry in South America is not developed and many South American furriers buy their fur skins raw and have them dressed in the United States. If a 10-percent tax were to be imposed at the point of dressing, it would automatically mean that the South American buyer would find that furs bought in the United States cost him 10 percent more than in the normal market. This would, undoubtedly, create a situation whereby the South American customers would try to buy their furs elsewhere or develop their own dressing trade, which would take away employment from the United States citizens.

I am sure it is not the intention of the Senate Finance Committee to harm our export trade in their desire to derive additional revenue by placing a tax on furs.

Very truly yours,

SILBERMAN FUR CORPORATION,
J. D. SILBERMAN.

The CHAIRMAN. Mr. Fillmore.

STATEMENT OF EDWARD FILLMORE, NEW YORK, N. Y., REPRESENTING THE ASSOCIATED FUR COAT & TRIMMING MANUFACTURERS, INC.

Mr. FILLMORE. Mr. Chairman and gentlemen, my name is Edward Fillmore. I am here in behalf of the members of the Associated Fur Coat & Trimming Manufacturers, Inc., which is a New York membership corporation. Its 750 members—individuals, corporations, and partnerships, all are engaged in the manufacture of articles made of fur. They employ approximately 10,000 skilled workers of various crafts and produce fully 85 percent of the fur-wearing apparel, including fur trimmings for cloth garments, sold within the United States. Therefore, any tax, regardless of where it may be imposed on fur articles, must necessarily affect every member of this association.

Despite the fact that the proposed tax is discriminatory because fur garments are the only articles of wearing apparel that have been singled out in this measure for taxation, since Congress, in its wisdom, because of a national emergency, and the Government's need for revenue, has seen fit to impose "an excise tax of 10 percent on the retail price of articles made of fur and articles of which fur is the component material of chief value," we unhesitatingly approve the action of Congress, and we give our support to a tax on the retail price of furs, as provided for in the section of the bill covering.

The sole reason for our appearance before the Senate Finance Committee in support of the tax on furs, as provided for in the new revenue bill now before the Senate, is because of the organized opposition by the retailers and the campaign which they are waging in order to influence the Congress to shift this proposed tax to some other point, regardless of the consequences as to how unsound, dangerous, and undesirable such a shift would be, or how little revenue the Government would obtain through such a shift.

The retailers and opponents of this proposed tax, as now provided

for in the revenue bill, undoubtedly being fearful of criticism in these critical times, in the event of open opposition to the imposition of a tax on the retail price of fur articles, conceived the ingenious idea of avoiding such criticism by advocating that the tax on furs be shifted from the retail sales prices of fur articles to the skins at the point of dressing.

Every branch of the fur industry, excepting the retailers, is unalterably opposed to the shifting of the tax from the retail price of manufactured articles to the skins at the point of dressing, as advocated by the retailers, or shifting the tax to a manufacturers' sales tax as has been proposed by the representative of the National Retail Dry Goods Association, inasmuch as the attempt to accomplish this end is motivated by pure selfishness and is definitely opposed to the best interests of the Government, the consumer, and the fur industry as a whole.

Senator CLARK. The tax is ultimately on the consumer anyway, isn't it?

Mr. FILLMORE. Certainly.

We submit briefly our reasons for supporting the action of the House in levying this tax on the retail sales price and our opposition to its being shifted to the skins at the point of dressing.

Point I.—The retail sales price of articles made of fur, or of which fur is the component material of chief value, is the only logical point for taxation—easiest to administer—will yield the most revenue, and will be least disturbing to the industry.

The United States Treasury Department in its report to the Ways and Means Committee, respecting the Government's need for revenue, recommended among other things a 10-percent excise tax on the retail sales price of articles made of fur. This recommendation of a tax on the retail sales price was undoubtedly the result of expert study of the subject by the Treasury Department, including its difficult administrative experience with the manufacturers' excise tax on furs that had been imposed in previous revenue measures. And I endorse the chairman's statement, when he said what difficulties they have had with this manufacturers' excise tax It may interest the committee to know that I have appeared before every committee that has considered this tax since the World War, and I was the first one to be consulted, and, because having had over 30 years' experience in the fur business, they deferred somewhat to my opinion when the regulations were written.

The revenue quota to be obtained from the fur trade was fixed by the Treasury Department at $20,700,000. The Treasury Department undoubtedly based this figure on its knowledge that the total sales of fur-wearing apparel and articles of which fur is the component material of chief value is approximately $207,000,000.

Hence, if the Government requires at least $20,000,000 of revenue from the fur trade, it could not be obtained at any point other than the retail sales price, at a 10-percent rate. Of course, if you raised the tax rate higher, that would make it prohibitive.

Despite the testimony of the retailers before the Ways and Means Committee, in opposition to the proposed tax on the retail price, and despite their suggestions to Ways and Means Committee to have the tax shifted to some other point, the Ways and Means Committee, after

a careful study of the subject, accepted the recommendations of the Treasury Department and voted that the tax of 10 percent be imposed on articles made of fur, and on articles of which fur is the component part of chief value, when sold at retail.

As a tax on fur articles appears unavoidable, and the revenue for governmental needs is imperative, we concur with and approve the action of the Ways and Means Committee in imposing a tax of 10 percent on the retail sales price of articles made of fur and of articles of which fur is the component material of chief value because—

(*a*) It will indisputably yield the greatest amount of revenue.

(*b*) It will be least burdensome and disturbing to the industry.

(*c*) No one will have to finance or advance the tax, and it will be payable by the retailer only when the article will have been sold to the consumer.

(*d*) It is simple and specific.

(*e*) It is easily collected and offers no administrative difficulties. There was some mention made of the difficulties to be experienced in collecting this tax from about 40,000 retailers. The answer to this is that the Government has been collecting our income taxes from 13,000,000, and it is now proposed to increase that number to 23,000,000 individuals. I can't see that is a valid objection to a tax on the retail sales price.

(*f*) It is not an experimental tax and will create no confusion.

(*g*) It is most fair to the consumer, as it only increases the normal cost of the article by 10 percent, which is the fixed amount of tax.

It is unscientific despite that they have it in Canada. The Treasury Department has investigated the Canadian system. Mr. Beldock was in error when he said that this system had not been before the committee. I think the committee will remember distinctly that in 1932 the same thing was urged upon it. At that time there was an excise tax on the manufacturer, and we urged the adoption of the Canadian system, feeling that the change might give some relief to manufacturers, but the committee decided, after investigating the matter fully, that it would not work here, that it was not acceptable, and they discarded it, and so did the Treasury Department.

Point II. Shifting of the tax to the skins at the point of dressing, as advocated by the retailers, would be confusing and experimental; would not yield the required amount of revenue; and would unnecessarily disturb and burden the industry without any benefit either to the Government, the industry, or the consumer.

The retailers are the only ones that advocate the shifting of the tax from the sale at retail of fur articles to the skins at the point of dressing. No other branch of the industry supports the shifting of the tax.

From advertisements sponsored by the retailers, appearing in trade papers, we are apprised that they are soliciting large contributions for the obvious purpose of influencing the Senate and organizing an effective lobby to bring this about.

They admit having engaged a well-known firm of public-relations counsel to formulate protests and flood the Senate with them. They further announce their intention to retain nationally known attorneys to present their case before the Senate Finance Committee.

We are constrained to disapprove of the methods employed by the

retailers in endeavoring to accomplish their object of shifting the tax, for if there were any merit to their objections to the tax as voted by the House, and if the shifting of the tax to the skins would benefit the trade, there would be no need of this great pressure campaign to influence the Congress, as every branch of the fur industry would support it; but recognizing that the shifting of the tax would be injurious to the trade, every branch, except the retailers, is opposed to it.

The retailers have not advanced a single sound, constructive, or convincing reason that would justify the Congress to change and shift the tax from the retail sales price to the skins at the point of dressing. I say they have not advanced any good argument, because we do not know what arguments they are going to advance, and I might say at this time I regret that the retailers advocating this change would not appear today, because they are here; they were originally scheduled to be heard at the same time we were, but presumably they wanted to hear what we had to say and so asked to be heard next week.

In the main, the contention of the retailers is that a tax on the retail sales price will engender price resistance on the part of the consumer, whereas a tax on the skins at the point of dressing would be hidden in the sale price and would not have this effect.

There is no merit to this contention. Taxes on sales price are universal and have been accepted by the consuming public, and they have not caused sales resistance in other commodities.

The buying public today is tax-conscious, and it is the intent of the Government to make the people tax-conscious. There is no advantage in resorting to any effort to hide the tax from them. Every woman will know that there is a tax somewhere which she must pay when she buys a garment, and a tax on the retail sale price will eliminate all uncertainties or conjectures.

If the tax is shifted to the skins, it would not make the garment cheaper, but, on the contrary, it would even be higher because a tax on the skins at the point of dressing will be incorporated in the cost of production and successive increments of mark-up for overhead, sales cost, and profit will be computed thereon by manufacturers, distributors, and retailers, so that by the time the articles reach the consumer the tax will have multiplied itself to the detriment of the consumer and without any increase of revenue for the Government. As a matter of fact, if you were to place a tax at the point of dressing, there the tax would be ever so much less because, supposing we would value the skin—and, by the way, the Canadian system says that the tax is fixed upon the current market value. Now, who is to say what the market value is? It may be that if you adopt that you would have to employ some expert that would value the article, or would you want to leave it to the manufacturer to make the valuation? If you did, naturally the manufacture will not value it at a higher, but at a lower price, so we would pay less taxes.

Another objection on the part of the retailers: They say that the buyer would resist if she knows of the tax. For instance, the buyer would resist and say they didn't want to pay a $100-tax on a $1,000-dollar coat. They don't have to disclose it. They may include the tax in the sales price. The article sells for $1,000, the tax included

therein is $100. As I understand the bill, that is permissible; they need not tell the buyer about it. That overcomes their objection to resistance because of the existence of the tax.

Against this form of "profiteering in tax," the consumer will have no way of protecting himself because he has no way of determining what portion of the price at which he purchases the garment represents cost and what portion is tax.

On the other hand, a tax of 10 percent on the retail sales price is not added until the garment is actually sold to the consumer, is readily computed, and does not lend itself to mathematical pyrotechnics.

The retailers are urging that Congress adopt, instead of a tax on the retail price of furs, a tax on the skins at the point of dressing. They say that Canada employs this method, and the only reason they advance for the adoption of this method is, that it would cost the Government less to administer.

In answer to this argument, we wish to point out that the United States Treasury Department has examined the Canadian system of taxing skins very carefully and has discarded it. The same method of taxation was also advanced to the Senate Finance Committee as long ago as 1932, and that committee, after considering the subject, with the experts of the Treasury Department, found this method of taxation impractical, and so fraught with administrative difficulties, that the committee unhesitatingly discarded it.

Senator Smoot was the chairman at that time of the Senate Finance Committee. We appeared in force, our entire industry appeared in force, because we felt it was possible that might give the industry some relief. We examined it and so did the experts, and discarded it, because we felt it was not feasible and would not produce the revenue.

While this should be sufficient to dispose of the argument in question, we want to point out that the basis of the Canadian tax is the "current market value of skins." If we were to adopt the Canadian system, it would mean that every owner sending skins to the dresser would have to put his own valuation on his own skins. Obviously, this would open up an avenue for evasion and fraud, and constant controversies would arise as to what would be considered "current market value."

The fact that such a system has been adopted in Canada is no reason for its adoption here.

If the tax were shifted to the skins at the point of dressing and the rate of 10 percent were retained, aside from its impracticability and other difficulties hereinbefore pointed out, the yield of revenue to the Government would be most uncertain and would not be half of the amount which would be obtained from a tax on the retail sales price.

No one has any records or statistics of the value of the skins dressed in any given year, and, hence, no accurate appraisal is possible, but it is fair to assume that if the total retail sales are approximately $200,000,000, as estimated by the Treasury Department, the skins could not be valued at more than one-third, which is hardly more than $66,000,000. However, assuming that the skins at the point of dressing were valued at one-half, or $100,000,000, the tax at the rate of 10 percent would yield only $10,000,000 instead of the needed $20,700,000.

Moreover, the Government would receive practically nothing or very little in the year 1941 if the tax were shifted to the skins at the point of dressing now, because substantially all of the skins to be used in this year's output by the industry have already been processed and manufactured into garments.

On the other hand, a tax on the retail sales price will yield substantially the entire tax quota since the retail sales period is just beginning.

In addition to all the foregoing arguments, the tax should remain on the retail sales price and not be shifted to the skins at the point of dressing for the following reasons:

(*a*) That a tax on the skins at the point of dressing would be impractical, experimental, uncertain, and full of administrative difficulties in the collection thereof.

(*b*) The revenue to the Government would be less than half of what it would be by a tax on the retail price.

(*c*) That there would be pyramiding and profiteering on the tax.

(*d*) That it would entail extraordinary and unnecessary hardships to all the producing branches of the trade as they could neither absorb nor finance the tax.

(*e*) That it would unproductively tie up large sums of money until the merchandise reaches the consumer.

(*f*) That there would be no benefit to the consumer, as the cost to the consumer, if the tax were on the skins, would not be less but, on the contrary, would be even higher.

I am now addressing myself to that part of the provision which deals with the "component material of chief value." I have heard the witness, Mr. Printz here, on the subject, and this is our point on it. We are vitally interested in this specific provision because we are manufacturers.

Point III.—That part of section 2401 which imposes a tax on "articles of which fur is the component material of chief value" must be retained.

We have reason to believe that the cloak and suit industry will join with the retailers in opposing that part of section 2401 which provides that a 10-percent tax be levied on "articles of which such fur is the component material of chief value."

We understand now they do object to it; they are offering an amendment. While we might be in accord with their views, you asked a question of the previous witness, namely, if there be any reason to consider the suggestion of the cloak and suit industry to exempt cloth coats of $71, we will have no objection to such an exemption providing the exemption will apply to fur coats as well. What we want is equal opportunity. We feel we must have that because we are in direct competition with cloth coats if the article of chief value be fur.

Naturally, the "articles" so classified consist almost entirely of the vast quantity of ladies' cloth coats trimmed with fur, which constitute the outerwear of a large portion of the women of our country, and include other articles of wearing apparel trimmed and lined with fur. Bear in mind that there are other articles besides cloth coats which have fur.

The reason for including these "articles" in the revenue law is twofold:

(*a*) The additional revenue to be derived from this source.

(*b*) Protection to the fur-coat industry against unfair competition by the manufacturers of cloth coats.

Treasury Department experts, in arriving at the revenue quota of $20,700,000 required of the fur industry, and predicated on a sales total of $207,000,000, unquestionably included in the total the sales receipts of articles of which fur is the component material of chief value. To withdraw such articles now from the application of the statute would violate all precedents established by former revenue acts and would result in a very substantial curtailment of the revenue which the Government expects to realize from the fur industry. Therefore, if the revenue quota required of the fur industry is to be realized, the tax on articles of which fur is the component material of chief value must be retained.

The fur-coat industry must be protected against prejudicial competition by cloth-coat manufacturers. Almost all cloth coats manufactured are trimmed with fur. It is the fur trimmings that sell the cloth coats. They are sold in competition with coats made entirely of fur.

When Mr. Printz talked about the cotton, of the value of the cotton, that was taken into consideration in the regulations. So, when the Treasury Department looked into it and found that no one article in a cloth coat was as valuable as the fur, and fur being the component material of chief value, the tax was fixed on the sale price of the garment.

To fully appreciate and understand this, one must get away from the old fallacy that fur coats are expensive and cloth coats are cheap. Nothing could be further from the fact. A very large majority of the fur coats sold are those made of comparatively inexpensive pelts and selling at retail for as little as $75, and in that price range. I put in there "as little as $75," but we know now that there are fur coats being sold and advertised at $39, so you can readily see that if you were to fix an exemption of $50 that the fur coats would have to pay the tax while the cloth coats would be free of tax, and that seems to us to be unfair.

Cloth coats, on the other hand, trimmed with furs, sell for $100 and upwards and frequently when adorned with costly furs, retail for as much as $500, depending on the kind of furs used.

It is thus apparent, at a glance, that these fur and cloth coats are sold in competition. Any arbitrary factor which affects the one and not the other, would disturb the balance between these industries to an extent which would be ruinous to those engaged in the industry which was put at disadavantage.

The corollary is obvious. A 10-percent tax on fur coats without a similar tax on fur-trimmed cloth coats, would tilt the scales of competition so far against the fur-coat manufacturer as to threaten his industrial existence.

Obviously, the Congress in the past has painstakingly refrained from penalizing the fur industry to the advantage of the cloth-coat industry, in so framing the provisions of the excise taxes on furs as to include fur-trimmed cloth coats, and certainly there is no reason to change this now.

Any course which would impose a tax on fur garments and exempt fur-trimmed cloth garments from bearing any portion of the tax would be inequitable and unfair to the industry.

Should it be contended that such articles should be exempted from the tax, because of the alleged difficulty of determining when fur is the component material of chief value, the answer is to be found in the fact that this provision was included in every prior revenue act which contained a provision taxing furs and no difficulty was found in administering the law or collecting the tax thereunder.

Conclusion: We rely solely on the merits of our position. We have no axes to grind and no selfish motives to actuate us. For all of the foregoing reasons, if articles made of fur are to be taxed at all, we respectfully urge:

I. That the provisions of section 2401 of H. R. 5417 with respect to a tax on furs be left undisturbed.

II. That the tax on fur articles be levied on the retail price thereof and not on the skins at the point of dressing.

III. That the provisions of said section with respect to a tax on articles of which fur is the component material of chief value, be retained intact.

The CHAIRMAN. There are some garments in which the cloth is the chief value, are there not?

Mr. FILLMORE. Mr. Chairman, I don't believe there are any. Even in the cheapest cloth garment, when they use fur as trimmings the fur is most always the component material of chief value.

The CHAIRMAN. So you think any item that has fur on it that is the component item of chief value?

Mr. FILLMORE. Yes. It would be very simple, although Mr. Printz said it would be difficult, to make the segregation. The cloth coat manufacturer knows the value of the fur article on the garment. All he has to do is to note it on the bill. The reason they don't want to do so is most likely because it will be seen what the cost of the trimmings may be—unless a general statement can be made that the fur is the component article of chief value in the garment itself.

The CHAIRMAN. Any questions?

Mr. FILLMORE. I have already stated that we opposed the manufacturers' tax. We do hope that that shall never be placed upon us unless there be a general sales tax enacted so as to cover everybody. Fur has paid more taxes than any other apparel industry.

The CHAIRMAN. Yes; I remember some of the difficulties. Thank you very much.

There are two witnesses here not listed today. Mr. Miller.

STATEMENT OF ROBERT N. MILLER, WASHINGTON, D. C., CHAIRMAN, EXCESS PROFITS TAX COMMITTEE OF THE TAXATION SECTION OF THE AMERICAN BAR ASSOCIATION

The CHAIRMAN. All right, Mr. Miller.

Mr. MILLER. My name is Robert N. Miller and I appear as chairman of the excess profits tax committee of the taxation section of the American Bar Association.

The American Bar Association has quite a number of recommendations but this is the only one that is material now in view of the rule this morning. The others can go over to some other hearing.

The CHAIRMAN. The others are administrative?

Mr. MILLER. Yes. This has reference to what is proposed in connection with the increased excess-profits tax.

The CHAIRMAN. You mean the 10-percent tax?

Mr. MILLER. Yes; that and the reversal of the deduction for income and excess-profits taxes—everything that relates to that extra billion.

The recommendation of the association is for a restoration of the provision for the adjustment of abnormalities when excessive hardship is caused by such abnormalities, either in income or invested capital. A provision having that effect has been in all the excess-profits tax laws up to the present; that is, it was in the 1917 law, the 1918 law, the 1921 law, and the 1940 law, passed last year. It was not repealed until last March, and at that time this provision—section 722—was just taken out of the law entirely and a very narrow provision having a different effect became the new section 722.

We feel that something having the same effect as section 722 as originally enacted in the Second Revenue Act of 1940 must go back into the law for the Government's own good. When the Treasury officials started to administer the Revenue Act of 1917—our first Excess Profits Tax Act—they didn't want to have anything to do with relief provisions. At first they said, "We hate this thing; we are not going to take this responsibility of supplying so-called relief." They started out making only relatively scant use of the provisions, but then they found that many of the 1917 cases were frozen up so tightly that the situation was practically hopeless. One of them said: "I wish the returns were sunk in the ocean."

Then the Treasury began to make full use of these special relief provisions and the administrative machinery began to move successfully. They began to receive the money in frozen cases, and eventually the excess-profits tax for the 5 years 1917 to 1921 was remarkably productive. I know that is true because I was one of those officials worrying about this very thing. Dr. Adams and Mr. Sterrett were the men who were in charge of Treasury excess-profits tax policies at that time, and after dealing with the 1917 returns, these two men saw to it that a broad relief provision was again inserted in the new law, that is, the Revenue Act of 1918, and again in the 1921 law. Both men were sure that the Government had to have such provisions in the law in order to keep the money coming in, because abnormalities do occur. They produce absurd situations, and thus result in litigation and delay for the Government.

It was found that these provisions were even more essential to the Government than to the individual in getting money, in any situation where very high tax rates are involved. The excellent productivity of those revenue acts is well known, and it was due in large part to the fact that the Treasury could and did act under broad relief provisions.

The only other thing I want to say is this: If anyone suggests that the present law as it stands—that is, with the old section 722 out and the new section 722 in—gives the Government these adjusting powers which it needs and must have in substantially all the cases, you don't have to take my word for the fact that it does not. If you just

read the present provisions which purport to adjust these abnormalities and see how narrow they are, you will realize that of the total number of cases in which the Government would need such relief, only a small fraction could be effectively dealt with under existing law.

I won't go into details; those details are in the statement I have filed, but I mention this: One of the things which produces crazy results is abnormality in invested capital. Nowhere in the present law is any power given to the Commisisoner to recognize and adjust that type of abnormality. It was in the old provision; it is not there now. The new section 722 has nothing to do with anything but base period income, and as to base period income—just to show you how small an area is covered—of all the possible abnormalities which might arise, it is limited to just two. A company has to change the character of its business or suffer an interruption during the base period for its case to be affected by the present section 722, and no other type of abnormality of income is covered. It couldn't possibly be true that the few situations that are specifically picked out in these relief provisions are sufficient to give the Commissioner the power he needs in the great field of business.

One other example and I am through.

In the present section 722 changes in business under certain conditions are recognized as an abnormality and as a reason for making an adjustment. This section says that such adjustments shall occur only if the change in business came on or before January 1, 1940; that is, if the change does not exist until January 2—1 day later—it is in this category of things with respect to which the Commissioner cannot make an adjustment under this law.

I do not mean now to be rubbing in the illogic of making perhaps millions in taxes for one taxpayer depend on whether a thing happens on the 1st or 2d; I am bringing it our merely as an illustration—and I could point out 40 of them—to show that a general relief provision is still needed. Dr. Adams and Mr. Sterrett simply had to have such general powers, to make the law work, and they are omitted from this law. I have been in touch with the administration of the revenue laws for 20 years. I have yet to hear any man who ever carried the burden of trying to get money out of a high rate excess-profits tax say that the Government could get along at all without the power to straighten out abnormalities—make them right and clean them up.

The CHAIRMAN. I wish you would convince the Treasury of that because I have attempted and failed. I did my very best in the excess-profits tax, and then subsequently, of course, we were able to do something which did give some relief in certain narrow cases.

Mr. MILLER. Those provisions are good as far as they go, but they cover such a narrow field. We are not moving in the right direction if we use all our effort trying to convince the Treasury. Is it not the responsibility of Congress to pass good laws?

The CHAIRMAN. Yes; that is true, but the Treasury Department has to furnish us with considerable data and information, and we have to regard it, and the Treasury Department just didn't want to assume the burden of making these adjustments; they thought it would lead up to too much trouble.

Mr. MILLER. As I said, the Treasury Department hated like poison in 1917 to exercise the powers they already had. They were afraid of

congressional investigations and that kind of thing, but they were driven to it, and if the gentlemen who are advising the Treasury now had ever actually administered such a provision for adjustment of abnormalities, actually ever done this thing, they wouldn't be so afraid of it. A man who has never learned to swim is afraid of the water. It gives him the shivers to go near it, but once he overcomes that fear, it is different. Furthermore, if a man takes office as Secretary of the Treasury or Commissioner of Internal Revenue, there are problems that go with those jobs, and the Government needs the kind of service that will try to solve those problems. As a matter of fact, the difficulty of valuation, the difficulty of dealing with depreciation, or invested capital, and other problems under this law are no harder and no easier than this adjustment problem. It is one of those tasks that go with being Secretary of the Treasury or Commissioner of Internal Revenue. A soldier doesn't like going into battle, but when his country's good requires him to go into battle, he assumes the responsibility and goes

The CHAIRMAN. I agree very definitely with your views and I am very glad to have you express the thought here that the Treasury, the Government itself, needs some elasticity and power to make these adjustments of abnormalities both in investments and income.

Mr. MILLER. That is absolutely correct, and if Dr. Adams or Mr. Sterrett were alive they could tell you better than I. They carried that burden. Here is what happens: Suppose you had four companies in an industry and they were very nearly alike, about the only difference being that one of them has a long history behind its invested capital—reorganizations and that kind of thing. Because of some peculiar provisions of law, this unfortunate corporation finds its tax a million dollars while the other three have only half a million to pay, but it is apparent that the taxes for all four ought to be the same—this one just ran afoul of a provision which produces an unconscionable result in its case.

Senator GUFFEY. Didn't you have that situation in Pennsylvania where there were two corporations, steel corporations, involved?

Mr. MILLER. I don't clearly recall that case.

Senator GERRY. I think I remember the case.

Mr. MILLER. What I have in mind is, this fellow isn't going to pay the million dollars without a long fight. It would ruin him to pay when his competitors do not; he can't, and that case gets frozen after a time, and you have only long delay instead of collection.

The CHAIRMAN. Litigation?

Mr. MILLER. Yes; litigation and all the rest of it. The Government needs to do justice, and to do justice you have to have the statutory power.

The CHAIRMAN. Thank you very much.

(The statement submitted by Mr. Miller is as follows:)

STATEMENT OF ROBERT N. MILLER, CHAIRMAN, EXCESS PROFITS TAX COMMITTEE OF THE TAXATION SECTION OF THE AMERICAN BAR ASSOCIATION

THE NEED FOR RESTORING TO THE EXCESS-PROFITS-TAX LAW A BROAD PROVISION FOR ADJUSTMENT OF ABNORMALITIES OF INCOME OR OF CAPITAL

The American Bar Association, at the last meeting of its house of delegates, directed the section of taxation to ask the Congress to restore to the excess-profits-tax law a provision giving the Commissioner the power, granted in sufficiently

general terms, of making adjustments for abnormalities of income and invested capital, which results in excessive hardship. Provisions having this effect were in the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, and proved workable and highly useful to the Government. As you know, there was also such a provision in the Second Revenue Act of 1940, but it was removed last March. The kind of provision we have in mind would be a "technical" provision just as definitely as the provisions about invested-capital or excess-profits net income, in that the computation of the tax could not be regarded as finished until the adjustments called for by this provision had been made, if the case were one involving abnormalities requiring adjustment.

1. *General statement as to need for broad provisions for adjusting abnormalities.*—The Government is in much greater need of having such a provision in the tax law than any taxpayer is. It happens that I know this from my own experience as an official of the Treasury when the Treasury was forced to deal with the Revenue Act of 1917.

Professor Adams, of Yale, and Mr. Sterrett, of Price, Waterhouse, who for a while devoted their whole time to managing the excess-profits-tax administration, are dead, but I saw them from day to day while they were carrying that burden, and I know that they saw to it that such provisions were continued in the Revenue Act of 1918 and in the Revenue Act of 1921 because they were useful to the Government. I am also convinced that if the present Treasury advisers had actually lived through the audit of tax returns under any excess-profits-tax law, they would see as clearly as Dr. Adams and Mr. Sterrett did, that there is a compelling administrative necessity for such provisions.

The fact is that these provisions were in the 1917, 1918, and 1921 laws not because of the importunities of taxpayers but because the Government needed to have them there. About 18 months after the returns under the Revenue Act of 1917 had been filed it became clear that there were a very large number of important cases which were frozen in the Bureau. As to some of these cases, the Bureau felt very uncertain as to what the technical amount of tax really was under the law. As to others, the Bureau, following technical provisions of the law, was demanding a great deal more money than the taxpayer could possibly afford to pay. The Treasury then, as the Treasury now does, hesitated to assume the responsibility of acting under broad relief provisions, but the Treasury officials found that, if they did not so act, almost endless litigation, as well as interruption of the revenues, must necessarily occur. It was the judgment of the Treasury at that time that the Treasury got more money, both in the short run and in the long run, because they could act under those relief provisions.

To give a specific illustration, suppose there are four important competitors in a certain industry, very similarly situated as regards product, customers, etc. Three of them are normal, and each of the three liable for excess-profits taxes of $500,000. The other is peculiar as to its financial and corporate history or as to certain features, and as a result would have to pay $1,000,000 under the technical provisions of the law. In a common-sense view of the whole situation, we will say, this result is one that Congress could not have wanted. It will necessarily put the abnormal competitor at a terrific disadvantage in competition with the other three, all because of matters which happened long before the excess-profits-tax law was passed.

In such a case the taxpayer who is the victim of the technical provisions of the law cannot afford to agree to what the Government must demand under those provisions, and simply has to fight to the end; furthermore, the chances are that somehow or other the courts will find a way to prevent the obvious injustice caused by the technical provisions. But if the law furnishes an equalizing formula, such as has been provided in the other excess-profits-tax laws, the Government can do justice and get the money in promptly from all four of those taxpayers instead of only three.

I think it is especially important in this connection that Dr. Adams and Mr. Sterrett, after grueling and long-continued experience with the frozen cases, decided not only to make full use of the relief provisions of the 1917 law instead of resisting their use, but saw to it that similar provisions were introduced in the other two later revenue acts as to which they gave advice—that of 1918 and that of 1921.

Do the various specific relief provisions which are now in the excess-profits-tax law constitute an adequate substitute for such a general provision? We have only to read those provisions to see that they cover only a small part of the necessary area of relief. The actual language of the provisions is full of express limitations.

For instance, take the present section 722 of the law, which was substituted last March for the general provision. It is entitled "Adjustment of Abnormal Base Period Net Income." In the first place, you see that it has nothing to do with abnormal income in the current taxable year, nor with any abnormality of invested capital. Instead of dealing with all abnormalities of base-period income, it relieves no abnormality unless it arises from (1) a change in the character or business or (2) an interruption of production; certainly no one could say that all abnormalities of income arise from these two somewhat unusual causes. In the second place, even if the case meets these requirements, there are other express and specific limitations written into the provision. A particular case which runs afoul of any of those specific limitations gets no relief whatever under that section, however clearly it is within the spirit of the relief provisions.

As an example of such a limitation, it is to be noted that a taxpayer which changed the character of its business during the base-period years or on January 1, 1940, is given a certain type of limited relief; but the act is so drawn that if the change occurred on January 2, 1940, or thereafter, the taxpayer gets no relief whatever under the section. I am not now trying to emphasize the obvious unfairness of a limitation under which millions in tax may depend on whether the business changed its character on one day or on the day following; I am merely illustrating the fact that anyone who says that the specific relief provisions in the law can be depended on to relieve practically all the cases that need relief should read the provisions and discover that their actual terms prevent any such conclusion. They relieve only some of the anticipatable cases, and none of those which have not been foreseen.

For another illustration, consider section 721. The title is "Abnormalities in Income in Taxable Period," but a reading of the long provision itself shows that it is designed to operate only in certain sharply defined classes and, even when it operates, is subject to sharp limitations.

One of the most important reasons why a high-rate excess-profits tax must contain broad relief provisions is that there will be a great many cases in which neither the Government nor the taxpayer can tell from the language of the act what Congress intended in such a case. That was true under all the previous revenue acts, and it will be even more true under the present act, which is far more complicated. Specifically, it is impossible in the case of many important American corporations to determine what the invested capital is or what the basis of the corporation's property is. That proved to be true under the other excess-profits-tax acts, and as to many of the cases no actual determination was ever made, because the data were not available.

If we turn to section 723, entitled "Equity Invested Capital in Special Cases," we see that it purports to tell what shall be done in a case where the equity invested capital cannot be determined. But the statement as to what shall be done in such a case speaks in terms of the adjusted basis of the assets of the taxpayer. In almost all cases in which it is impossible to determine the invested capital it is also impossible to determine the adjusted basis of the assets, so that the section is useless in most cases. When section 722, as it stood before last March, was removed from the law, the Commissioner was left without any real power at all to deal with this important group of cases in which invested capital cannot be determined. A fuller statement regarding the limitations is given in part 4 of this statement.

As recently as last winter both this committee and the Ways and Means Committee of the House said in formal reports:

"Experience with excess-profits taxes, both in the United States and abroad, has demonstrated conclusively that relief in abnormal cases cannot be predicated on specific instances foreseeable at any time. The unusual cases that are certain to arise are so diverse in character and unpredictable that relief provisions couched in other than general and flexible terms are certain to prove inadequate."

That is absolutely true and is certainly inconsistent with any idea that limited relief provisions of the type that are in the tax law now can by any possibility give the Government the power it needs to deal with the many cases of abnormality which cannot be predicted or foreseen.

It was in recognition of all these facts that Congress in the Second Revenue Act of 1940 inserted in the law the following provision (the then sec. 722, the text of which was repealed last March):

"ADJUSTMENT OF ABNORMALITIES IN INCOME AND CAPITAL BY THE COMMISSIONER.—For the purposes of this subchapter, the Commissioner shall also have authority to make such adjustments as may be necessary to adjust abnormalities affecting

income or capital, and his decision shall be subject to review by the United States Board of Tax Appeals."

This provision has been criticized as being vague, and our belief is that it can be improved upon, but from the Government's standpoint as well as from the standpoint of the taxpayers, it is immensely better than having no general powers at all.

The American Bar Association is not asking for the enactment of any specific language, or for any specific standard by which such relief is to be computed. In its report the excess-profits-tax committee suggests one acceptable method by which such a standard can be established, but it believes that provision for the relief is the main thing and that the method is subordinate.

The only reason which suggests itself why the two committees of Congress should bring out so clearly the fact that relief provisions couched in "other than general and flexible terms are certain to prove inadequate," and yet, within a month, should take out of the law a general provision and substitute a highly limited one, is that the Treasury's advisers dislike for the Treasury to assume the responsibilities admittedly connected with the application of general relief provisions.

We submit, however, that when the Government is imposing a high-rate excess-profits tax, experience has demonstrated that, for the good of the Government, someone must be found who is willing to undertake this task. The Commissioner of Internal Revenue, advised by the Secretary, is undoubtedly the Government official to whom we have to look for the performance of these difficult and perhaps unpleasant duties. Our feeling is that these particular duties should be regarded as incident to the assumption of the office of Commissioner of Internal Revenue and that of Secretary of the Treasury, because the Government needs the service. In the same way, a soldier would much rather not undergo the dangers of battle, but if he is convinced that the country's good requires it, he is willing to undergo them.

It is clear, also, that no one can say such provisions cannot be administered, because similar provisions were administered as to the years 1917, 1918, 1919, 1920, and 1921—with remarkable success in making the applicable laws productive.

2. *Need for adjustment of excessive hardship due to abnormalities of invested capital.*—With reference to abnormalities of invested capital, it is to be noticed (*a*) that in the present condition of this law there is no provision for correcting abnormalities, no matter how oppressive the result, (*b*) that there are bound to be corporations whose situation is abnormal both as to the income credit and as to the invested capital credit, and as to those, the Commissioner is not now permitted to recognize the abnormality, (*c*) that the view of the businessman, which is an essential element in the successful enforcement of any tax, is that a tax is dangerous to business if of two competitors one is penalized in the tax rate because of what might be called ancient history—things that happened in the corporation's financial history before this excess-profits tax was thought of.

To explain this last statement, let us realize first that in times such as these American business knows the taxes have to be very high and that its interest is not in keeping tax rates down but rather in seeing to it that businesses are not ruined by unreasonable tax differentials. If two competing corporations have precisely the same normal tax net income and their situation is generally the same except as to things which happened before 1940—at a time when no issue of high-rate taxes was involved—with the result that because of different technical invested capital one business gets into the 50-percent bracket and the other into the 35-percent bracket, business cannot help regarding this differential as dangerous and unjust. So great a tax differential between two competing businesses is likely to kill one of them off. There is no question that the technical rules of invested capital might produce this dangerous result. That is the reason why section 210 of the 1917 act, sections 327 and 328 of the Revenue Acts of 1918 and 1921, and section 722 of the Code (as it existed up until March 7) were enacted.

3. *Consideration by the committee last February.*—In the report of the Ways and Means Committee dated February 24, 1941, with reference to H. R. 3531, amending the Excess Profits Tax Act of 1940, it was said:

"* * * The tax rates provided, or even higher rates, are thoroughly justified if the income subject thereto is clearly of the type intended to be reached. At the same time, equitable considerations demand that every reasonable precaution be taken to prevent unfair application of the tax in abnormal cases. The weight of the burden imposed carries with it a commensurate need for restricting its application to the cases for which it was designed.

"Sensible to these considerations, your committee and the Congress, in formulating and enacting that legislation, exercised caution both with respect to the methods provided for measuring the portion of the corporate earnings to be subjected to the tax and in alleviating the specific hardships which were disclosed. At the same time, it was observed that specific treatment designed alone for such unusual cases as could then be foreseen would not prove adequate to meet the equitable demands.

"For this reason the committee of conference on the second revenue bill of 1940 adopted a provision hastily designed to take care of unforeseeable situations by providing adjustments for abnormalities of both income and capital. This provision was known to be inadequate at that time but nevertheless was inserted in the law as a token of assurance to taxpayers that further congressional action would be taken in this respect * * *." (This reference is to sec. 722 as it was before the amendments of March 7, 1941.)

An examination of the changes made by the amendments shows that instead of adding to this section 722, which "was known to be inadequate," the amendments give a great deal less relief than the replaced section 722 did. The new section 722 relates only to the relief of two kinds of abnormalities of income in base-period years, whereas the old section 722, quoted above, gave the Commissioner power to adjust any abnormalities of income or of invested capital.

4. *Extreme narrowness of present relief provisions.*—As stated above, the provisions in the present law dealing with the treatment of abnormalities of net income are not general in character; in fact, they are so phrased and limited that it is the exceptional abnormality that can be relieved under these provisions, because of the strictness of their terms. They fail to give relief not only in cases of unanticipated abnormality but in many cases where hardship due to abnormality can be anticipated.

(*a*) No kind of abnormality of invested capital is relieved against. (See 2 above.)

(*b*) In the case of abnormalities of income for the current taxable year no adjustment is provided for, except with reference to an item which can be attributable in whole or in part to some other than the current taxable year.

The vast field of other income abnormalities in the current taxable year is left wholly unrelieved. One of them is mentioned in part 5 below—the case where income has been substantially increased merely by improving executive management or by going into a different kind of business; for instance, improvement starting in the year 1940 and culminating 2 or 3 years later in sound business results having nothing to do with profiteering or anything connected with the war situation. The only place in the law where any special treatment for abnormalities of income in the current taxable period is dealt with is section 721; even as to income which is attributable to some earlier or some later year, no relief at all is to be given unless a comparison with a 4-year test period shows that the abnormal item in the taxable period is more than 125 percent of the average amount of the gross income of the same class during the test period.

Thus the adjustment under section 721 depends entirely on how the word "class" is construed, and at best puts an unreasonable limitation on the amount of the relief. Suppose the taxpayer has an unusual item of income for services in the current taxable year, with no taint of profiteering or of war activity. Even though attributable to another year, it cannot be shifted or adjusted if the Bureau holds, in determining the average amount of the gross income of the same class during the 4-year test period, that certain other items of income abnormally received during those test years are of the same class. Also, if the income of that class in the current taxable year is, say, $125,000 and the average amount of gross income of the same class for the test period is, say, $100,000, the corporation gets no relief whatever for the $25,000 excess. In other words, this $25,000 of income is treated in this law as if it deserved to be considered excess, when it plainly is not excess income.

(*c*) The only other provisions for the adjustment of abnormalities are those dealing with base-period income for purposes of the income credit. Any relief along this line must be found either in section 711 (b) (1) (H), (I), (J), and (K), or in section 722.

In the provision concerning abnormal deductions in section 711 (b) (1) (J) there are the same difficulties as to the application of the term "class" and the same difficulties growing out of the 125-percent figure.

Suppose a corporation had to pay a fee of $25,000 in one of the base-period years for attorneys' fees in resisting an unfounded Government claim for wind-

fall taxes. That would seem to be abnormal; but if the Government should hold that the class is attorneys' fees and the company from year to year has paid attorneys' fees averaging $20,000 a year, any relief is denied here. Furthermore, if the taxpayer is otherwise entitled to relief under section 711 (b) (1) (II), (I), or (J), he does not get the relief unless the taxpayer "establishes" that the abnormality is not due to "an increase in the gross income of the taxpayer" in its base period or a decrease in the amount of some other deduction in its base period, and is not due to "a change at any time in the type, manner of operation, size, or condition" of the business (subdivision (K) (ii)).

If the taxpayer gets by all these obstacles, it is still denied the relief by subdivision (K) (iii) unless the abnormal-deduction item in the base-period year is less than the amount of the deductions of such class for the current taxable year. That is, suppose the amount paid for attorneys' fees in defending against a windfall tax claim was $30,000, and the average for attorneys' fees in the test period was $20,000, the taxpayer might get an adjustment to the extent of $5,000, but if, because of business expansion and war conditions, its attorneys' fees in the current taxable year had been as much as $30,000, section 721 does him no good.

To make this relief depend upon the peculiar conditions of the current taxable year—presumably a year influenced by war conditions—must result in the failure of any relief, in many cases which ought to have it.

(*d*) Coming now to the long and involved section 722, entitled "Adjustment of Abnormal Base Period Net Income," we find that it covers an extremely narrow class because it does not apply at all, except to cases where the taxpayer has changed the character of the business and cases where there was interruption of operations, due to the occurrence of abnormal events. In other words, no taxpayer that did not change the character of its business before 1940 or did not interrupt its operation can look to 722 for any relief whatever.

Even the taxpayer whose abnormalities are due to one or the other of the foregoing causes gets no relief except it establish the fact showing that it is outside the following limitations:

(*a*) Genuine abnormalities, no matter how unreasonable the results, cannot be considered under section 722 if they belong to the following most frequently met with instances of abnormality: High prices of materials, labor, capital, or any other agent of production, low selling price of the product of the taxpayer or low physical volume of sale owing to low demand of such product or for the output of the taxpayer.

(*b*) Even though a taxpayer suffered abnormal losses of very large sums in the first 3 taxable years, it gets no relief at all if its excess-profits net income (as computed under sec. 722) showed a reasonably good result. That is, under section 722 (b) (4), the average base period net income under section 722 can never be adjusted to a lower point than can its last taxable year in the base period. The insertion of this limitation will prevent relief under section 722, without any logical reason at all, in a considerable number of cases.

(*c*) There is no relief at all unless the tax computed without reference to section 722 exceeds 6 percent of the taxpayer's normal tax net income for such year.

(*d*) No relief under section 722 is possible except to the extent that the application of the section would result in a diminution of the excess-profits tax otherwise payable by more than 10 percent.

The fact that a great many words in the law have been devoted to the provisions about treatment of abnormalities does not mean that the provisions are broad in their effect. On the contrary, most of the words have been devoted to cutting down the area of application. The unusual cases are the ones that are relieved, the usual ones are the ones that are left unrelieved by the existing provisions.

5. *Unwisdom of taxing normal income as if it were excess income; example.*—The Government levies taxes at very substantial rates, on normal corporate income; then, an even higher rate is imposed on such part of that income as is regarded to be excess profits.

Suppose a corporation in 1940 gets a new and vigorous management, improves its product, increases its advertising appropriation, and opens up new markets. Perhaps it even begins producing an entirely different product—as for instance, a bakery adding milk to its business. As a result of these activities it succeeds, by the year 1942, in adding a million dollars to its income. Under this law,

this $1,000,000 may be taxed just as if added income of this type constituted an excess profit. The fact is that, especially in wartime, it is important that normal business activity shall not stop, and the Government must see to it that at least some of the normal businesses have a healthy growth to take the place of those businesses which, in the natural course of affairs or by reason of war emergencies, will dry up and blow away. Under a system which divides income into two classes—one to be taxed at normal rates only, and one deserving to be taxed both at normal and at excess-profits rates—this income clearly belongs in the one-tax class.

Of the two compelling motives set out in the Ways and Means Committee report dated February 24, 1941, one purpose of the excess-profits tax was to provide additional revenue and the other was to prevent the rearmament program from furnishing an opportunity for the creation of new war millionaires or the further substantial enrichment of already wealthy persons. These motives afford no possible reason for imposing this extra, high-rate tax on profits which have nothing to do with defense or the rearmament program, which do not involve profiteering and which represent merely the fruits of good management. Yet, as the example shows, this law as it stands has the effect in certain cases of imposing the tax (in addition to the normal tax) on income which is solely due to vigorous new management.

It is true that an excess-profits tax deters people from making the kind of income which is defined as "excessive profits," but it is also true that if healthy forms of income—such as profits due to better management—are defined in this law as excess profits, then the effect of this law, as now drawn, will be to stop the healthy profits as well as the unhealthy ones.

6. *Illustration showing how an improved standard could be provided.*—In response to a suggestion made during a hearing before the Ways and Means Committee that I submit a draft illustrating how a special relief provision might be phrased so as to improve on the provisions of the 1918 and 1921 laws, and yet be more specific than section 722 of the 1940 act as it was before the amendment, I did so, and include it in this statement. Although it is based in part on suggestions received from my colleagues, it is submitted with no representation that it has anyone's approval but mine. The Bar Association does not ask for any particular wording; its recommendation goes to the necessity of some broad provision for the adjustment of excessive hardship due to abnormalities, whether of income or of capital.

DRAFT OF NEW SECTION

"*Adjustment of abnormal items affecting tax for current taxable year.*—

"(a) In the case of a corporation which establishes that the amount of its invested capital credit or its excess-profits credit, or of its excess-profits net income, for the taxable year is affected by an abnormal item or items in such manner as to increase the tax, adjustment shall be made for each abnormal item as provided in subsection (b) or (c), of this section.

"(b) If the taxpayer establishes, to the satisfaction of the Commissioner, the amount of any abnormal item as it would have been if unaffected by abnormalities, then the tax under this subchapter shall be computed by substituting for the abnormal item the normal amount so established.

"(c) If the taxpayer cannot establish the amounts under subsection (b) to the satisfaction of the Commissioner, then the Commissioner shall adjust each abnormal item to a normal amount by comparison with the experience of representative corporations whose excess-profits net income in the base period or the taxable year, or invested capital, or excess-profits credit, as the case may be, is unaffected in any substantial degree by abnormalities. The tax under this subchapter shall then be computed by substituting for the abnormal item the normal amount so established.

"(d) For the purposes of this section, comparison shall be made with corporations similarly situated, as nearly as it is possible to find them, as regards the trade or business carried on, the net sales of products or the net receipts from services furnished, the capacity for production or furnishing of service, the number of units of business transacted, and the total wages paid for the production of product or furnishing of service.

"(e) For the purposes of this section, no deviation of less than — percent from normal shall be taken account of.

"(f) (Here insert the present section 722 (e), omitting the last sentence.)"
Section 732, Internal Revenue Code, would also be amended by inserting in paragraph (a) and in paragraph (c) a reference to the new section, so that determinations in connection with the new section would be subject to the same type of review as is provided for those relating to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722.

The CHAIRMAN. Senator Taft has asked that Prof. Irving Fisher, professor emeritus of Yale University, be heard this afternoon. We haven't a full committee to hear you, but there are five or six members who will be glad to listen.

STATEMENT OF PROF. IRVING FISHER, NEW HAVEN, CONN.

Mr. FISHER. I will try to be brief. I know it is the fag end of the day. I am sorry that I have not had an appointment for which I should have applied, because there are some matters here I would like to present in more detail.

I represent no special interest; am simply a student of this subject and have spent the last 2 years very largely on studying how to reform the income tax without reference to this special defense situation today; but there is one feature, in particular, of reform as I have conceived it which I think would be of very definite benefit at this time, and which would raise a revenue of between half a billion and two-thirds of a billion dollars at the start and in increasing amounts as time went on. You can incorporate this feature either in addition to the other provisions of the act as it is before you or in substitution of any parts of it which you do not approve.

I know you are having difficulty with the excise taxes and if I had to deal with them I would cut out most of them; this would take its place, and fulfill its object better, being far less costly in administration with far more equality between persons. It is in effect a luxury tax but not in the way of excise or on specific luxury articles, but a tax on luxury spending. It is essentially the same proposal as that of Ogden Mills and Thomas Adams who worked with him on the subject. In effect, it is simply a graduated tax, progressive tax, and that part of the income which is spent, the theory being that a high income is spent on luxuries and a lower income on necessities, and if you exempt $800, or whatever the minimum exemption should be, and tax only the excess above that at 5 percent up to $5,000; 10 percent up to $10,000; 15 percent up to $15,000, and so on up to 50, you have a very simple quasispending tax, easy to administer, and merely requiring a supplemental return in addition to the present income-tax return, and a much simpler form than the present income-tax return. It is a tax which would include no tax on savings. My studies have convinced me that any tax on savings is a mistake and that it really in the end raises no revenue at all, because it kills one of the chief sources of revenue; namely, the investment made by those savings; so it would merely be a change in the present income tax, but not including that part of income which is now saved and invested.

It is astonishing when you work it out in figures how a tax on savings will kill savings and future income, and thereby kill even future revenue. For instance, take the great builders of industry. Take

Henry Ford. He is supposed to have started with a blacksmith shop in 1900, worth $1,000, and he ended with the River Rouge plant 40 years later worth $700,000,000 together with his other assets. That means that through his inventiveness and management there was an increase in the capital equipment of this company at a rate of 40 percent per annum, beginning with the $1,000 a year for 40 years, making $700,000,000. During most of that period there was no income tax—a corporation tax, but no income tax. If there had been, there couldn't have been any such River Rouge plant. There couldn't have been the automobile industry as we have it today, if we had imposed an income tax on Ford's income, and an income tax on the income of his corporation, the Ford Corporation. I am taking this not from statistics but for purposes of illustration. I use his name because he is typical of such capital increases. Instead of having $700,000,000 at the end—his plant at the end—after having paid 20 percent tax every year for 40 years, he would only have $66,000,000. In other words, that tax would have killed 90 percent of the industry, and as to the revenue, the Government has not made the difference. The Government has only $16,000,000 in tax receipts out of that 20 percent. It would have been far wiser to let that accumulate and have a fortune, at the end, of $700,000,000, which could be taxed under State and Federal inheritance-tax laws. I am in favor of very high estate and inheritance taxes. That is not what I wanted to speak about, but it is a complementary part of the tax question, so if that 20 percent could be eliminated—and we now have 20 percent in corporation taxes, including undivided profits—we would not, all the time, be killing the goose that lays the golden egg. One of the greatest difficulties is that nobody even sees this disastrous effect or calculates it, and I am sorry that when adding to the income taxes in this bill there were any savings included. I would recommend that they be left out entirely.

But if you want to add anything to the bill, or substitute, for parts you don't approve of, something very workable, I recommend this as a new feature—one extremely simple. The method of computation is not adding the spendings for food, rent, and so forth, but an indirect computation, taking the receipts, just as we do now, from salaries, commissions, and the other recompenses of labor, dividends, interest, rent, and every other income that is now received, and subtract the reinvestment. That gives you the spending with some other specific deductions that are nonspending. I have it all worked out in detail if you have time to go into it. So there is a very simple method of calculating spending. I know of no revenue measure that exceeds this in simplicity. It would add very little to what you have to deal with here, and if you put it in place of the excise taxes, for instance, which might properly be done, or in place of nine-tenths of them—reduce some of the items—you would reduce the size of this bill, at the same time reducing the cost of operation a great deal, and increasing the revenue a great deal. I think that covers it.

The CHAIRMAN. Any questions, gentlemen?

(No response.)

The CHAIRMAN. You say you have the formula for ascertaining the spending worked out?

Mr. FISHER. Yes.

The CHAIRMAN. And the suggestions of the facts on spending as you briefly described it; have you worked that out?

Mr. FISHER. Yes.

The CHAIRMAN. I think the committee would like to have it.

Mr. FISHER. Yes. I appeared before the Committee on Ways and Means and I have here what I gave them, which is somewhat longer than I gave you, but I didn't know until this morning that I was going to be here.

Senator GUFFEY. You referred to inheritance taxes awhile ago. Would you increase them to get away from these educational, charitable, church trusts, which might be designed to evade the payment of taxes?

Mr. FISHER. I would make the inheritance taxes, except for a reasonable minimum that ought to be transmitted to one's children—I would make them as heavy as the traffic would bear.

Senator GUFFEY. A case recently came to my attention where an individual died leaving an estate of $20,000,000, of which $500,000 was willed away, and the other $19,500,000 was put in educational and charitable trusts.

Mr. FISHER. I think that should be excluded, deducted; if it is a genuine philanthropy I think it should be untaxed.

Senator GUFFEY. You would exclude that entirely?

Mr. FISHER. Yes.

Senator GUFFEY. Don't you think they are occasionally designed to evade taxation?

Mr. FISHER. Yes; I think so, but if you can drive a rich man to become a philanthropist, I think you are doing a good job. What you don't want to do is to have his children and grandchildren spoiled by not wanting to work. If we are going to preserve our way of life it is essential that we not create an aristocracy such as existed in England, but I think that estate and inheritance taxes are very important. It is a tax on savings, and a saver like Henry Ford, who saves hundreds of millions, isn't doing it in order to leave it to Edsel Ford; he is simply interested in being creative, but where small savings are left for children, they ought not to be taxed.

Senator GUFFEY. You referred to it and I thought I would like to ask you about it.

The CHAIRMAN. Thank you very much.

Mr. FISHER. Here is the memorandum I have prepared for the record.

The CHAIRMAN. It will be included in the record.

(The memorandum submitted by Professor Fisher is as follows:)

As your committee is pressed for time, my statement will be confined to one recommendation only—that the new income taxes should not add to the present taxes on savings but be levied solely on spendings.

Later, when you are not so pressed for time, I would recommend a thoroughgoing reform of our present income taxes, by repealing all taxes whatsoever on savings.

By "savings" is meant any sort of capital accumulation whether of individuals, partnerships, or corporations.

These two recommendations—one for immediate adoption (namely, not to saddle savings with any new tax burdens) and the other for adoption later (namely, to take off the old tax burdens on savings)—constitute essentially the income-tax reform favored by the late Ogden L. Mills, who, in his day, was recognized as perhaps the leading American authority on taxation.

The immediate proposal is merely to place special new taxes on all personal spendings above a specified minimum exemption.

Such, for instance, as the present exemptions of $800 for single individuals and $2,000 for married couples, although I would favor lowering these a little.

For a single individual, the tax might be 5 percent on his spendings up to $5,000—that is, on whatever thereof exceeds the minimum exemption of, say, $800.

On the next $5,000, or any part thereof, i. e., up to spendings of $10,000, the tax would be, say, 10 percent.

For the next bracket up to $15,000, 15 percent.

Up to $20,000, 20 percent.

To $25,000, 25 percent.

And so on up to a maximum rate of 50 percent for the . .t $5,000 bracket (namely, $45,000 and $50,000) and beyond. Thereafter, the same 50 percent without further progression, in view of the high rates already applying to the upper brackets in our existing income-tax laws.

For married couples the bracket ranges should be doubled, that is, not $5,000 but $10,000, which is $5,000 for each of the two people.

To reckon the spendings the best way is an indirect way, not by adding up the separate spendings for food, clothing, rent, amusements, etc., but by adding up the gross receipts from all sources and then deducting certain specific items to be specified in the law. The most essential deductibles are:

All business expenses and reinvestments;

All taxes paid within the taxable years; and

Reasonable deductions for dependents.

What is left after all the deductions must necessarily be personal spendings.

A detailed schedule for thus ascertaining personal spendings is appended to this statement.

It will be seen that this proposed new tax is not merely a spendings tax but a luxury tax.

The minimum exemption and the deductions for dependents mean that there is no tax on necessities, as is involved in a sales tax. The spendings of the very poor would not be taxed at all. Only the middle class and the rich would bear the tax. Moreover, the greater the spendings—which means the more luxurious—the higher the rate.

Such a luxury tax is more truly a luxury tax than any tax which can be devised on specific "luxuries" such as costly automobiles or oriental rugs.

It is absolutely impossible to define satisfactorily a luxury as a specific object. But it is easy to specify, and with absolute definiteness, what constitutes luxurious spending and in its various gradations.

Such a tax is also one form of "incentive taxation" to use a term applied in another connection by Mr. Hazelett. For it creates an incentive for every taxpayer to spend less luxuriously. This effect is just as important in the present defense emergency as raising revenue.

Even more important than creating this incentive to cut down unnecessary spending is the incentive to save. An airplane factory should have every incentive to enlarge. But if all its earnings are taxed, including its undivided profits, plowed back in the business, this reinvestment is thereby penalized when it should be encouraged.

We should also encourage the upbuilding of our country's capital in general, as well of defense equipment in particular. Otherwise we shall impair our national capital and reduce our future national income.

Even if taxes on capital accumulation did not thus discourage and reduce that capital accumulation, the mere payment of a tax thereon automatically reduces the rate of that accumulation.

This destructive effect is far more important than is realized.

We all know that "power to tax is power to destroy," but we little realize how differently that power may be exercised. A tax on savings is many times as destructive as a tax on any other sort of income.

Moreover, a yearly tax on capital accumulation is far more destructive than a tax on the final total after the accumulator has finished his work of accumulating. At first sight the opposite might seem true, that the Government would get more revenue by taxing yearly increments than to tax the final estate created by those increments, that to tax the yearly increments is simply to tax the estate in advance and in installments. But this is not true.

It might also seem that the most revenue of all could be gotten by taxing both the estate at the end of an accumulator's life and yearly installments out of which it is built during his life. But the opposite is true.

It might also seem that the higher the tax on savings the more the revenue. But the opposite is true.

Savings on capital increases are a very peculiar and sensitive sort of income, if we choose to call them income. To tax them kills them. The consequence is, paradoxically, that the higher the tax the less the tax yields, that more can be collected out of the estate left at death than out of the installments out of which it was built and that more can be gotten by taxing the estate alone than by taxing both the estate and the installments which built it up.

All of these contentions can be substantiated mathematically. Here they will be merely illustrated by numerical examples.

Suppose at first, that the tax is 100 percent so that the whole of the savings or capital-increase is confiscated. Of course, no one would seriously propose such an extreme tax, knowing that it would put a stop to all savings and so yield no revenue at all. But such an extreme case is the clearest for beginning an exposition.

Let us also suppose that a certain man's net worth increases at the rate (before taxes) of 40 percent per year and that it does so for 40 years. This rate is high but not unprecedented.

It is said that Henry Ford became a billionaire in 40 years, from 1900 to 1940.

If there were no tax on capital increase so that the full 40 percent could be compounded for 40 years, it is true that a little blacksmith shop in 1900 worth $1,000 would become a River Rouge plant in 1940 worth $700,500,000. Halfway between, in 1921, the plant would have reached the $1,000,000 mark.

At the end of the first year, in 1901, the capital increase would be from $1,000 to $1,400, or $400. In 1921 the increase would be from $1,000,000 to $1,400,000, or $400,000. This looks as if there would be $400,000 which could be taxed in 1921.

But any tax on capital increase would prevent that $400,000 from coming into existence.

For the sake of argument let us suppose that the 100 percent tax did not deter the saver from saving. That is, we suppose that he was fool enough or saint enough to keep on each year adding 40 percent to his net worth despite the fact that the Government takes it all away from him forthwith.

In the first year he would increase his initial $1,000 to $1,400, and under a 100 percent tax, pay over to the Government the entire $400 capital increase. He would then have left $1,000, exactly what he started with. Next year the same thing would happen. He would still have only $1,000 left at the end of that year, and of every succeeding year. In the 21st year his capital increase, instead of being $400,000, will be just the usual $400. After the 40 years were up he would have the same $1,000, instead of the $700,500,000 which he would have had were there no taxes.

We see that the $700,500,000 fortune which would have come into existence were there no tax on savings has died-a-borning—died, in fact, 40 times in succession. Every time it started, the tax has destroyed it all.

But didn't the Government gain what the taxpayer lost? No; the taxpayer lost $700,499,000 and the Government gained $400 a year for 40 years, or $16,000 in all. The Government thus really lost also, for it lost the opportunity to tax an estate of $700,500,000. It had only $1,000 left to tax. For the sake of that paltry $16,000 the Government has therefore deprived itself of millions.

Worst of all, the public was deprived of the indirect benefits of that capital. It was as if the Ford plant, the General Motors plant, the Chrysler plant, and all other automobile plants had been prevented by the Government from ever coming into existence, all for the sake of collecting a total of $16,000 in taxes.

Let us now leave our impossible 100-percent example and substitute 80 percent, a rate actually approximated in the higher brackets today. Assume, as before, that every year's capital-increase is taxed separately, as it accrues.

In the first year, before taxes, the capital increase is $400. On this an 80-percent tax is $320, leaving only $80 net capital increase after taxes. This set-back to the savings has an after effect next year; for the fortune then starts at $1,080 instead of at $1,400 and clearly a 40-percent increase on $1,080 is less than 40 percent on $1,400. The second years' tax again sets back the increase and now both of these set-backs have after-effects on the third year's capital increase. The next year will feel the after effects of all 3 previous years' set-backs, and so on cumulatively. At the end of 40 years there are felt the effects of 40 successive set-backs but not all equal. The last is the least while the first is the greatest—in fact, far more than 40 times the last because of compounding.

Each year, though the fortune grows by 40 percent before the tax knocks off 32 points, the net increase is only 8 percent. The fortune thus grows not at 40-percent compound interest, as it would without the tax, but only at 8 percent. After 40 such annual set-backs, each reducing a 40-percent to an 8-percent increase and each setting back all that follows it, the final fortune is not $700,500,000 but only $21,700.

And how much did the Government get in taxes?

In the first year it collected $320, in the second $346, and so on, the collection in the last, or fortieth, year being the most—$6,437. The total through the 40 years was only $83,000. That is, the Government for the sake of getting $83,000 virtually destroyed over $700,000,000—a high administrative cost—nearly $10,000 for every $1 collected.

Let us further pursue the tax-lowering by substituting 50 percent for 80 percent. Again we find the lower of the two taxes the more profitable to the Government as it is to the taxpayer and the public.

The higher 80-percent tax would yield more in the first year, namely $320, instead of the $200 yielded by the 50-percent tax. In the second year the 80-percent rate also has the advantage, $346 instead of $240. But the advantage is not so great. Year by year the 50-percent yield creeps up on the 80-percent yield until it overtakes it in 6 years. The Government revenues under the two systems are contrasted for each of the 6 years in the following table:

Year	Government revenue under—		Year	Government revenue under—	
	80 percent	50 percent		80 percent	50 percent
1901	$320	$200	1904	$403	$346
1902	346	240	1905	436	415
1903	373	288	1906	470	497

Here it takes 6 years for the annual revenue under a 50-percent tax to overtake that under an 80-percent tax, in spite of a bad handicap at the start.

Under a 20-percent tax we find the same threefold advantage from lowering the tax rate. As to Government revenue, it is true that the 20-percent tax yields far less in the first year—only $80 as compared with $200 under a 50-percent tax. But the 20-percent revenue overtakes the 50-percent revenue in the eleventh year, when it becomes $1,284 as against $1,239.

The lower the tax rate the higher the tax yield in the end, and best results can be obtained by not taxing accumulations at all during the lifetime of an accumulator. We should only tax the accumulation on his death.

I believe in heavy estate and inheritance taxes. But if these are to bring in important revenue they must not be killed or stunted while growing, that is during the lifetime of the accumulator.

Cases as extreme as Henry Ford's are rare. But the capital equipment of America is largely the product of a relatively small number of capital creators of which he is the extreme type.

To exempt savings during life from all taxes would really pay for itself in most cases long before the death of the accumulator. For as he accumulated he would soon increase his income so much that he would spend much more. That means the Government would soon get much more than it could possibly get by taxing the savings also. The reason is that the tax on the savings kills the savings and so prevents the spendings which otherwise would follow.

The death of the accumulator usually marks the end of the rapid accumulation. From a fiscal point of view, therefore, there is usually little, if any, advantage in delaying beyond that point the taxation of savings, if savings are ever to be taxed at all; while, from a social point of view, the argument is strong to appropriate most of the accumulation. From every point of view, therefore, the death of the accumulator marks an appropriate, in fact, the only appropriate, time to tax accumulations of capital.

If we were today to repeal all our present taxes on capital increase or even merely to exempt from taxation that part of the earnings of corporations which is plowed back—the undivided profits—the result would be, in the end, not a reduction of tax revenue but a tremendous increase.

The reason and the only reason I do not recommend such a repeal at this particular time is that Congress could not be induced to make such a radical change in our tax laws without a prolonged debate. We are in a hurry, and radical reform must wait.

Some of you may wonder why I do not allege another objection, namely, that we are seeking bigger revenues now and not in the end.

This seems a big objection, but in reality it is not. For the loss in immediate revenue would be made up a hundredfold or a thousandfold in the end. Even if, in the meantime, the Government had to borrow substantially, it would be the smart thing to do. It would generate so much more income later. Why eat up our seed corn instead of planting it?

Why are we so anxious to impose heavy taxes now? The only rational answer is: "In order that we in this generation shall pay the bills of this generation and not leave so much for our successors to pay."

But that argument works just the other way. If we are trying to help the next generation we can do it most effectively by spending less and saving more now. That is precisely what would follow from putting more taxes on spendings and less on savings. Today's tax yield is not the important consideration but tomorrow's income. To tax capital accumulation is, if I may repeat, for emphasis, to kill capital accumulation—to kill the goose that lays the golden egg.

While I am forced to accept as an unfortunate fact the impossibility of suddenly so amending our tax laws as to eliminate entirely the deadly blighting tax on capital accumulation, I recommend all the more earnestly that, at this time, the mistake be avoided of adding to such taxes.

It may be pointed out that, when the time does come that your committee can take up consideration of a complete change in our income tax, the transition from the immediate emergency spendings tax as here proposed to a permanent and exclusive spendings tax can be easily made with little more legislation than to merely reduce and ultimately eliminate all the other existing taxes on income and letting the new spendings tax, which I am here proposing, remain.

Incidentally, to tax spendings as such, instead of the income as such, would, I am told by good legal authorities, circumvent the abuses of tax-exempt securities. That is, we would not ostensibly tax the income from tax-exempt bonds but would nevertheless tax all the spendings out of that income.

To some extent this benefit regarding tax-exempt securities would be felt from the adoption of the immediate recommendation, namely, to avoid adding anything to the blighting effects of taxing savings.

I know of no economic boon (except the prevention of inflation and deflation) as great as that which our people could enjoy, both rich and poor, from removing the stunting influence of taxes on capital accumulation. Moreover, removal would tend to prevent the inflation now threatening us.

APPENDIX

SCHEDULE FOR SPENDINGS-TAX RETURN

[For a given taxable year: To be filled out by taxpayer, reporting all cash yields (from work, "Investments, etc.," and cash balance]

1. Net cash receipts from salaries, wages, fees, commission.
2. Net cash receipts from private business or profession, partnership, syndicates, pools.
3. Dividends.
4. Rents and royalties.
5. Interest received, less interest paid (this may be either plus or minus).
6. Repayments of money which had been lent to others less any new loans made to others (may be either plus or minus).
7. Borrowings from others less any repayments to others[1] (either plus or minus).
8. All cash received from sales of investments, less all cash paid out in purchase of investments and less all brokerage and other expenses incidental to said transactions (plus or minus).
9. Cash from windfalls—gifts, bonuses, bequests, etc.
10. Net cash from any other sources (specify).

[1] But when these repayments to others consist of paying off a mortgage on a dwelling or other consumer-good the repayments may, for simplicity, be treated simply as spendings.

11. Total net cash yield from "Investments, etc." (sum of lines 2–10).
12. Cash on hand at beginning of year.
13. Cash on hand at end of year.
14. Net cash yield from cash balance (line 12 less line 13) (plus or minus).

Summary

15. From work (line 1 repeated).
16. From "Investments, etc." (line 11 repeated).
17. Drawn (net) from cash balance (line 14 repeated).
18. Total net cash yield from all sources (sum of lines 15, 16, 17) subject to the deductions below.

Deductions (of outgo)[2] *to be specifically authorized by law*

19. Payments, made within the taxable year, of all taxes.
20. Payments of insurance premiums for business purposes and of all life-insurance premiums.
21. Costs of medical, nursing, surgical, and dental care.
22. Funeral expenses; birth expenses.
23. Fines, forfeitures, penalties, and payments for damages.
24. Gifts and contributions subject to specific legal limitations.
25. Legally specified part of expenses for dependents.
26. Any other deductions authorized by law.
27. Total of such deductions (sum of lines 19–26).
28. Taxable spendings (line 18 less line 27).

(Whereupon, at 4 p. m., the committee adjourned until 10 a. m., Friday, August 15, 1941.)

[2] No deductions of income are here recommended other than minimum exemptions.

REVENUE ACT OF 1941

FRIDAY, AUGUST 15, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

I expected Senator McCarran around, who wished to be heard, but he is not here now.

The first witness on this list is Mr. Briggs, of St. Paul, Minn.

STATEMENT OF CHARLES W. BRIGGS, ST. PAUL, MINN., OF BRIGGS, GILBERT & MACARTNEY

The CHAIRMAN. This is Mr. Charles W. Briggs?

Mr. BRIGGS. Yes, sir, Mr. Chairman.

The CHAIRMAN. Mr. Briggs, you have a printed brief?

Mr. BRIGGS. Yes; I have a printed statement which I would like to have printed in the record in full.

The CHAIRMAN. Yes.

Mr. BRIGGS. But I would like very briefly to touch a few of the high spots and call attention to some of the salient features of this memorandum, which is not very long in and of itself, Mr. Chairman.

The CHAIRMAN. Well, sir, your brief will be entered in the record, and we will appreciate it if you will indicate the position that you are taking in the matters that you are discussing.

You are appearing here as an attorney?

Mr. BRIGGS. I am appearing here as an attorney, as a member of the firm of Briggs, Gilbert & Macartney, which firm is in general practice in the city of St. Paul; but I represent various clients who are interested in the subject matter of this memorandum.

The CHAIRMAN. Yes, sir.

Mr. BRIGGS. Now, I should like to read a few of the salient portions of the memorandum so that the members of the committee may know what I am driving at.

This memorandum has to do with the so-called surtax on personal holding companies.

Now, in representing in a legal capacity certain personal holding companies we have encountered a very great hardship and inequity resulting to many of these companies by reason of the imposition of the so-called surtax on their undistributed subchapter A net income.

The definition of a personal holding company is one coined by a statute, as many other conceptions in the revenue act are coined.

We shall refer more specifically to this definition later on in this memorandum.

Briefly, such a company is one more than 50 percent in value of whose stock is owned by not more than five individuals and 70 percent of whose taxable income is of a restricted nature.

It is a closely held corporation and not of the type that excited so much interest and adverse criticism a few years ago.

We cannot help but feel that the Congress never intended the imposition of this surtax to work the way it does. It is a rather curious thing and arises by reason of the combined effect of several provisions of the revenue act, to which we shall call attention.

We firmly believe that the Treasury Department concedes the existence of the hardship and inequity which is the subject of this memorandum and is prepared to recommend corrective amendments when requested to do so.

We took this matter up with the Ways and Means Committee of the House, but that committee did not have before it any recommendations of the Treasury Department.

Inasmuch as the surtax on personal holding companies is to remain in the law—it is left there by House bill 5417 and made permanent by section 109 thereof—the inequity as a substantive matter of taxation should be removed by appropriate provisions in the bill ultimately to be enacted into law.

I might say here that the matter we are considering now is not an administrative matter; it is a matter that concerns the vital sections of the tax law.

Senator CONNALLY. You realize, of course, that the purpose of that act was to reach a certain situation.

Mr. BRIGGS. I realize that, Senator.

Senator CONNALLY. Naturally it is complicated in some cases. Probably in some cases it will work a hardship in order to fix these meshes so as to catch some of the fish.

Mr. BRIGGS. The trouble is that the meshes are so fixed that the fish are entirely annihilated.

Now, what I am calling attention to is to see if we can devise something that works. We feel that it works without any justification in a case that I will call to the attention of the committee.

Senator CONNALLY. It is a measure which the administration could use to differentiate between the concerns who adopted this device for tax avoidance and those who adopted it with bona fide intent, so that it would be a simple problem.

Mr. BRIGGS. The differentiation is not there. The innocent fall with the guilty, Senator.

Later on I shall call attention to three alternatives—that is, alternative proposals—by either one of which we think that this inequity could be remedied; and I think the one you are talking about could be adequately remedied by preference No. 2, and I will briefly call attention to that a little later on, Senator.

Senator CONNALLY. Pardon me for the interruption.

Mr. BRIGGS. Now, we come to the example that I put on page 2.

In order at the outset to focus attention upon the drastic nature and effect of this surtax on personal holding companies we should like to give an example of its workings: Suppose a personal holding company has current earnings in the tax year of $25,000, no capital gains and no prior accumulated earnings, and has capital losses of $30,000. Suppose it distributes $25,000 to its stockholders.

Under the subchapter A, net income surtax provisions, this personal holding company is allowed to deduct only $2,000 of its capital losses for the purpose of computing the surtax in question, which subchapter A, net income, arbitrarily determined by the act, would be $23,000 under section 500 (a) of the Revenue Code.

This personal holding company would pay as a surtax 65 percent of the first $2,000 of this $23,000, 75 percent of the remaining $21,000, plus the defense tax of 10 percent, or a total tax thus computed of $18,755.

This imposition would amount to an aggregate percentage of over 80 percent.

The ordinary corporation, not one defined as a personal holding company, in a similar situation with respect to current earnings and capital losses, would pay no tax whatsoever. See section 117 (d).

The ordinary corporation is allowed to deduct, under that section, all long-term capital losses and all short-term capital losses which do not exceed short-term capital gains.

The curious and harsh result to the personal holding company arises by reason of the fact that it cannot deduct from current earnings more than $2,000 of its capital losses in computing its subchapter A, net income, because of the provisions of section 505 (d) of the revenue act and because of the further fact that it cannot obtain or be allowed any dividends-paid credit in computing its undistributed subchapter A, net income, under section 504 of this act.

I am still referring back to the result that would flow from the example that I put.

Therefore, the burdensome surtax rates are applied to this so-called undistributed income when the personal holding company had no income to distribute. Its capital losses were more than its current earnings. Even though it distributed all its current earnings, a surtax would nevertheless be imposed. The company is in a helpless position.

Senator CONNALLY. That is just some hypothetical case.

Mr. BRIGGS. These are cases that have come to us. We have had several of these cases already.

The CHAIRMAN. They are regular cases, but you have to take into consideration the whole policy of your tax legislation during the period of years was to eliminate the holding companies—put them out of business.

Mr. BRIGGS. I realize that, but I think that elimination process ought to be lightened some at the present time, Mr. Chairman, because in the particular instance that I am putting to the attention of this committee—that is, where the personal holding company has capital losses which entirely wipe out its normal income—it is a special situation.

The CHAIRMAN. I appreciate that. I think there was a very great inconsistency on the part of the Treasury and on the part of the Government that we would propose to put out of business a form of organization which in some respects could be justified and in some respects and in some instances is justified.

Mr. BRIGGS. Yes.

The CHAIRMAN. And then did not make it possible for dissolution of the company and distribution of assets under any fair or reasonable formula.

Mr. BRIGGS. Yes; I think there are many of the personal holding companies, Senator, which ought not to be choked off, that serve a useful purpose.

The CHAIRMAN. I can agree with you, but then the effect of the legislation was practically to eliminate them or to make it very difficult for them to go along. Then, I think, in all absolute fairness, we should have made it possible for them to distribute assets and dissolve the holding companies.

We did that very begrudgingly.

Mr. BRIGGS. I think, however, Mr. Chairman, that the public purpose or the purpose to be served by the legislation to which the chairman is calling attention can be subserved and still remove this inequity from the law, and I have suggested later on three alternative methods by which I think that could be done so that the public interest could be protected and at the same time this very harsh inequity removed in the case that I put.

This unusual exaction becomes all the more an unjust penalty when the company suffers capital losses involuntarily.

One such case is where a corporation whose stock is held by a personal holding company not in control of that corporation liquidates and causes a capital loss to that personal holding company.

Such a loss would arise where the personal holding company's base for the stock was higher than the amount realized by the personal holding company as a result of the liquidation of the corporation above referred to. Another such case is where a personal holding company suffers capital losses by reason of securities held by it becoming worthless for reasons entirely beyond its control. See section 23 (g) (2).

I should like briefly to call attention to the sections that are involved in connection with this inequity about which I am speaking:

Sections of Internal Revenue Code involved.—It might be helpful to skeletonize certain sections of the Internal Revenue Code which create the inequity we are considering.

In order to arrive at the undistributed subchapter A net income of a personal holding company we start with the ordinary net income of the corporation computed in accordance with sections 22 and 23 and other applicable provisions of the Revenue Act.

Firstly, the subchapter A net income is computed.

Section 505 of the Internal Revenue Code provides as follows:

> For the purposes of this subchapter the term "subchapter A net income" means the net income with the following adjustments:
>
> (a) Additional deductions allowed:
>
> (1) Federal income, war profits, and excess-profits taxes paid or accrued during the taxable year * * *.
>
> (2) Certain contributions as defined.
>
> (3) In the case of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a decedent, amounts paid in liquidation of any liability of the corporation based on the liability of the decedent to make contributions or gifts * * *.
>
> (b) Deduction for rent is not allowed in certain instances.
>
> (c) Deduction for net operating losses provided in section 23 (s) is disallowed.
>
> (d) *Capital losses.*—The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall

be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

The above paragraph (d) is the one with which we are vitally concerned here, as its effect is to deny to the personal holding company, in the example given, the right to deduct more than $2,000 for the purpose of computing the surtax on its undistributed subchapter A net income.

Secondly, we compute the undistributed subchapter A net income, which is the amount to which the rates under section 500 (a) are applied in the manner above set forth.

Section 504 of the Internal Revenue Code provides:

For the purposes of this subchapter the term "undistributed subchapter A net income" means the subchapter A net income (as defined in sec. 505) minus—

(a) The amount of the dividends-paid credit provided in section 27 (a) * * *.

(b) Amounts used or irrevocably set aside to pay or retire an indebtedness incurred prior to January 1, 1934, if such amounts are reasonable. * * *

(c) Dividends paid after the close of the taxable year and before the 15th day of the third month following the close of the taxable year if claimed under this subsection in the return but only to the extent to which such dividends are includible for the purposes of chapter I in the computation of the basic surtax credit for the year of distribution.

Thirdly, as required by the provisions of section 504 (a) it will be seen that in the computation of the surtax we are concerned with the dividends-paid-credit provisions and in turn the consent-dividends-credit provisions of the Internal Revenue Code.

Section 26 provides:

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing taxes—* * *

(c) Dividends-paid credit.

For corporation dividends-paid credit, see section 27.

(f) Consent-dividends credit.

For corporation consent-dividends credit, see section 28.

Section 27 provides:

(a) As used in this chapter with respect to any taxable year the term "dividends-paid credit" means the sum of:

(1) The basic surtax credit for such year computed as provided in subsection (b). * * *

(b) As used in this chapter the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent-dividends credit provided in section 28. * * *

(i) If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

That is the reason the corporation in the example which I put, after it had distributed its $25,000, was entitled to no basic surtax credit because it had no income to distribute, the capital losses having wiped out all its current earnings.

Now we turn to section 28 of the revenue act. This has to do with consent distributions.

Section 28 provides:

(a) * * *

(4) The term "consent distribution" means the distribution which would have been made if on the consent-dividends day (as defined in par. (3)) there had actually been distributed in cash and received by each shareholder making

a consent filed by the corporation under subsection (d) the specific amount stated in such consent.

Paragraph (c), which immediately follows, is very significant and very pertinent to the proposition we are discussing. I will read this paragraph (c):

(c) There shall be allowed to the corporation as part of its basic surtax credit for the taxable year a consent-dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d),"—

Notice this language:

as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and such shareholder making such consent had received on the consent day the amount specified in the consent.

The effect of that language is that even though they distributed $25,000, you see, that would not have been a taxable dividend and therefore they cannot get a consent-dividend credit, because if they distributed the $25,000 they could not get any dividends-paid credit, so we are shut out under that section.

Thus it will be seen that as a result of the application of the foregoing provisions the personal holding company in the example we have heretofore given could not obtain any dividends-paid credit because the capital losses having wiped out the current earnings, a distribution to the stockholders would not be a taxable dividend to the stockholders.

Furthermore, the personal holding company in the example given could not obtain any credit under the consent-dividends-paid-credit provisions.

On page 7 I call attention to the definition of a personal holding company. I think that you will see that this is sort of a specialized type of animal, this personal holding company with which we are dealing.

Definition of personal holding company.—The term "personal holding company" is an arbitrary conception—with respect to any taxable year.

By section 501, it means any corporation at least 80 percent of whose gross income for the taxable year is personal-holding-company income with respect to any taxable year beginning after December 31, 1936, and 70 percent of whose taxable income for any year thereafter is personal-holding-company income and more than 50 percent in value of whose outstanding stock is owned directly or indirectly by or for not more than five individuals.

The term "personal holding company," however, does not include a bank, life-insurance company, a surety company, or a foreign personal holding company, or a licensed personal-finance company.

With reference to individuals, I might say that families are grouped together, that is, lineal descendants, ancestors, wives, brothers, sisters, spouses are all grouped together as a family group, so that when an individual of that group owns stock and the other individuals own stock they are all grouped together for the purpose of this act and called one individual.

I think you understand that provision.

Senator CONNALLY. That helps them, if they counted each one of them it would be much more strict.

Mr. BRIGGS. Yes; I just want to call attention to the manner of ascertaining the five individuals.

The term "personal-holding-company income" means the portion of the gross income which consists of dividends, interest, royalties, annuities, except in the case of regular dealers in stocks or securities, gains from the sale or exchange of stock or securities, rents, mineral, oil, or gas royalties, in certain instances, and certain other types of income defined by statute.

I might say that this paragraph does not define the type of income to which the rates are applied, this is the type of income which is called personal-holding-company income, which determines whether or not the company is a personal holding company within the provisions of the act.

On page 8 I have alluded to the history of this act.

History and background of provisions.—The history and background of the provisions with which we are dealing are as follows:

A good many years ago, in order to discourage the accumulation of earnings by corporations, Congress imposed surtaxes on corporations improperly accumulating surpluses. The Revenue Act of 1934 retained the surtax on corporations improperly accumulating surpluses but in addition it imposed new surtaxes on personal-holding companies by way of what is called surtaxes on undistributed subchapter A net income. This act also limited the deductibility of capital losses incurred and allowed a deduction not to exceed $2,000 for net-capital losses.

This limitation was evidently designed to prevent taxpayers offsetting depression losses against taxable income. This $2,000 limitation applied to all taxpayers, corporations, personal-holding companies, and individuals.

The 1936 Revenue Act continued the $2,000 limitation on capital losses which could be deducted by all taxpayers.

The 1938 Revenue Act removed this limitation as to individuals but continued it as to corporations, including personal-holding companies, so that they could, under this act, still deduct only $2,000 of capital losses. This act applied to 1938 and 1939 returns.

The 1939 Revenue Act amended the Internal Revenue Code in many particulars effective and applicable for the 1940 calendar year. Section 117, which has to do with capital gains and losses, paragraph (d), was amended to read as follows:

(d) *Limitation on capital losses.*—Long-term capital losses shall be allowed but short-term capital losses shall be allowed only to the extent of short-term capital gains.

This paragraph (d), applied in computing the net income of corporations and individuals for the purposes of normal income taxes, is applicable to personal-holding companies. But paragraph (d) was added to section 505, the effect of which is to disallow all capital losses in excess of $2,000 plus capital gains, in computing the surtax on the undistributed subchapter A net income, as previously pointed out.

Typical and actual cases of inequity.—The effect of the statutory provisions hereinabove considered and referred to have been considered by us in our office in several cases. The following are typical. Amounts are assumed.

1. In one case the personal-holding company had borrowed up to the limit on its marketable assets. It had to have money to pay the

operating expenses of the corporation. It had some stock which was unpledged and which could be sold at a considerable loss but on which not enough money could have been borrowed to pay the operating expenses. Therefore the corporation sold this asset at a considerable loss. The following figures are assumed. The corporation had a net income under the provisions of the code of $15,000. It had a capital loss of $50,000. It could take only $2,000 of that loss, which left a subchapter A net income of $13,000.

It had no earnings or profits accumulated since March 1, 1913. In computing its subchapter A net income it was allowed to deduct only the $2,000, but in determining whether or not the corporation had any earnings or profits for the year the total capital loss of $50,000 was deducted, leaving a net loss of $35,000. The corporation therefore had no current earnings or profits to distribute. The corporation had a pre-March 1, 1913, surplus, and it did in fact distribute more than its subchapter A net income. This distribution, however, was not a dividend, and no dividends-paid credit was allowed. There were no other deductions from the subchapter A net income, so that net income became the statutory undistributed subchapter A net income, on which a tax of $9,350 was assessed.

The above therefore was a case where the corporation was obliged by the circumstances to incur a capital loss which it would not have voluntarily incurred otherwise.

2. In another case the taxpayer—a personal holding company—held stock in another corporation. It did not have the controlling interest in such other corporation. The other corporation liquidated, and, because of the high basis of the stock in that corporation held by taxpayer, and the small value of the distribution received on liquidation, the taxpayer sustained a substantial capital loss which more than wiped out its earnings and profits for the current year. It had no accumulated earnings and profits.

Here again the capital loss was allowed only to the extent of $2,000 in figuring the subchapter A net income; the taxpayer had no earnings or profits to distribute and so could not get a consent-dividends credit; and there was no other deduction to be made from the subchapter A net income. Therefore, the subchapter A net income became the undistributed subchapter A net income, on which the surtax was assessed.

The above was a case where the corporation had a capital loss forced upon it. This corporation also distributed much more than its entire income for the year.

3. The same situation has arisen where a corporation has an impairment of capital at the start of the year. It makes its profit during the year but so much of the profit as is necessary to restore the capital impairment is treated as having been put back into the capital structure of the corporation and only the balance is treated as earnings and profits available for distribution.

This in turn cuts the dividends-paid credit to the excess of the earnings and profits over the impairment of capital and although the corporation paid out more than its income for the year the court held that only a part of that payment was a dividend.

Alternative methods of curing inequity.—We submit that the hardship and inequity should be eliminated and we submit three alterna-

tive methods or formulas, in the order of our preference, by which the elimination could be accomplished:

First preference.—Amend section 505 by striking therefrom paragraph (d).

The effect of this amendment would be to allow personal holding companies long-term capital losses in full and short-term capital losses to the extent of short-term capital gains as deductions in computing the surtax on the undistributed subchapter A net income.

Senator CONNALLY. Let me ask you there, in the case of capital losses, would it be possible, under that provision, for the company to choose what year to take those losses?

Mr. BRIGGS. I think it would.

Senator CONNALLY. In other words, if the taxes were high, they would take them, and when the taxes were low, they would not take them?

Mr. BRIGGS. I think it would be a possibility of exercising a choice there.

Senator CONNALLY. The statistics of the Treasury show that is the habit. Naturally, it is all right, as long as they can do it under the law. They withhold taking losses until rates get pretty high, and then they all at once discover that they ought to take these losses.

Mr. BRIGGS. If it is a rather precarious change, I have a better proposal which would suit us all right.

Second preference.—Section 23 (g) (1) reads as follows:

> Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

We propose that section 117 (d) be amended to read as follows:

> Long-term capital losses shall be allowed, but short-term capital losses shall be allowed only to the extent of short-term capital gains, except in the case of a personal holding company, as defined in section 501 (a), capital losses shall be allowed only to the extent of $2,000 plus capital gains.

Section 505 (d) provides:

> The net income shall be computed without regard to section 117 (d) and (e) and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

The effect of that would be in the case that I put, the personal holding company, while it really did not have any income at all, yet, for the purpose of these sections, it would have a net income. In other words, it would have to pay the normal corporation tax which, in the case of a corporation having more than $25,000 earnings, would be 30 percent, and then upon that would be superimposed the defense tax of 10 percent, and then the corporation surtax of 6 percent, so you get a tax of around 35 percent. That would be a special penalty which would be imposed upon a personal holding company, and the ordinary corporation in a similar situation would not pay any tax at all.

We propose, in connection with the above amendment of section 117 (d) that the above-quoted paragraph (d) of section 505 be stricken out, and that a new paragraph (a) (4) be added to section 505, to read as follows:

> The amount of capital losses not allowed as a deduction under section 117 (d).

The effect of these amendments proposed under this second preference would be a penalty to a personal holding company by requiring

it to pay a normal corporation income tax without any deduction for capital losses of more than $2,000, plus the gains from sales or exchanges of capital assets; but in the computation of the surtax on the undistributed subchapter a net income," the personal holding company would be allowed to deduct all capital losses not allowed as a deduction under section 117 (d) (amended as proposed).

Third preference.—We propose that subsection (i) of section 27 be amended so as to read as follows:

> Except for the purpose of computing the undistributed subchapter A net income of a personal holding company, if any part of a distribution (including stock dividends and stock rights, is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

And we further propose that section 28 be amended by adding a subsection, as follows:

> For the purpose of computing the undistributed subchapter A net income of a personal holding company the basic surtax credit shall include amounts distributed to shareholders either from earnings or profits accumulated after February 28, 1913, or from any other source, provided that each shareholder of the corporation includes such distributions in his income-tax return for the year in question, as taxable income; and shall also include a consent-dividend credit equal to the total sum agreed to be included in the gross income of the shareholders by their consents filed under subsection (d) of section 28.

The effect of the amendments proposed under this third preference would be to give the personal holding company a consent-dividends credit in computing its "undistributed subchapter A net income" where distributions are made to its stockholders and where a sum is agreed to be included in gross earnings of the shareholders by their consent.

Senator CONNALLY. Your theory being, since the purpose of the act is to make them distribute dividends, that when they do distribute them, they ought to be free from tax?

Mr. BRIGGS. I think so. And that is the hardship that we think is caused unjustifiably by the provisions to which we have called attention.

Efforts to have inequity eliminated.—We have, on numerous occasions, taken this matter up with the Treasury Department, with the Legislative Counsel of that Department and with the office of the General Counsel of the Bureau of Internal Revenue. We understand that other representatives of personal holding companies have likewise taken this matter up. We have been assured by the Treasury Department, by its legislative counsel, and by its General Counsel for the Bureau of Internal Revenue, that the inequity of which we are now complaining is recognized, and the same should be remedied. We submitted the matter to the Ways and Means Committee of the House. We understand that the Treasury Department is prepared to submit recommendations as to how the inequity should be eliminated, but we have not yet had access to such recommendations.

We also considered this matter with the conference committee legal staff.

Schedule 1.—Certain sections of Internal Revenue Code. "Personal holding company income" as defined in the act does not enter into the computation of taxable income of a personal holding company (the tax being computed on the "undistributed subchapter A net income"), but is purely a test to determine whether 80 percent of a corporation's

gross income is of such a nature as to bring it within the classification of a personal holding company.

In order to arrive at the "undistributed subchapter A net income," we start with the ordinary taxable net income of the corporation.

The "subchapter A net income" is determined as follows:

SEC. 505 (Internal Revenue Code). For the purposes of this subchapter the term "Subchapter A net income" means the net inocome with the following adjustments:

(a) *Additional deductions.*—There shall be allowed as deductions—

(1) Federal income, war profits, and excess-profits taxes paid or accrued during the taxable year to the extent not alowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

(2) In lieu of the deduction allowed by section 23 (q), contributions or gifts, payment of which is made within the taxable year to or for the use of donees prescribed in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 percent of the taxpayer's net income, computed without the benefit of this paragraph and section 23 (q) and without the deduction of the amount disallowed under subsection (b) of this section.

(3) In the case of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a decedent, amounts paid in liquidation of any liability of the corporation based on the liability of the decedent to make contributions or gifts to or for the use of donees described in section 23 (o) for the purposes therein specified, to the extent such liability of the decedent existed prior to January 1, 1934. No deduction shall be allowed under paragraph (2) of this subsection for a taxable year for which a deduction is allowed under this paragraph.

(b) *Deductions not allowed.*—The aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Commissioner with the approval of the Secretary) to the satisfaction of the Commissioner:

(1) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(c) *Net loss carry-over disallowed.*—The deduction for net operating losses provided in section 23 (s) shall not be allowed.

(d) *Capital losses.*—The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

The "Undistributed subchapter A net income" is determined as follows:

SEC. 504 (Internal Revenue Code). For the purposes of this subchapter the term "undistributed subchapter A net income" means the subchapter A net income (as defined in section 505) minus—

(a) The amount of the dividends-paid credit provided in section 27 (a) without the benefit of paragraphs (3) and (4) thereof (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations); but, in the computation of the dividends-paid credit for the purposes of this subchapter, the amount allowed under subsection (c) of this section or of section 405 of the Revenue Act of 1938 in the computation of the tax under this subchapter or under title 1A of the Revenue Act of 1938 for any preceding taxable year beginning after December 31, 1937, shall be considered as a dividend paid in such preceding taxable year and not in the year of distribution, and in the computation of the dividend carry-over for the purposes of this subchapter, the term "adjusted net income" as used in section

27 (c) means the adjusted net income minus the deduction allowed for Federal taxes under section 505 (a) (1):

(b) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness;

(c) Dividends paid after the close of the taxable year and before the 15th day of the third month following the close of the taxable year, is claimed under this subsection in the return, but only to the extent to which such dividends are includable for the purposes of chapter 1, in the computation of the basic surtax credit for the year of distribution; but the amount allowed under this subsection shall not exceed either:

(1) The accumulated earnings and profits as of the close of the taxable year; or

(2) The undistributed subchapter A net income for the taxable year computed without regard to this subsection; or—

(3) 10 percent of the sum of—

(A) The dividends paid during the taxable year (reduced by the amount allowed under this subsection in the computation of the tax under this subchapter for the taxable year preceding the taxable year or, in the case of a taxable year beginning in 1939, by the amount allowed under section 405 (c) of the Revenue Act of 1938 in the computation of the tax under title 1A of such act for a taxable year beginning prior to January 1, 1939); and

(B) The consent-dividends credit for the taxable year.

The "dividends-paid credit" is determined as follows:

SEC. 27 (Internal Revenue Code). (a) *Definition in general.*—As used in this chapter with respect to any taxable year the term "dividends-paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

(2) The dividend carry-over to such year, computed as provided in subsection (c);

(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1939), exceeds the amount of the credit provided in section 26 (c) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); and

(4) Amounts used or irrevocably set aside to pay or retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness.

As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest. A renewal (however evidenced) of an indebtedness shall be considered an indebtedness.

The basic surtax credit is determined as follows:

SEC. 27 (Internal Revenue Code). * * * (b) *Basic surtax credit.*—As used in this chapter the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent-dividends credit provided in section 28 and reduced by the amount of the credit provided in section 26 (a) relating to interest on certain obligations of the United States and Government corporations:

(2) The net-operating-loss credit provided in section 26 (c) (1).

(3) The bank-affiliate credit provided in section 26 (d).

The aggregate of the amounts under paragraphs (2) and (3) shall not exceed the adjusted net income for the taxable year.

Section 27 (i), however, provides as follows:

SEC. 27 (Internal Revenue Code). * * * (i) *Nontaxable distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxa-

tion under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

The consent-dividends credit is defined as follows:

SEC. 28 (Internal Revenue Code). (a) *Definitions.*—As used in this section—

(4) *Consent distribution.*—The term "consent distribution" means the distribution which would have been made if on the consent dividends day (as defined in paragraph (3)) there had actually been distributed in cash and received by each shareholder making a consent filed by the corporation under subsection (d), the specific amount stated in such consent.

* * * * * * *

SEC. 28 (Internal Revenue Code). * * * (c) *Allowance of credit.*—There shall be allowed to the corporation, as a part of its basic surtax credit for the taxable year, a consent dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d) as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and each shareholder making such a consent had received, on the consent dividends day, the amount specified in the consent.

Now while this is a rather complicated subject, I hope that, in a measure, the committee has understood me and this inequity we sincerely believe should be removed.

The CHAIRMAN. Thank you very much.

Mr. BRIGGS. I thank the committee for your kind attention.

(The complete memorandum by Mr. Briggs is as follows:)

MEMORANDUM CONCERNING INEQUITABLE PROVISIONS OF THE REVENUE ACT IMPOSING A SURTAX ON PERSONAL HOLDING COMPANIES

By CHARLES W. BRIGGS, of St. Paul, Minn.

To the Honorable Walter F. George, chairman, and to the members of the Finance Committee, United States Senate:

I am a member of a firm of lawyers practicing in St. Paul, Minn.

In representing, in a legal capacity, certain personal holding companies, we have encountered a very great hardship and inequity resulting to many of these companies by reason of the imposition of the so-called surtax on their "undistributed subchapter A, net income." The definition of a personal holding company is one coined by a statute, as many other conceptions in the revenue act are coined. We shall refer more specifically to this definition later on in this memorandum. Briefly, such a company is one, more than 50 percent in value of whose stock is owned by not more than five individuals, and 70 percent of whose taxable income is of a restricted nature. It is a closely held corporation and not of the type that excited so much interest and adverse criticism a few years ago.

We cannot help but feel that the Congress never intended the imposition of this surtax to work the way it does. It is a rather curious thing, and arises by reason of the combined effect of several provisions of the revenue act, to which we shall call attention. We firmly believe that the Treasury Department concedes the existence of the hardship and inequity which is the subject of this memorandum, and is prepared to recommend corrective amendments when requested to do so. We took this matter up with the Ways and Means Committee of the House, but that committee did not have before it any recommendations of the Treasury Department.

Inasmuch as the surtax on personal holding companies is to remain in the law (it is left there by House bill 5417 and made permanent by Sec. 109 thereof), the inequity as a substantive matter of taxation should be removed by appropriate provisions in the bill ultimately to be enacted into law.

Example.—In order, at the outset, to focus attention upon the drastic nature and effect of this surtax on personal holding companies, we should like to give an example of its workings:

Suppose a personal holding company has current earnings in the tax year of $25,000, no capital gains and no prior accumulated earnings, and has capital losses of $30,000. Suppose it distributes $25,000 to its stockholders.

Under the "Subchapter A, net income" surtax provisions, this personal holding company is allowed to deduct only $2,000 of its capital losses for the purpose of computing the surtax in question, which "subchapter A, net income," arbitrarily determined by the act, would be $23,000 under section 500 (a) of the revenue code. This personal holding company would pay as a surtax 65 percent of the first $2,000 of this $23,000, 75 percent of the remaining $21,000, plus the defense tax of 10 percent, or a total tax thus computed of $18,755. This imposition would amount to an aggregate percentage of over 80 percent.

The ordinary corporation—not one defined as a personal holding company—in a similar situation with respect to current earnings and capital losses, would pay no tax whatsoever. (See sec. 117 (d).) The ordinary corporation is allowed to deduct under that section all long-term capital losses and all short-term capital losses which do not exceed short-term capital gains.

The curious and harsh result to the personal holding company arises by reason of the fact that it cannot deduct from current earnings more than $2,000 of its capital losses in computing its "subchapter A net income," because of the provisions of section 505 (d) of the revenue act, and because of the further fact that it cannot obtain or be allowed any "dividends paid credit" in computing its "undistributed subchapter A net income" under section 504 of this act.

Therefore, the burdensome surtax rates are applied to this so-called undistributed income when the personal holding company had no income to distribute. Its capital losses were more than its current earnings. Even though it distributed all its current earnings, a surtax would nevertheless be imposed. The company is in a helpless position.

This unusual exaction becomes all the more an unjust penalty when the company suffers capital losses involuntarily. One such case is where a corporation, whose stock is held by a personal holding company not in control of that corporation, liquidates and causes a capital loss to that personal holding company. Such a loss would arise where the personal holding company's base for the stock was higher than the amount realized by the personal holding company as a result of the liquidation of the corporation above referred to. Another such case is where a personal holding company suffers capital losses by reason of securities held by it becoming worthless for reasons entirely beyond its control. (See sec. 23 (g) (2).)

Sections of Internal Revenue Code involved.—It might be helpful to skeletonize certain sections of the Internal Revenue Code which create the inequity we are considering.

In order to arrive at the "undistributed subchapter A net income" of a personal holding company, we start with the ordinary net income of the corporation, computed in accordance with sections 22 and 23 and other applicable provisions of the Revenue Act.

Firstly, the "subchapter A net income" is computed.

Section 505 of the Internal Revenue Code provides as follows:

"For the purposes of this subchapter, the term 'subchapter A net income' means the net income with the following adjustments:

"(a) *Additional deductions allowed.*—(1) Federal income, war profits, and excess-profits taxes paid or accrued during the taxable year * * *.

"(2) Certain contributions as defined.

"(3) In the case of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a decedent, amounts paid in liquidation of any liability of the corporation, based on the liability of the decedent to make contributions or gifts * * *.

"(b) Deduction for rent is not allowed in certain instances.

"(c) Deduction for net operating losses provided in section 23 (s) is disallowed.

"(d) *Capital losses.*—The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The above paragraph (d) is the one with which we are vitally concerned here, as its effect is to deny to the personal holding company, in the example given, the right to deduct more than $2,000 for the purpose of computing the surtax on its "undistributed subchapter A net income."

Secondly, we compute the "undistributed subchapter A net income," which is the amount to which the rates under section 500 (a) are applied in the manner above set forth.

Section 504 of the Internal Revenue Code provides:

"For the purposes of this subchapter, the term "undistributed subchapter A net income means the subchapter A net income (as defined in sec. 505), minus—

"(a) The amount of the dividends paid credit provided in section 27 (a) * * *.

"(b) Amounts used or irrevocably set aside to pay or retire an indebtedness incurred prior to January 1, 1934, if such amounts are reasonable * * *.

"(c) Dividends paid after the close of the taxable year, and before the 15th day of the third month following the close of the taxable year, if claimed under this subsection in the return, but only to the extent to which such dividends are includable for the purposes of chapter I in the computation of the basic surtax credit for the year of distribution."

Thirdly, as required by the provisions of section 504 (a), it will be seen that, in the computation of the surtax, we are concerned with the dividends-paid credit provisions, and, in turn, the consent-dividends credit provisions of the Internal Revenue Code.

Section 26 provides:

"In the case of a corporation, the following credits shall be allowed to the extent provided in the various sections imposing taxes—

* * * * * * *

"(e) *Dividends-paid credit.*—For corporation dividends-paid credit, see section 27.

"(f) *Consent-dividends credit.*—For corporation consent-dividends credit, see section 28."

Section 27 provides:

"(a) As used in this chapter with respect to any taxable year, the term 'dividends-paid credit' means the sum of:

"(1) The basic surtax credit for such year computed as provided in subsection (b).

* * * * * * *

"(b) As used in this chapter, the term 'basic surtax credit' means the sum of:

"(1) The dividends paid during the taxable year, increased by the consent-dividends credit provided in section 28. * * *

* * * * * * *

"(i) If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit."

Section 28 provides:

"(a) * * *

"(4) The term 'consent distribution' means the distribution which would have been made if on the consent-dividends day (as defined in paragraph (3)), there had actually been distributed in cash and received by each shareholder making a consent filed by the corporation under subsection (d), the specific amount stated in such consent.

* * * * * * *

"(c) There shall be allowed to the corporation as part of its basic surtax credit for the taxable year a consent-dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d), as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and such shareholder making such a consent had received on the consent day the amount specified in the consent."

Thus, it will be seen that, as a result of the application of the foregoing provisions, the personal holding company in the example we have heretofore given, could not obtain any dividends paid credit, because the capital losses having wiped out the current earnings, a distribution to the stockholders would not be a taxable dividend to the stockholders.

Furthermore, the personal holding company in the example given could not obtain any credit under the consent dividends paid credit provisions.

Definition of personal holding company.—The term "personal holding company" is an arbitrary conception.

By section 501, it means any corporation at least 80 percent of whose gross income for the taxable year is personal-holding-company income with respect to any taxable year beginning after December 31, 1936, and 70 percent of whose

taxable income for any year thereafter is personal-holding-company income, and more than 50 percent in value of whose outstanding stock is owned directly or indirectly by or for not more than five individuals. The term "personal holding company," however, does not include a bank, life insurance company, a surety company, or a foreign personal holding company, or a licensed personal finance company.

The term "personal holding company income" means the portion of the gross income which consists of dividends, interest, royalties, annuities, except in the case of regular dealers in stocks or securities, gains from the sale or exchange of stock or securities, rents, mineral, oil, or gas royalties, in certain instances, and certain other types of income defined by statute.

History and background of provisions.—The history and background of the provisions with which we are dealing are as follows:

A good many years ago, in order to discourage the accumulation of earnings by corporations, Congress imposed surtaxes on corporations improperly accumulating surpluses.

The Revenue Act of 1934 retained the surtax on corporations improperly accumulating surpluses, but in addition it imposed new surtaxes on personal holding companies by way of what is called surtaxes on "undistributed subchapter A net income." This act also limited the deductibility of capital losses incurred, and allowed a deduction not to exceed $2,000 for net capital losses. This limitation was evidently designed to prevent taxpayers offsetting depression losses against taxable income. This $2,000 limitation applied to all taxpayers, corporations, personal holding companies, and individuals.

The 1936 Revenue Act continued the $2,000 limitation on capital losses which could be deducted by all taxpayers.

The 1938 Revenue Act removed this limitation as to individuals, but continued it as to corporations, including personal holding companies, so that they could, under this act, still deduct only $2,000 of capital losses. This act applied to 1938 and 1939 returns.

The 1939 Revenue Act amended the Internal Revenue Code in many particulars, effective and applicable for the 1940 calendar year. Section 117, which has to do with capital gains and losses, paragraph (d) was amended to read as follows:

"(d) *Limitation on capital losses.*—Long-term capital losses shall be allowed, but short-term capital losses shall be allowed only to the extent of short-term capital gains."

This paragraph (d), applied in computing the net income of corporations and individuals for the purposes of normal income taxes, is applicable to personal holding companies. But paragraph (d) was added to section 505, the effect of which is to disallow all capital losses in excess of $2,000 plus capital gains, in computing the surtax on the "undistributed subchapter A net income," as previously pointed out.

Typical and actual cases of inequality.—The effect of the statutory provisions hereinabove considered and referred to have been considered by us in our office in several cases. The following are typical (amounts are assumed):

1. In one case, the personal holding company had borrowed up to the limit on its marketable assets. It had to have money to pay the operating expenses of the corporation. It had some stock which was unpledged and which could be sold at a considerable loss but on which not enough money could have been borrowed to pay the operating expenses. Therefore the corporation sold this asset at a considerable loss. The following figures are assumed. The corporation had a net income under the provisions of the code of $15,000. It had a capital loss of $50,000. It could take only $2,000 of that loss which left a "subchapter A net income" of $13,000. It had no earnings or profits accumulated since March 1, 1913. In computing its "subchapter A net income," it was allowed to deduct only the $2,000, but in determining whether or not the corporation had any earnings or profits for the year, the total capital loss of $50,000 was deducted leaving a net loss of $35,000. The corporation therefore had no current earnings or profits to distribute. The corporation had a pre-March 1, 1913, surplus and it did in fact distribute more than its "subchapter A net income." This distribution, however, was not a dividend, and no "dividends paid credit" was allowed. There were no other deductions from the "subchapter A net income," and so that net income became the statutory "undistributed subchapter A net income" on which a tax of $9,350 was assessed.

The above therefore was a case where the corporation was obliged by the circumstances to incur a capital loss which it would not have voluntarily incurred otherwise.

2. In another case the taxpayer, a personal holding company, held stock in another corporation. It did not have the controlling interest in such other corporation. The other corporation liquidated, and because of the high basis of the stock in that corporation held by taxpayer, and the small value of the distribution received on liquidation, the taxpayer sustained a substantial capital loss which more than wiped out its earnings and profits for the current year. It had no accumulated earnings and profits. Here again, the capital loss was allowed only to the extent of $2,000 in figuring the "subchapter A net income"; the taxpayer had no earnings or profits to distribute and so could not get a "consent dividends credit"; and there was no other deduction to be made from the "subchapter A net income." Therefore, the "subchapter A net income" became the "undistributed subchapter A net income" on which the surtax was assessed.

The above was a case where the corporation had a capital loss forced upon it. This corporation also distributed much more than its entire income for the year.

3. The same situation has arisen where a corporation has an impairment of capital at the start of the year. It makes its profit during the year, but so much of the profit as is necessary to restore the capital impairment is treated as having been put back into the capital structure of the corporation, and only the balance is treated as earnings and profits available for distribution.

This, in turn, cuts the "dividends paid credit" to the excess of the earnings and profits over the impairment of capital, and although the corporation paid out more than its income for the year, the court held that only a part of that payment was a dividend.

Alternative methods of curing inequity.—We submit that the hardship and inequity should be eliminated, and we submit three alternative methods or formulas, in the order of our preference, by which the elimination could be accomplished:

First preference.—Amend section 505 by striking therefrom paragraph (d). The effect of this amendment would be to allow personal holding companies long-term capital losses in full and short-term capital losses to the extent of short-term capital gains as deductions in computing the surtax on the "undistributed subchapter A net income."

Second preference.—Section 23 (g) (1) reads as follows:

"Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117."

We propose that section 117 (d) be amended to read as follows:

"Long-term capital losses shall be allowed, but short-term capital losses shall be allowed only to the extent of short-term capital gains, except in the case of a personal holding company, as defined in section 501 (a), capital losses shall be allowed only to the extent of $2,000 plus capital gains."

Section 505 (d) provides:

"The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

We propose, in connection with the above amendment of section 117 (d), that the above-quoted paragraph (d) of section 505 be stricken out, and that a new paragraph (a) (4) be added to section 505, to read as follows:

"The amount of capital losses not allowed as a deduction under section 117 (d)."

The effect of these amendments proposed under this second preference would be a penalty to a personal holding company by requiring it to pay a normal corporation income tax without any deduction for capital losses of more than $2,000, plus the gains from sales or exchanges of capital assets; but in the computation of the surtax on the "undistributed subchapter A net income," the personal holding company would be allowed to deduct all capital losses not allowed as a deduction under section 117 (d) (amended as proposed).

Third preference.—We propose that subsection (1) of section 27 be amended so as to read as follows:

"Except for the purpose of computing the undistributed subchapter A net income of a personal holding company, if any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of

such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit."

And we further propose that section 28 be amended by adding a subsection as follows:

"For the purpose of computing the undistributed subchapter A net income of a personal holding company, the basic surtax credit shall include amounts distributed to shareholders either from earnings or profits accumulated after February 28, 1913, or from any other source, provided that each shareholder of the corporation includes such distributions in his income-tax return for the year in question as taxable income; and shall also include a consent dividends credit equal to the total sum agreed to be included in the gross income of the shareholders by their consents filed under subsection (d) of section 28."

The effect of the amendments proposed under this third preference would be to give the personal holding company a consent dividends credit in computing its "Undistributed subchapter A net income," where distributions are made to its stockholders.

Efforts to have inequality eliminated.—We have, on numerous occasions, taken this matter up with the Treasury Department, with the legislative counsel of that Department, and with the office of the general counsel of the Bureau of Internal Revenue. We understand that other representatives of personal holding companies have likewise taken this matter up. We have been assured by the Treasury Department, by its legislative counsel, and by its general counsel for the Bureau of Internal Revenue, that the inequity of which we are now complaining is recognized, and that the same should be remedied. We submitted the matter to the Ways and Means Committee of the House. We understand that the Treasury Department is prepared to submit recommendations as to how the inequity should be eliminated, but we have not yet had access to such recommendations.

BRIGGS, GILBERT & MACCARTNEY,
Attorneys at Law,
By CHAS. W. BRIGGS.

Attached is schedule 1, containing verbatim copies of certain pertinent sections of the Internal Revenue Code.

SCHEDULE 1.—*Certain sections of Internal Revenue Code*

"Personal holding company income" as defined in the act does not enter into the computation of taxable income of a personal holding company (the tax being computed on the "undistributed subchapter A net income") but is purely a test to determine whether 80 percent of a corporation's gross income is of such nature as to bring it within the classification of a personal holding company.

In order to arrive at the "undistributed subchapter A net income" we start with the ordinarily taxable net income of the corporation.

The "subchapter A net income" is determined as follows:

"SEC. 505 (Internal Revenue Code). For the purposes of this subchapter the term 'subchapter A net income' means the net income with the following adjustments:

"(a) *Additional deductions.*—There shall be allowed as deductions—

"(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

"(2) In lieu of the deduction allowed by section 23 (q), contributions or gifts, payment of which is made within the taxable year to or for the use of donees described in section 23 (q) for the purposes therein specified, to an amount which does not exceed 15 percentum of the taxpayer's net income, computed without the benefit of this paragraph and section 23 (q), and without the deduction of the amount disallowed under subsection (b) of this section.

"(3) In the case of a corporation organized prior to January 1, 1936, to take over the assets and liabilities of the estate of a decedent, amounts paid in liquidation of any liability of the corporation based on the liability of the decedent to make contributions or gifts to or for the use of donees described in section 23 (o) for the purposes therein specified, to the extent such liability of the decedent existed prior to January 1, 1934. No deduction shall be allowed under paragraph (2) of this subsection for a taxable year for which a deduction is allowed under this paragraph.

"(b) *Deductions not allowed.*—The aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Commissioner with the approval of the Secretary) to the satisfaction of the Commissioner:

"(1) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

"(2) That the property was held in the course of a business carried on bona fide for profit; and

"(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

"(c) *Net loss carry-over disallowed.*—The deduction for net operating losses provided in section 23 (s) shall not be allowed.

"(d) *Capital losses.*—The net income shall be computed without regard to section 117 (d) and (e), and losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The "undistributed subchapter A net income" is determined as follows:

"SEC. 504 (Internal Revenue Code). For the purposes of this subchapter the term 'undistributed subchapter A net income' means the subchapter A net income (as defined in section 505) minus—

"(a) The amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraphs (3) and (4) thereof (computed without its reduction, under section 27 (b) (1), by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations); but, in the computation of the dividends paid credit for the purposes of this subchapter, the amount allowed under subsection (c) of this section or of section 405 of the Revenue Act of 1938 in the computation of the tax under this subchapter or under Title 1A of the Revenue Act of 1938 for any preceding taxable year beginning after December 31, 1937, shall be considered as a dividend paid in such preceeding taxable year and not in the year of distribution, and, in the computation of the dividend carry-over for the purposes of this subchapter, the term 'adjusted net income' as used in section 27 (c) means the adjusted net income minus the deduction allowed for Federal taxes under section 505 (a) (1):

"(b) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness;

"(c) Dividends paid after the close of the taxable year and before the 15th day of the third month following the close of the taxable year, if claimed under this subsection in the return, but only to the extent to which such dividends are includible, for the purposes of chapter 1, in the computation of the basic surtax credit for the year of distribution; but the amount allowed under this subsection shall not exceed either:

"(1) The accumulated earnings and profits as of the close of the taxable years; or

"(2) The undistributed subchapter A net income for the taxable year computed without regard to this subsection; or

"(3) 10 per centum of the sum of—

"(A) The dividends paid during the taxable year (reduced by the amount allowed under this subsection in the computation of the tax under this subchapter for the taxable year preceding the taxable year or, in the case of a taxable year beginning in 1939, by the amount allowed under section 405 (c) of the Revenue Act of 1938 in the computation of the tax under title 1A of such act for a taxable year beginning prior to January 1, 1939); and

"(B) The consent dividends credit for the taxable year."

The "dividends paid credit" is determined as follows:

"SEC. 27 (Internal Revenue Code). (a) *Definition in general.*—As used in this chapter with respect to any taxable year the term 'dividends paid credit' means the sum of:

"(1) The basic surtax credit for such year, computed as provided in subsection (b);

"(2) The dividend carry-over to such year, computed as provided in subsection (c);

"(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1939), exceeds the amount of the credit provided in section 26 (c) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); and

"(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term 'indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest. A renewal (however evidenced) of an indebtedness shall be considered an indebtedness."

The "basic surtax credit" is determined as follows:

"SEC. 27 (Internal Revenue Code) * * * (b) *Basic surtax credit.*—As used in this chapter the term 'basic surtax credit' means the sum of:

"(1) The dividends paid during the taxable year, increased by the consent-dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations:

"(2) The net operating loss credit provided in section 26 (c) (1):

"(3) The bank affiliate credit provided in section 26 (d).

The aggregate of the amounts under paragraphs (2) and (3) shall not exceed the adjusted net income for the taxable year."

Section 27 (i), however, provides as follows:

"SEC. 27 (Internal Revenue Code) * * * (i) *Nontaxable distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit."

The "consent-dividends credit" is defined as follows:

"SEC. 28 (Internal Revenue Code). (a) *Definitions.*—As used in this section—

* * * * * * *

"(4) *Consent distribution.*—The term 'consent distribution' means the distribution which would have been made if, on the consent-dividends day (as defined in paragraph (3)), there has actually been distributed in cash and received by each shareholder making a consent, filed by the corporation under subsection (d), the specific amount stated in such consent."

* * * * * * *

"SEC. 28 (Internal Revenue Code) * * * (c) *Allowance of credit.*—There shall be allowed to the corporation, as a part of its basic surtax credit for the taxable year, a consent-dividends credit equal to such portion of the total sum agreed to be included in the gross income of shareholders by their consents filed under subsection (d) as it would have been entitled to include in computing its basic surtax credit if actual distribution of an amount equal to such total sum had been made in cash and each shareholder making such a consent had received, on the consent-dividends day, the amount specified in the consent."

The CHAIRMAN. Mr. A. W. Clapp, of Tacoma, Wash.

STATEMENT OF A. W. CLAPP, TACOMA, WASH., VICE PRESIDENT, WEYERHAEUSER TIMBER CO.

Mr. CLAPP. Mr. Chairman, and members of the committee. I have a statement. I do not intend to read it except in certain instances.

I would like to have it included in the record, if I may.

The CHAIRMAN. Yes, sir; we will be glad to have you include it in the record.

Mr. CLAPP. I am the vice president and general counsel of Weyerhaeuser Timber Co., a lumber company operating on the west coast. In making this appearance before the committee, I also represent some other companies, mostly lumber companies which are more or less related to each other.

We have no disposition to object to the substantial tax increases contemplated by the pending bill. It is not my purpose to discuss rates as such or the amounts to be raised from various sources, from individuals, from corporations, or by so-called excise taxes.

The subjects that I wish to discuss are only provisions that we think are inconsistent with what we conceive to be the true principles of taxation or those which inflict unjustifiable and unnecessary discriminations or hardships.

The first subject is the special 10-percent excess-profits tax imposed under the special rule proposed in section 201 of the pending bill. That was the subject covered by Judge Fletcher, representing the railroads, a few days ago; and I think possibly you gentlemen have heard objections to that particular tax from other taxpayers, and will.

To state it shortly, a proposal to tax the difference between the income, the average earnings of a corporation in the test years, and its invested-capital credit.

It applies only to corporations who use the invested-capital credit.

Now, in the present law, in the excess-profits-tax law of 1940, there are two methods of computing your excess-profits credit. We agree that there should be those two methods.

The policy of allowing the average-earnings credit was based upon the belief of Congress that it was unfair to tax income or any earnings beyond those earnings which, you might say, normally, in the test years, the corporation had made. Congress might have stopped with the provision for the average-earnings method.

That average-earnings method, however, was and still is the more controversial of the two methods; but Congress did not stop with providing the average-earnings method.

It did provide, because it knew there were some corporations, there were very many corporations, which in the test years may have had no profits, or may have had very few profits, that until the corporation had earned in the current year a certain percentage upon its invested capital, which was 8 percent in the original law, it should not pay excess-profits taxes because it would not be considered to have excess profits.

As I say, we believe that there should be the two methods of computing the excess profits granted. What we do object to, and we do object most strenuously, is to be asked to pay a 10-percent tax really as a penalty upon our failure to earn in the test years 8 or 7 percent upon our invested capital. To tax the difference between nothing, in many thousands of cases, or 1 or 2 or 3 percent, on your invested capital, and 8 or 7 percent is wholly illogical and inconsistent with the permitted invested-capital method.

We are given with one hand this invested-capital method, the right to earn 7 or 8 percent upon our invested capital, and with the other hand it is wholly or partly taken away from us.

Senator CONNALLY. Are you referring to the defense tax of 10 percent?

Mr. CLAPP. No; I am referring to the special tax in this bill, which is now in section 201 of this bill under what they call a special rule.

Senator CONNALLY. I see.

Mr. CLAPP. Now, this proposed 10-percent tax will affect and penalize practically all railroads, I am sure 99 percent of all lumber companies, practically all coal companies, a large majority of mining companies, to name only some of the classes of industry. It will not only affect and penalize them but it will penalize any corporation which, for any reason, had, in the test years, less than 7- or 8-percent earnings upon its invested capital. There are thousands—there must be thousands and thousands—of retail stores, department stores, all kinds of businesses, whether large or small, whether they are participating either directly or indirectly or not at all in what we call the defense program.

Because I represent lumber companies I would like to give you some statistics which will indicate the effect of this 10-percent tax on the Douglas-fir industry. The Douglas-fir industry is in the western part of Washington and Oregon. They produce approximately 30 percent of all the softwood lumber that is produced in the United States.

The general statements I will make are based upon statistics contained in a publication called the Douglas Fir Industry, a study undertaken by Dr. Dexter M. Keezer for the Bureau of Research and Statistics of the Advisory Commission of the Council of National Defense.

On pages 25 to 41, inclusive, he discusses the financial history of the industry, of the Douglas-fir industry. It clearly appears—and I have given the citations of the document in my statement—that for the industry as a whole the total earnings of the industry were such that the total average earnings of the base years, counting a heavy-loss year, 1938, as zero, could not have exceeded $4,500,000 upon a total apparent invested capital as of 1937—capital, surplus, and 50 percent of borrowed capital—of approximately $292,000,000, or an average of 1.54 percent.

I am sorry to say, after my statement was prepared I found that whereas in the statement of earnings there were included some 414 companies, in the statement of their capitalization were included only 391, so it is probable that this average of 1.54 percent is too small.

There are, of course, high-cost and low-cost, well-managed and poorly managed companies. It is a moral certainty that of the hundreds of companies whose financial histories were analyzed by Dr. Keezer, a very large majority of them had no earnings in any of the base years excepting possibly 1937 and would have no average earnings or practically none.

In other words, they would have to pay 10 percent on their earnings of this year even though they earned only 4 or 5 percent.

These statistics they have given you are general statistics. I can and will give you the results of particular companies that I know of and represent.

These are four lumber companies in the Douglas-fir region, those that I read, that are well-managed and are among the lower cost operations.

One had average earnings in the test period amounting to 2.25 percent of invested capital and another 2.05 percent, another approximately 4 percent, and the fourth, 8.21 percent.

This last company is a comparatively small company, operating in a very fine quality of timber with exceptionally favorable operating conditions.

Judge Fletcher said the other day that there were only several—I do not know whether he said three or four—of the railroad companies in the United States which could use the average-earnings method. Now, here is one company, and it is my judgment, I am quite sure, that it may be the only lumber company in the Douglas-fir region that can elect to compute its excess-profits tax under the capital-earnings method.

In other words, it would be the only company that would not be subject to this 10-percent tax.

Earnings in the Douglas-fir industry in 1940 were greatly improved, though few companies, and none of the four I have referred to, earned enough to pay an excess-profits tax.

Present prospects for 1941 are that many lumber companies will earn enough to pay the graduated excess-profits tax. Those which I represent and, I am sure, all in the Douglas-fir industry are willing to pay the tax on all earnings over the 8- or 7-percent credit, willing to pay, along with our more fortunate brothers who use the average-earnings credit, whatever rate the Congress finds necessary to collect from corporations; but we do object most emphatically to paying a tax on earnings which are not excessive by any standard.

Of the four I have mentioned two will pay a very substantial graduated excess-profits tax.

Senator CONNALLY. On the invested-capital method?

Mr. CLAPP. Yes; on the invested-capital method.

Senator CONNALLY. All right.

Mr. CLAPP. Of course, we can only guess what the remainder of the year will be, but on computations we make at present one will pay over $4,000,000 of the graduated excess-profits tax.

I do not want you gentlemen to think that we are trying to get out of anything, out of paying the excess-profits tax; it is not that. We are not arguing as to what the rates on excess-profits tax shall be; we are willing, and I am sure that all of the lumber industry is willing, to pay our share of excess-profits taxes.

Senator WALSH. Is that $4,000,000 estimated on the taxes under the present law?

Mr. CLAPP. I should have said it is estimated on the House bill, and, of course, we have had to estimate what our earnings will be; but, as nearly as I can figure it, it will be over $4,000,000.

Senator WALSH. Have you estimated what it would be under the present law, assuming there is no change?

Mr. CLAPP. It probably would be around—we did not estimate it but we imagine it would be around $2,000,000. You see, there is really a 10-percent increase in the rate and then, instead of getting 8 percent on invested capital, we get somewhat less than 8 percent because some of our invested capital is in the 7-percent class.

Our next proposition is that the graduation of rates should be based not on dollar amounts of adjusted excess profits but largely upon the percentage which those profits bear to the excess-profits credit.

Mr. Sullivan, of the Treasury Department, in his second appearance before the Ways and Means Committee, recommended that. Of course, in his second appearance he recommended an excess-profits tax based upon invested capital and without the average-earnings method, and he proposed that the rate of tax be based upon the percentage which the company in the current year made on its invested capital. That was the 1918 excess-profits-tax law.

Well, whether you have one method or two, what we say is that the rates of tax should be based upon the extent to which the profits are excessive. If a corporation, with the average-earnings method, makes 200 percent or 300 percent of its average earnings, it should pay a higher rate of tax than the corporation with the same adjusted excess-profits income but whose increase in its earnings and whose excessive earnings are only 9 or 10 percent.

As it is at present, the corporation that only increases its earnings 9 or 10 percent will pay, in certain brackets, more than the corporation which has made two or three times as much as its previous earnings.

At the bottom of page 5 of my statement I have given an illustrative schedule as to how rate brackets might be constructed.

In doing that I have assumed—I do not know that it is necessary to assume—that Congress might continue to favor the smaller companies, so that the schedule that I have is constructed on the principle of making the lower rates apply on the dollar amounts of adjusted excess profits; but when you get into the higher amounts they are adjusted on the basis of the percentage which you adjusted excess profits bear to your excess-profits credit, which, in the case of the average-earnings method, is the average earnings in the test years.

Senator CONNALLY. You mean by that if a company made an average over the 4 years of $100.000 and now makes $200,000 that that extra $100,000 ought to be the basis of the tax?

Mr. CLAPP. We will take two companies, each one of which made $100,000 in the base years.

Senator CONNALLY. Yes.

Mr. CLAPP. Now, in the current year one of them makes $200,000.

Senator CONNALLY. Yes.

Mr. CLAPP. And the other makes $110,000.

Senator CONNALLY. Yes.

Mr. CLAPP. In the higher brackets, at least, the company which has only increased slightly should pay a lesser rate of tax.

Senator CONNALLY. That is what I was getting at.

Mr. CLAPP. Yes.

Senator CONNALLY. You figure the one that makes $200,000 is making 200 percent compared to what it made during the base period and therefore it ought to bear a heavier rate than the company that only makes 10 or 15 or 25 percent more; is that your theory?

Mr. CLAPP. Yes. That was the theory of the 1918 excess-profits-tax law and it was, as I said, recommended by Mr. Sullivan in his second appearance before the Ways and Means Committee.

I have an illustrative schedule, starting at the bottom of page 563, which will illustrate what I mean. Of course, we cannot suggest what the rates of these brackets shall be; they will have to be fixed and the brackets themselves will have to be fixed by experts so that the Congress may receive as much revenue as it desires from the excess-profits tax.

The CHAIRMAN. What you wish for is a percentage rather than a flat dollar?

Mr. CLAPP. Yes. At least when you get beyond $50,000 or $25,000. I do not know that it is necessary to have any exemption from the percentage rate for even the small corporation, if it doubles its earnings and another one just the same size and with the same record in the test years has only a 10-percent increase, why, in that case, even as between the small ones I think that the rates should be different.

The CHAIRMAN. The rate is different. It is broken down now on the dollar basis.

Mr. CLAPP. That is true, up to $500,000.

The CHAIRMAN. But the theory of our excess-profits tax, Mr. Clapp, is simply this, that when you get above the credit, whatever your credit is, everything is excess profits, and by breaking it up on a dollar-bracket basis you do aid the smaller corporations, you do assist them; that is the theory, whether you would agree with it or not.

Mr. CLAPP. In my proposal you find that I have, up to the point where the adjusted excess profits reach $50,000, based it upon the dollar in order to take care of the small fellow.

I do not think you need go beyond that in this kind of a plan.

The CHAIRMAN. The Senate agreed with you on that point when we passed the excess-profits tax but in conference we were not able to prevail against the House, so we have this other system now; and that is the theory of it.

Once you have had full benefit of your credits, whether you are on the average-earnings basis or whether you are on the invested-capital basis, anything above that in the way of earnings is excess profits, and without regard to the percentage involved you simply break it up in taxes, so much up to $25,000, so much after $25,000, and, in this bill, 60 percent after $500,000.

Mr. CLAPP. I understand, of course, the position that the Senate took. I think it was correct.

It is just as simple to base your rates upon percentages to your excess-profits credit as it is to base them upon dollars.

The CHAIRMAN. Just the other view, though, prevailed.

Mr. CLAPP. What I am making is a plea that the other view now be discarded and that we start on the right principle. The real principle, it seems to me——

Senator VANDENBERG. You just want the Senate to revert to its own wisdom?

Mr. CLAPP. Exactly, Senator Vandenberg. I have given an illustration of two rather large companies. That is on page 6.

Each of the companies makes an adjusted excess-profits income of $2,200,000. Of course, I am not interested in any such corporation as corporation B, which is a pretty large corporation, but you will notice that on the same excess-profits income the same tax is paid by each corporation, although one of them has earned 22 percent on its invested capital and the other one only 7.75 percent.

Senator CONNALLY. You mean they paid the same rate?

Mr. CLAPP. Yes; paid the same tax.

Senator CONNALLY. Is that right?

Mr. CLAPP. Yes, sir.

The first one has made 300 percent, if it is on the average-earnings basis, of its average earnings; and the second one has made only 109 percent. In other words, it has increased only 9 percent.

The first one may be profiteering; the second one, the fluctuation of its income may be only a normal fluctuation. I say that first corporation should pay a higher rate of tax than the other corporation.

Now, of course, the other corporation, corporation B in this example, is a very large corporation; it has enough money to pay the tax so it may be said, "Well, it has got that big income; it can afford to pay the tax."

I hope that the Congress is not going to allow the mere bigness of corporations to affect it in prescribing corporation rates. I think Congress has gone far enough in differentiating the corporations who have an income under $25,000 from those who have over that, and the reason that Congress has not, in fact, placed a graduated surtax upon corporations is, I assume, the well-known fact that it is the stockholder of the corporation who bears the corporation tax, not the corporation; the corporation hasn't anything; the crporation pays it but it is the stockholder who bears it. In my statement I have given some statistics which may or may not be appropriate, contained in Monograph 29, compiled as of December 31, 1937, in Investigation of Concentration of Economic Power, the Temporary National Economic Committee.

Now, from that it appears that in the 200 largest nonfinancial corporations of the country there were 948,000,000, in round figures, shares of equity stock. These were held in 7,026,793 shareholdings which averaged only 135 shares per holding.

In these same 200 corporations there were 6,189,709 shareholdings each of 100 shares or less. The shares so held were 167,144,000, or an average of 27 plus shares per holding.

The average market value of each one of these holdings averaging 27 plus shares was $931 plus.

Of the total of 7,026,000 shareholdings in the same 200 corporations, 6,689,000, or 95.2 percent, had a market value of less than $10,000 each; and the average annual income from holdings of $10,000 would probably be not over $600.

Now, it is apparent that these smaller shareholdings are those of individuals in the lower and lower-middle income brackets. I know of no statistics with reference to the size of average shareholdings in corporations smaller than the 200 largest nonfinancial corporations that I have referred to but I think it can be said with confidence that there is no such proportion of small shareholdings of the size mentioned in medium-sized or even smaller corporations. The fact is that many millions of our people, desiring to invest part of their money in equity stocks, naturally go to the stock market to buy and, quite as naturally, invest in the better-known stocks.

Of the 200 corporations referred to above, the common stocks of all but 21 are listed on a national exchange.

I wonder if I could be excused for just a moment and resume in just an instant?

The CHAIRMAN. Certainly.

Senator DANAHER. Mr. Chairman, before you take up something else I would like to ask a question which somebody here perhaps can answer. I think it is pertinent and it will fill in this interim.

The CHAIRMAN. Yes, Senator.

Senator DANAHER. Is there anybody representing the Treasury who can explain why they should permit deduction of interest paid on a deficiency for an open year and deny the deduction of interest paid on a deficiency for a closed year?

Mr. RAY. Senator, that sounds to me like a special point and I would like to take that under consideration and prepare a reply in answer to Senator Danaher.

The CHAIRMAN. If you will, furnish that to Senator Danaher. Get his exact question and furnish him that information.

Senator DANAHER. It relates to what will be brought up presently anyhow. I thought perhaps if we had the explanation of the Treasury in the meantime we could follow more intelligently what is coming.

Mr. CLAPP. May I proceed?

The CHAIRMAN. Yes; Mr. Clapp.

Mr. CLAPP. The third proposition relates to the allowance of deduction, in computing excess-profits income as well as net income for normal and proposed surtax, of interest paid on adjustments made under section 734 of the Internal Revenue Code.

A few days ago, I think it was Tuesday, a gentleman from Boston, Mr. Blodgett, appeared and discussed section 734, its administration, and its effect. I am not going into a discussion of section 734 except with respect to one point.

Now, that section provides, in effect, that if a taxpayer, in computing its excess-profits-tax liability, takes a position inconsistent with that taken in an income return in a prior year which is not open, so that a deficiency may be assessed, it must, nevertheless, in making its excess-profits return, adjust the return of the prior year to make it consistent with the position taken in the current year, and add to its excess-profits tax any additional income shown for the prior year, with interest at the rate of 6 percent per annum.

Now, a good illustration is this: My company in 1927 sold to another wholly unrelated company a large block of timber under an installment contract. In 1933, in the depths of the depression, my company had to cancel the contract and take the timber back.

The timber had been sold on an installment contract. At that time the Commissioner had certain regulations with reference to the computation of profit or loss upon the cancelation of an installment contract, and we meticulously followed that regulation, and followed it because we felt it was in consonance with the law.

Just within about 2 years the courts have decided that the Commissioner was entirely wrong in the regulation, that the regulation did not conform with the law, and the courts laid down the correct rule for ascertaining the income or the profit to be accounted for by the cancelation of an installment contract.

Well, under the rule as laid down by the courts, we had understated income in making our 1933 return. Although we had followed the regulations of the Commissioner, we had understated the profit on the taking of that timber by considerably over $1,000,000.

If we had known what the correct rule was, if we had had the courts' decision at that time, we could have included it in our income for 1933 and paid the taxes on it. I might say that the Commissioner accepted that decision and changed his regulations.

But, of course, the year 1933 was closed; the Commissioner had no right to make any deficiency assessment.

Now, in computing our invested capital for 1940 we want to include that $1,000,000 or more profit as profits, of course; it was profits according to the true rule and it is a part of our earnings and profits and therefore a part of invested capital.

But when we do that we have to go back and figure what our tax would have been in 1933, what we should have paid in 1933, and any deficiency that we did not pay we have to add to our excess-profits tax, together with interest at the rate of 6 percent from the time when we should have paid, in 1933 or 1934.

Now to that we do not object. It is fair that if we want to have the advantage of an invested capital on that profit which we did make in 1933, we could go back and pay the tax which we should have paid in 1933, together with interest.

We have no objection to that. But under the law as it is drawn, the way in which it is drawn, and I think perhaps it is inadvertent, we cannot figure out that there is for us any deduction of the interest that we paid.

Now, of course, we are not entitled to deduct this back tax that we paid, but in all other cases where there are deficiencies the law provides that we may deduct the interest from our income for the current year; or if there is a refund, we must add the interest.

Universally, so far as I know, that has always been the rule on deficiencies.

Now, that is all this is. Although it is a calculation, it is not called a deficiency; it is a calculation of what we should have paid in that prior year, which is closed. To that we add the interest; and the whole we add to our excess-profits-tax assessment.

We think we should be entitled, as we always have been in the cases of deficiencies, to a deduction for interest; not for all back taxes, but for the interest that we paid.

The principle of section 734 with respect to income-tax returns has been in the law as section 3801 of the Internal Revenue Code for, I think, 3 years. In other words, as applied to income-tax returns, if you take a position which is inconsistent with that you took in prior returns you must go back or the Commissioner can go back—he can go back, however, only to 1932—and assess a deficiency for whatever the tax might appear if you had maintained the same position in that prior year that you now wish to make it. So in that case it simply is a case of the assessment of a deficiency and you pay that deficiency and you pay interest, but you have a deduction for the interest that you pay, and even under section 734 it applies only to closed years. In other words, if the position which we now take is inconsistent with the position which we took in 1938 or 1939 this section does not, of itself, apply; the Commissioner there has the right to, and he does, go back and assess you the additional income tax, and you pay the interest and you have a deduction for the interest.

The CHAIRMAN. That is the point of your complaint, is it?

Mr. CLAPP. That is the point of my complaint. We want a deduction for that interest that we paid; and that is the only point we complain of.

The CHAIRMAN. On the face of it, it looks like your complaint is very well founded. I think the Treasury ought to make a special note of that——

Mr. RAY. Yes, Senator George.

The CHAIRMAN. And see how that may be remedied.

Mr. RAY. The Treasury is considering this particular section with respect to that point and a number of other points. It is a very specialized problem, and we will look into it, sir.

The CHAIRMAN. Yes.

Senator DANAHER. Mr. Chairman, in that case he need not write me particularly and specifically, because that is the very point I had in my question. I think he is right.

Mr. CLAPP. Just one word with respect to the capital-stock tax.

Judge Fletcher said the other day—this is the capital-stock tax and has nothing to do with the excise tax. We have no objection or, at least, are not going to object to the increase in the rate; but, as Judge Fletcher pointed out the other day, this capital-stock-tax law, together with the accompanying excess—what they call the declared-value excess-profits taxes—were deliberately drawn so as to force the taxpayer to declare enough and pay on a value for his capital stock so he would not be liable for the declared-value excess-profits tax.

Now, in normal times, and usually, the rule has been that you have to declare for 3 years. I think in 1939 there was a special rule made that in 1939 and 1940 you could increase your declared value but not decrease it. In ordinary times it may be all right for the poor taxpayer to try to calculate what his income may be for the next 3 years, but here we have a year which, in my judgment, is a high-profit year, and we must declare a value high enough to protect us with respect to our income or earnings for 1941.

Now, if there should be a cessation of war by a negotiated peace or otherwise in 1942 or 1943 my judgment is that the profit liability in 1941 is just going to disappear and we will be paying capital-stock taxes on a valuation enormously in excess of that which we need to protect ourselves against the earnings.

On the other hand, of course, something else may occur.

There is a mild—it may be that the word "mild" should not be used—there is a mild tendency toward inflation. Now, suppose we have an inflation which progressively appears in 1942 and 1943.

Our profits—although the dollar value, the real value, may not be as much—but measured in dollars our profits may just jump enormously, and we have declared our value now on the basis of the present value of the dollar, and we may just simply have to pay enormous amounts of declared-value excess-profits taxes.

Senator WALSH. Your position is the same as the position of Judge Fletcher on that?

Mr. CLAPP. Yes. We should have each year, in these abnormal times, the right to make a new declaration either up or down.

I thank the committee.

The CHAIRMAN. How would it appeal to you to increase your normal taxes sufficient to take care of the capital-stock taxes and write the capital-stock tax out of the law? Or would you want to think on that?

Mr. CLAPP. I would want to think on that. As far as my own clients are concerned, I am inclined to think we would be in favor of it. It is pretty hard to figure. I would not like to make a statement on it.

The CHAIRMAN. Thank you very much.

(The statement submitted by Mr. Clapp is as follows:)

STATEMENT OF A. W. CLAPP ON THE 1941 REVENUE ACT

I am vice president and general counsel of Weyerhauser Timber Co., of Tacoma, Wash. In making this appearance, I represent that company and a number of other companies more or less related to it.

We have no disposition to object to the substantial tax increases contemplated by the pending bill. It is not my purpose to discuss rates as such, or the amounts to be raised from various sources—from individuals, from corporations, or by so-called excise taxes. I shall attempt to discuss only certain provisions and features of the bill which seem to be inconsistent with basic principles of taxation or to result in unjustifiable discrimination or hardship.

THE EXCESS-PROFITS TAX

1. The 10-percent excess-profits tax imposed under the special rule proposed in section 201 of the pending bill

The 10-percent tax applicable to those who elect the invested-capital method, and measured substantially by the excess of adjusted-excess-profits income if the average-earnings method were to be used, over adjusted-excess-profits income computed by the invested-capital method, is, we insist, illogical, unfair, and discriminatory. It imposes a severe and unfair burden on all corporations who were unfortunate enough to have relatively small (in many cases no) average profits during the years 1936-39.

The excess-profits-tax law of 1940 provides two methods of computing the excess-profits credit, and the pending bill retains the two methods. The policy of allowing the average-earnings credit was based on the belief that no matter how large were the average profits of a corporation during the base period, it was unfair to impose upon it an excess-profits tax unless its earnings in the current year exceeded those average earnings.

Congress might have stopped with the provision for the average-earnings method, although that method was and still is the most controversial of the two methods. But it did not, and why? Because it was, in 1940, well known that there were many corporations which, in the base years, were without any substantial earnings. Many industries and types of businesses made no substantial recovery from the depression years. This was notably true of the durable-goods industries, and particularly true of the building industries. And so, because this was an excess-profits tax—a tax on profits which are excessive, measured by some reasonable standard—a corporation which did not make an average of 8 percent on its invested capital during the base period was permitted an excess-profits credit of that amount. In the present bill, that percentage is 8 percent on the first $5,000,000 of invested capital and 7 percent on all above $5,000,000.

We have no objections to the use of the two methods; we think there should be two methods. We are not objecting to the percentage allowed in computing the excess-profits credit under the invested-capital method. But we do object most strenuously when asked to pay a 10-percent tax as a penalty for our failure to earn 8 percent or 7 percent in the base period. To tax the difference between nothing (in many thousands of cases) or 1 percent or 2 percent or 3 percent, and 8 percent or 7 percent on invested capital, is wholly illogical and inconsistent with the permitted invested-capital method. We are given the latter with one hand, and it is taken away, wholly or partly, by the other hand.

This new proposed 10 percent additional excess-profits tax will penalize practically all railroads, 99 percent of all lumber companies, practically all coal companies, a large majority of mining companies, to name only some of the classes of industries; in addition, many department stores, retail stores, and other businesses, large and small, those participating directly in the defense program, those indirectly, and those not at all.

Because I represent lumber companies, let me give you some statistics which will indicate the effect of this 10-percent tax on the Douglas-fir industry. General statements are based on statistics contained in the Douglas Fir Industry, a study undertaken by Dr. Dexter M. Keezer for the Bureau of Research and Statistics of the Advisory Commission to the Council of National Defense. On pages 25 to 41, inclusive, he discusses the financial history of the industry. It clearly appears (Keezer, pp. 26, 39) that for the industry as a whole, the total earnings of the industry were such that the total average earnings of the base years—counting a heavy loss year, 1938, as zero—could not have exceeded $4,500,000 upon a total apparent invested capital as of 1937—capital, surplus, and 50 percent of borrowed capital (Keezer, p. 33)—of approximately $292,000,000, or an average of 1.54 percent. Now there are, of course, high-cost and low-cost, well-managed and poorly managed companies. It is a moral certainty that of the hundreds of companies whose financial histories were analyzed by Dr. Keezer, a very large majority of them had no earnings in any of the base years, excepting possibly 1937, and would have no "average earnings," or practically none.

I represent four lumber companies in the Douglas-fir region. All are well managed and among the lower-cost operations. One had "average earnings" amounting to 2.25 percent of invested capital, another 2.05 percent, another approximately 4 percent, and the fourth 8.21 percent. This last company operates in fine-quality timber, with exceptionally favorable operating conditions. My judgment is that it may be the only lumber company in the Douglas-fir region who can elect to compute its excess-profits credit under the average-earnings method.

Earnings in the Douglas-fir industry in 1940 were greatly improved, though few companies (none of the four I have referred to above) earned enough to pay an excess-profits tax. Present prospects for 1941 are that many lumber companies will earn enough to pay the graduated excess-profits tax. Those whom I represent, and I am sure all in the Douglas-fir industry, are willing to pay the tax on all earnings over the 8-to-7-percent credit, willing to pay, along with our more fortunate brothers who use the average-earnings credit, whatever rates the Congress finds necessary to collect from corporations; but we do object most emphatically to paying a tax on earnings which are not excessive by any standard.

2. The graduation of rates should be based not on dollar amounts of adjusted excess profits, but largely upon the percentage which those profits bear to the excess-profits credit

The present law in providing for progressive rates of tax on brackets measured merely by the dollar amount of adjusted excess profits is unfair, inequitable, and seems to violate the principle of excess-profits taxation. Brackets should be based on the percentages by which income is excessive (as in the 1918 law) and not on the dollar amount of the excess profits. If it is desired to continue to favor or protect the smaller corporations, the Congress might base the lower rates upon dollar amount of adjusted excess profits—but not beyond $50,000, as that certainly is all that is necessary to protect small corporations; then bracket progressive rates on the remainder of the adjusted excess profits in accordance with the percentages which such remainder bears to the excess-profits credit. The following suggestion is illustrative only; the percentages and rates to be adopted to raise the necessary revenue must be worked out by experts:

Rate brackets

____ percent tax on dollar amount of adjusted excess profits up to $20,000.
____ percent tax on dollar amount of adjusted excess profits between $20,000 and $50,000.
____ percent tax on amount of adjusted excess profits (minus $50,000) which is 50 percent or less of excess-profits credit.

---- percent tax on amount of adjusted excess profits (minus $50,000) which is more than 50 percent and up to 100 percent of excess-profits credit.

---- percent tax on amount of adjusted excess profits (minus $50,000) which is more than 100 percent and up to 150 percent of excess-profits credit.

---- percent tax on amount of adjusted excess profits (minus $50,000) which exceeds 150 percent of excess-profits credit.

The rates on the last two brackets could, if necessary, be higher than any yet suggested.

We suggest that the bracket percentages be of the excess-profits credit (as above) rather than of invested capital (as in the 1918 law), because such a plan is applicable to those whose credit is based upon average earnings as well as to those using the invested-capital method.

To illustrate what seems to us to make the present method of bracketing inequitable, consider the following comparisons between two corporations, both large, but one much larger than the other.

	Corporation A	Corporation B
Invested capital	$15,000,000	$300,000,000
Excess-profits income	3,300,000	23,265,000
Excess-profits credit	1,100,000	21,065,000
Adjusted excess-profits income	2,200,000	2,200,000
	Percent	*Percent*
Percent of excess-profits income to invested capital	22	7.75
Percent of same to excess-profits credit	300	109.45
Tax under House bill	$1,274,000	$1,274,000

While the above illustration is given on the basis of an adjusted capital credit, exactly the same result occurs and exactly the same principle is involved if their respective excess-profits credit is computed under the average earnings credit.

The chances are that corporation A is profiteering. It may be that the increase in corporation B's income is but a normal fluctuation. We say that a corporation whose current earnings are only 9.45 percent over normal should not pay as much excess-profits tax on the same adjusted excess profit as a corporation whose current earnings are 200 percent in excess of its normal. Such a result seems to us to be totally inconsistent with the purpose and the principles of the excess-profits tax, whether it be considered an excess-profits tax or a war-profits tax.

Again, only for purpose of illustration, and well aware that rates and percentages in the illustrative schedule given above must be determined by the experts so as to produce the desired amount of revenue, if we use as rates of tax 35, 40, 50, 60, 65, and 70 percent, respectively, for the six brackets in that schedule, corporation A in the above illustration would pay excess-profits taxes of $1,331,560, and corporation B $1,094,000. We submit that such a result is more consonant with the purposes of the excess-profits tax.

But it may be said that corporation B is so big, its earnings so large, that it can afford to pay. Of course, other illustrations could be given of medium-size corporations and comparisons between two corporations of the same size, one with enormous profits over its normal and the other with but a slight increase. We say that, in every such case, the bracketing of rates should favor the latter.

We earnestly hope that the Congress is not going to allow the mere bigness of corporations to affect it in prescribing corporation rates. Aside from the difference in normal rates (and the proposed surtax rates) as between corporations with less and more than $25,000 net income, the Congress has not discriminated between the large and the small corporation, undoubtedly because of a realization that it is the stockholder who bears the burden of the corporation tax.

Congress should not forget the millions of investors in equity stocks, most of them in the largest corporations. It is not true that our large corporations are composed exclusively of a group of wealthy stockholders and the medium size and small corporations exclusively of a group of stockholders with income in the middle or lower brackets.

Consider the following statements (statistics compiled as of December 31, 1937, in Investigation of Concentration of Economic Power, Temporary National Economic Committee, Monograph 29):

In the 200 largest nonfinancial corporations in the country there were 948,717,572 shares of common (equity) stock outstanding. These were held in 7,026,793 shareholdings which averaged only 135 shares per holding.

In these same 200 corporations there were 6,189,709 shareholdings each of 100 shares or less. The shares so held were 167,144,681, or an average of 27+ shares per holding.

The average market value of each one of these holdings averaging 27+ shares was $931+.

Of the total of 7,026,793 shareholdings in the same 200 corporations, 6,689,235, or 95.2 percent, had a market value of less than $10,000 each, and the average annual income from holdings of $10,000 would probably be not over $600.

Total shareholdings of common stock of United States Steel Co. were 167,740. Of these shareholdings, 1,396 were of over 500 shares, and represented 46 percent of the outstanding stock; 166,344 shareholdings were of 500 shares or less, and represented 54 percent of the outstanding stock; and of the latter shareholdings 158,625 were of 100 shares or less, and represented 34.9 percent of the outstanding stock.

Total shareholdings of common stock of American Telephone & Telegraph Co. numbered 641,308. Of these shareholdings, 2,478 were of over 500 shares, representing 21.2 percent of the outstanding stock; 638,830 shareholdings were of 500 shares or less, representing 78.8 percent of the stock; and of the latter shareholdings, 614,383 were of 100 shares or less, and represented 53.9 percent of the outstanding stock.

Now it is apparent that these smaller shareholdings are those of individuals in the lower and lower-middle income brackets. I know of no statistics with reference to the size of average shareholdings in corporations smaller than the 200 largest nonfinancial corporations above referred to. But I think it can be said with confidence that there is no such proportion of small shareholdings of the size above mentioned in medium-sized or even smaller corporations. The fact is that many millions of our people, desiring to invest part of their money in equity stocks, naturally go to the stock market to buy, and, quite as naturally, invest in the better-known stocks. Of the 200 corporations referred to above, the common stock of all but 21 are listed on a national exchange.

3. Allowance of deduction in computing excess-profits income (also net income for normal and proposed surtax), of interest paid on adjustments made under section 734, Internal Revenue Code

Section 734, Internal Revenue Code, provides in effect that if a taxpayer, in computing its excess-profits-tax liability, takes a position inconsistent with that taken in an income return in a prior year which is not "open" so that a deficiency may be assessed, it must nevertheless, in making its excess-profits return, adjust the return of the prior year to make it consistent with the position taken in the current year, and add to its excess-profits tax any additional income shown for the prior year, with interest at the rate of 6 percent per annum.

A good illustration is this: My company, in 1927, sold to another wholly unrelated company a large block of timber under an installment contract. In 1933, in the depths of the depression, my company had to cancel the contract and retake the timber. The Internal Revenue Bureau had regulations providing for computation of profit (or loss) on the cancelation of such an installment contract. My company, in making its income-tax return for 1933, followed the Bureau's regulations, and with what at that time it believed to be the law. Recently the courts have decided that the regulation was not in accordance with law, and have laid down the correct rule for computing profit under the law in force in 1933 in cases of cancelations of installment contracts. The court's decision was followed by the Commission, who now has regulations which embody it. Under this correct rule we should have returned and paid for 1933 a tax on a profit of over a million dollars more than we did. But the year 1933 was "closed" when the court decisions were made.

Now, in making our 1940 excess-profits-tax return, we are including the profit which, under the correct rule, we made in 1933, in our surplus account as part of invested capital. But as that position is inconsistent with that taken by us in our original return for 1933, we must, under the provisions of section 734, recompute our tax for 1933 and now add to our excess-profits tax the tax we should have paid for 1933, together with interest at the rate of 6 percent per annum

from the date when it should have been paid. To all of this we have no objection. It is fair that we should pay this deficiency and interest if we desire to include the untaxed profit in our invested capital.

But the law as now written, as we understand it is interpreted by the regulations, does not allow us to deduct the interest which we will have to pay from our earnings either of 1940 or any other year. This is the first instance, to my knowledge, that taxpayers have not been allowed to deduct the interest paid on income-tax deficiencies. Heretofore, under all income-tax laws, interest on deficiencies has been a deductible item, and interest on refunds an addition to gross income.

The principle of section 734 has, with respect to inconsistent positions taken by the taxpayer (or by the Commissioner) in income-tax returns for subsequent years, been in the code for several years as section 3801, Internal Revenue Code. Deficiencies or overpayments for years as far back as 1932 (but not prior), even though the years are "closed" so that the statute of limitations precludes additional assessments or refunds, may be determined under circumstances similar to those covered by section 734, and deficiencies for prior "closed" years assessed, with interest, or refunds made, with interest. Interest on deficiencies is deductible in ascertaining net income, and interest on refunds included in gross income.

Furthermore, adjustments under section 734 apply only to years which are "closed." If a position taken in making excess-profits-tax returns is inconsistent with that taken in an income-tax return for a year not "closed," section 734 does not apply, but the Commissioner will assess, as income taxes, deficiencies for the prior year; and when such a deficiency is paid with interest, the taxpayer has a right to deduct the interest in computing his excess-profits net income.

There is no reason or logic in permitting deduction of interest paid on a deficiency for an "open" year and denying the deduction of interest paid on a deficiency for a "closed" year. We hope and believe that your experts will agree with this, and will agree that interest paid as a result of adjustments under section 734 should be a deductible item for the taxpayer.

It is difficult for me to say just where in the act the amendment should go and the wording for it. We think the committee should ask the drafting experts to draw the proper amendment or amendments to this effect:

Interest paid as a part of, and as a result of, adjustments made under section 734 is a deductible item in ascertaining excess-profits net income.

If the deduction is to be allowed in the year in the excess-profits tax return of which the adjustment is made, the amendment should be retroactive, because almost all adjustments to be made under section 734 will have been made in the 1940 returns.

CAPITAL STOCK TAX

Permission should be given taxpayers to make a new declaration of capital-stock valuation in 1942 and 1943—either up or down

As Judge Fletcher, appearing for the railroads, told this committee on August 13, declarations of capital-stock value are left entirely to the taxpayers. The capital-stock tax, together with the accompanying declared value excess-profits tax, are deliberately framed so as to force the taxpayer to declare enough value for the capital-stock tax to protect himself from incidence of the declared excess-profits tax. Prior to 1939, the taxpayer had to estimate what his earnings would be during each of the next 3 years. In 1939 taxpayers were given the privilege of raising, in 1939 and 1940, the value declared by them in 1938. The House bill permits no such adjustment to be made in values declared in 1941.

We submit that the state of the country, the uncertainty as to what will happen in the next few years, the impossibility of guessing the next 3 years in advance, are now such that it is unfair to the taxpayer to force him to make such a guess. Quite generally, 1941 will be a high-income year. With possible termination of the war in 1942 or 1943, all profits may disappear, and the taxpayer, unless given opportunity to redeclare capital-stock value, may be paying, out of capital, taxes on a wholly arbitrary and grossly exaggerated value, declared by him in 1941 to protect himself from declared value excess-profits tax on his 1941 income. On the other hand, profits may continue to grow beyond all reasonable expectation by reason of inflation, and the taxpayer may find himself with a declared value in 1942 or 1943 wholly inadequate to protect himself from the excess-profits tax. It may be all right in ordinary times to force the taxpayer to guess 3

years in advance what his profits will be each year, but in times such as these, when nobody can possibly tell what is going to happen, it is extremely unfair to hold a taxpayer to a declared value for 3 years, during which anything can happen. He should be permitted to make new declarations in 1942 and 1943, up or down.

Respectfully submitted.

A. W. CLAPP.

The CHAIRMAN. I will offer for the record a letter from Senator McCarran with reference to the elimination by the House of section 731 of the Internal Revenue Code, which has the effect of exempting from excess-profits taxes income derived from the mining of certain strategic metals.

Senator McCarran was here but he was not here at the opening of the hearing this morning, and he desires this letter, which is in the nature of a brief, together with other accompanying documents, inserted in the record.

The committee is pleased to get his personal appearance and to enter into the record his position in regard to the elimination of section 731 of the Internal Revenue Act.

(The material submitted by Senator McCarran is as follows:)

UNITED STATES SENATE,
August 6, 1941.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: You will recall that we were successful in having included in the Second Revenue Act of 1940 what is now known as section 731 of the Internal Revenue Code. Section 731 exempts from the provisions of the excess-profits tax, income derived from the mining of certain strategic metals.

As you doubtless know, the pending tax measure, H. R. 5417, contains a provision (sec. 206) expressly limiting the effect of section 731 of the Internal Revenue Code to the tax year 1940, and making it inoperative for subsequent tax years. In my judgment the pending provision would deliver a serious blow to the mining industry and, in turn, to the national defense of this country by impairing strategic metals mining activity.

At the hazard of being presumptuous, may I take this opportunity to draw to the attention of your honorable committee what I believe are some cogent reasons for at least a restoration of the provisions of the 1940 Revenue Act which, in my opinion, only rendered partial justice to the mining industry.

The excess-profits-tax provisions permit of two methods as the basis for the ascertainment of what constitutes excess profits, with some adjustments which are not necessary to enumerate, i. e.:

1. It taxes as excess profits anything in excess of an 8-percent return on invested capital; or

2. The income basis measured by the average earnings for the years beginning December 31, 1935, and ending December 31, 1939.

If a corporation was not in existence during the entire 48 months of the base period, it is awarded a constructive net profit income at the rate of 8 percent of the daily invested capital, as of January 1, 1940, and for the remainder of the base period it may average its income. With some adjustments, as stated, the basis for excess profits, therefore, is anything in excess of 8 percent on invested capital, or anything greater than the average of 4 years' profits. Both of these methods are extremely unfair to the mining industry.

As to invested capital.—The invested capital method is unfair for several reasons:

1. Because the small amount of invested capital in a going mine is comparatively small.

2. Because an 8-percent return on capital invested in the mining industry is entirely inadequate, and this is especially true as respects the State of Nevada.

Mining, at best, is an extremely hazardous undertaking involving in most instances a tremendous risk of capital with no assurance of a return on the

investment, much less a profit. The productive life of the average gold or silver, or gold and silver mine having strategic metals byproducts does not exceed 5 years.

There is an old phrase "prospects are found—mines are made," and they are not made in a day or even in a year, and generally not in several years. A discovery is made and this must be followed by considerable exploratory and development work before the mine can come into production. This is especially true of what is called low-grade mines. In all cases sufficient ore must be developed through workings to justify a plant. When sufficient ores have been developed, then the camp, power plant, and other facilities must be erected. This development period, as stated, will run from 1 to 4 years. Generally it may also be said that the first year of production will be comparatively low, increasing with succeeding years as mechanical and metallurgical difficulties are ironed out. As a general rule it is during the third years that normal production is reached.

Neither public nor private financing of mining developments can be done upon a basis of an 8-percent return on invested capital because this means that a mine must have a life of at least 12½ years to repay the capital, and when you take into consideration the normal corporate taxes and the additional taxes levied against the dividends coming to the stockholders, it is clear that only in exceptional circumstances will the investor recover his investment, must less a profit, in a precious-metal mine upon the basis of an 8-percent return.

As to income basis.—The income basis on its face would appear to be fair, but in fact it is extremely discriminatory. Companies which have an earning history for the whole of the base period or longer will pay little or no excess-profits tax. The largest silver mine in the United States and the largest gold mine in the United States, neither of which is in Nevada, because of their earning history, will pay little, if any, excess-profits tax. A penalty, however, is imposed upon new discoveries, new mines, and upon corporations coming into production subsequent to December 1935.

A corporation not in existence during the entire 48 months must take a constructive 8-percent capital return on its investment as of January 1, 1941, for the year or years not in existence and average its earnings for the other years of the base period.

The vice of this lies in the phase "not in existence," and in the practical application of the law. It is given no constructive capital investment or constructive earnings during the time it was in existence but not in production.

The Excess Profits Tax Amendments Act of 1941 amended section 722 of the Internal Revenue Code with respect to abnormal base period earnings. However, for a mining corporation to be entitled to relief under the so-called abnormal earnings section, it must first establish that the character of its business has been changed, or that its normal production was interrupted during one of the taxable base period years due to abnormal events. As a direct consequence, the constructive relief intended to be given by amending section 722 is not available to the mining industry unless it can be established that the character of business has been changed (a thing impossible on its face); or that production was diminished or abandoned during any taxable base period year as a result of abnormal events. The most frequent instances of abnormalities, however, such as an unusual increase in the cost of labor or necessary essential materials, or an extremely low metals price making production highly unprofitable, are not included within the official construction of "occurrence of events abnormal." Thus, the mining industry is effectively precluded from seeking relief under section 722 of the Internal Revenue Code.

In my opinion, a mining corporation should not be liable for excess-profits taxes until it has had a profitable production of at least 3 years and, in any event, the years of existence when it is under development and not in production, should be excluded and it should be permitted to take its average earnings after it comes into production.

Because of the inequitable operation of the excess-profits tax, and realizing that a capacity production in existing strategic metals mines, as well as a constantly accelerating activity in the exploration and development of a strategic-metals deposit is essential and paramount for national defense, Congress wrote into the Second Revenue Act of 1940 section 731 of the Internal Revenue Code. To remove the exempting provisions of 731 at this stage of our domestic development of strategic metals and subject strategic-metals producers to the discriminatory operation of the excess-profits tax would deal a paralyzing blow to our vast development program, and would unnecessarily impair our achievement of complete national defense.

I hope you will pardon my addressing you at such length on this matter. I realize, as I know you must realize, that if our natural resources of strategic metals deposits in the Nation are to be adequately developed, the industry must have every encouragement at our disposal. I do not believe that the Congress should now attempt to tax the mining industry out of existence.

I am opposed to section 206 of the bill H. R. 5417, and I earnestly beseech your honorable committee to strike this section from the bill.

Respectfully,

(Signed) PAT MCCARRAN.

States producing strategic metals exempted from excess-profits tax in present law

WESTERN STATES

State	Tungsten	Quicksilver	Manganese	Platinum	Antimony	Chromite	Tin
Arizona	X						
California	X	X	X	X	X	X	
Colorado	X		X				
Idaho	X	X	X		X		
Montana	X		X				X
Nevada	X	X			X		
New Mexico			X				X
Oregon		X		X		X	
South Dakota		X					X
Utah	X		X				
Washington	X		X		X		
Wyoming	X					X	

OTHER STATES

Alabama			X				
Arkansas		X	X				
Georgia			X				
Minnesota			X				
North Carolina			X				
Pennsylvania						X	
South Carolina			X				
Tennessee			X				
Texas		X	X				
Virginia			X				

UNITED STATES SENATE, *August 6, 1941.*

HON. PATRICK MCCARRAN,
United States Senate, Washington, D. C.

DEAR SENATOR MCCARRAN: I appreciate receiving your letter with respect to the manner in which the new revenue bill now pending in the Finance Committee will effect the mining industry. I have carefully noted the arguments which you have advanced and find myself in complete agreement with them.

I hope that nothing will be done by the Congress to impede or hinder the mining industry in this pending tax measure. You will have my hearty cooperation to this end.

Sincerely,

ED C. JOHNSON.

UNITED STATES SENATE, *August 8, 1941.*

HON. PAT MCCARRAN,
United States Senator, Washington, D. C.

DEAR SENATOR: I have studied with much care yours of July 31.

I can assure you that it will be a pleasure to join with you in an effort to have section 206 stricken from the proposed new revenue bill.

Sincerely,

DENNIS CHAVEZ,
United States Senator.

UNITED STATES SENATE, *August 6, 1941.*

Hon. PATRICK MCCARRAN,
United States Senate, Washington, D. C.

MY DEAR SENATOR: So far from resenting the length of your letter of August 2, I am very pleased to have such a comprehensive analysis of the probable effect of the provisions of H. R. 5417, to which you call attention, upon the mining industry of our State.

I have read your letter with a great deal of interest, and as you know, I, too, am vitally concerned about this matter.

Sincerely,

BERKELEY L. BUNKER.

UNITED STATES SENATE, *August 8, 1941.*

Hon. PATRICK MCCARRAN,
United States Senate, Washington, D. C.

MY DEAR SENATOR MCCARRAN: You will permit me to acknowledge your letter of August 6 with reference to section 206 of the House revenue bill and to the excess-profits tax as applied to the mining industry.

I assure you that your views will be presented to the committee prior to the filing of the report in the Senate.

Sincerely yours,

WALTER F. GEORGE.

UNITED STATES SENATE, *August 5, 1941.*

Hon. PATRICK MCCARRAN,
United States Senator.

DEAR SENATOR: Your letter of July 31 with regard to excess-profits-tax provisions embodied in H. R. 5417 and their relation to the mining industry of the West has been received during the absence of Senator Murray, who is now in Montana. Your letter will be brought to his attention upon his return to Washington, and I feel sure that he will want to take an active part in the effort to have section 206 stricken from the bill.

Sincerely yours,

W. G. RAGSDALE, *Acting Secretary.*

UNITED STATES SENATE, *August 6, 1941.*

Hon. PATRICK MCCARRAN,
United States Senate, Washington, D. C.

MY DEAR PAT: I thank you for your letter of July 31 with reference to section 731 of the Internal Revenue Code. I shall certainly be glad to do what I can to be helpful in connection with the strategic-minerals exemption.

With kindest personal regards, I am,

Yours very sincerely,

CARL HAYDEN.

UNITED STATES SENATE, *August 7, 1941.*

Hon. PATRICK MCCARRAN,
United States Senate, Washington, D. C.

MY DEAR SENATOR MCCARRAN: As Senator Holman is absent from Washington, I am writing to acknowledge your letter of July 31.

You will note from the attached copy of a wire I have received from Senator Holman that he feels as you do with respect to the elimination of the previous exemption from the excess-profits tax on certain strategic minerals.

Sincerely yours,

ROBERT B. PARKMAN,
Secretary to Senator Holman.

[Telegram]

ROBERT B. PARKMAN, PORTLAND, OREG., *July 24, 1941.*
Secretary, Washington, D. C.:

Referring to elimination of exemption of strategic minerals from excess-profits tax in 1941 House revenue measure—this will prove a catastrophe to development of additional strategic mineral production. This will have an immediate effect in decreased quicksilver and tungsten production and will effectively prohibit development by private capital of any new deposits of chrome, manganese, nickel quicksilver, and tungsten. Since preliminary estimates possible revenue which might be derived from this source could not exceed million and half dollars and probably much less, it would appear that this step by Ways and Means Committee is very short-sighted and exceedingly detrimental to defense program. Since development of strategics involves high-cost production which probably cannot compete after present emergency, private capital must be assured either of possibility of profit or guaranty against loss. Since present Government policy is not to guarantee against loss, elimination of any possible profit will prevent development of strategics by private capital and would require Federal money and Federal supervision and much delay before obtaining any appreciable additional strategic production. The shipping situation is so critical foreign ores cannot be relied upon. This is breach of faith and slap in the face to the very producers whom Government has been trying to encourage to expand strategic-mineral production.

RUFUS C. HOLMAN,
United States Senator from the State of Oregon.

The CHAIRMAN. Mr. Larsen, D. P. Larsen.

STATEMENT OF D. P. LARSEN, MINNEAPOLIS, MINN., VICE PRESIDENT, SHEVLIN, CARPENTER & CLARKE CO.

Mr. LARSEN. I am David P. Larsen, vice president, Shevlin, Carpenter & Clarke Co., of Minneapolis, which manages generally, among other companies, two companies which produce ponderosa pine on the West coast. I have a statement to present with three illustrating tables which I hope may go in the record. I think I can present the matter most concisely by commenting on the matters contained in my prepared statement.

The CHAIRMAN. You may put your statement in the record but we hope you can make your oral statement as brief as possible since the whole brief will be in the record.

Mr. LARSEN. I think I can present the matter in 10 or 15 minutes.

Our informed people realize that they must pay much heavier taxes for, except as Congress limits expenditures, it cannot limit ultimate taxes. The time of collection should be determined by sound finance and a desire not to leave our descendants a mountainous burden of debt. I, therefore, make no objection to the total dollars of taxes proposed to be collected by this bill (H. R. 5417), but to promote equality shall suggest one change in the proposed distribution of the burden.

I shall discuss only section 201 (2) which disregards equality and ability to pay more than any tax provision encountered during the 25 years I, as accountant and auditor, have handled income and excess-profits-tax matters for several corporations in United States and Canada.

I wish to make clear by words and illustrations that the pending bill's section 201 (2) penalizes with an extra 10-percent tax those who for innumerable reasons had subnormal profits in the base period, but fails to apply any excess-profits tax to earnings of others to the extent of their base-period earnings ranging from 8 percent to 44 percent or more of capital. Extreme discrimination results from the arbitrary and erroneous assumption that for all industries earnings were normal from 1936 to 1939, inclusive, and that current earnings above that average represent defense profits. The fact is that during that period corporate earnings were above normal in some cases, normal in others and subnormal for a large part of the total. The year 1936 did not show full recovery from the depression. The year 1937 came the nearest to being normal. A secondary depression made 1938 a very bad year generally. For many businesses (including the lumber business, with which I am most familiar), the low prices and profits continued during 1939. In all of those years the Government took steps to bring business and employment up to normal.

Instead of duplicating statistics already furnished, may I suggest reference to the illuminating figures given the Ways and Means Committee by Mr. Nielson according to pages 1662 to 1669 of the House hearing.

While he proceeded to justify retention of the option to use base period earnings, his figures also prove my contention that in years before the defense effort there was great variation in profit between different years, industries and individual corporations. His figures picture many corporations with such high rates of earnings upon capital that they escape not only the 10-percent special excess-profits tax, but they escape the regular excess-profits tax until they have earned several times the invested capital exemption proposed in this bill. In the four base period years erroneously called normal, 67 companies taken at random varied in earnings from 1.2 percent to 36.7 percent on capital.

The following example illustrates how it is possible under the proposed law for a corporation earning $2,000,0000 in 1941 to pay less than one-half of the excess-profits tax payable by a company having earnings of $850,000, both having the same invested capital:

You will note the invested capital and credit were identical for both companies.

	Company C (beverages)	Company D (lumber)
1. Average invested capital	$10,000,000	$10,000,000
2. Invested-capital credit, 1941	750,000	750,000
3. Average earnings, 1936-39	2,000,000	200,000
4. Average earnings credit, 1941	1,900,000	190,000
5. Earnings for 1941	2,000,000	850,000
6. Amount subject to 10-percent special tax (2 less 4)	None	660,000
7. Amount subject to regular excess-profits tax:		
(5 less 4)	100,000	
(5 less 2)		100,000
8. Regular excess-profits tax on 7	41,500	41,500
9. Special 10-percent tax on 6	None	56,000
Total excess-profits tax	41,500	97,500

Company C on an income of $2,000,000, or 20 percent of invested capital, pays an excess-profits tax of $41,500, while company D, because it has raised its earnings rate from a poor showing of 2 percent to 8½ percent of invested capital pays a tax of $97,500 on an income of only $850,000, whether or not any of the increased income resulted from the defense program. The demand for the product of company C is fairly stable and its profit margin is maintained from year to year. The product of company D is subject to wide fluctuations in volume and its poor showing during the base period is partly due to continuing overhead costs borne by low volume of business.

The adequacy of the exemption from excess-profits tax measured by 7 to 8 percent of invested capital depends on the time and nature of the investment. The probable yield must vary with the risk in order to attract capital. High-risk businesses must be allowed to earn more in good years than those not so hazardous.

I will summarize the situation of the lumber-producing industry partly to illustrate its hazardous nature and its low and varying profits and partly to disclose a weakness in the proposed bill which, if continually applied to such a wasting asset industry, would gradually eliminate its earnings base from 1936 to 1939, inclusive, long before the operation ceased because of exhausting the timber. First, I refer you to table B, which is the next to the last sheet before you, and which summarizes gross and net profit for lumber and timber products industries as compiled by the Treasury Department from income returns. The net income percentages shown are of gross income, not of invested capital. Such data from 1926 to 1934 appeared in table 23 of exhibit 47, *Ex parte No. 123*, before the Interstate Commerce Commission, December 9, 1937. The subsequent 5 years were obtained from the same Government source. The witness, Wilson Compton, president of National Lumber Manufacturers Association, summed up the situation on page 12 of that exhibit in these words:

> As to the ability of the lumber industry to absorb additional costs of transportation of its products, may I cite the only conclusive information available in the statistics of income reported by the Bureau of Internal Revenue. This, in table 23, shows for the sawmills and planing mills, during the period from 1926 to 1934 a net income during 4 years ranging from less than 1 percent to about 3 percent of the gross income, followed by an unbroken 5-year period of deficit ranging from 7 to 32 percent of the gross income, with a total net result for the 9-year period of a deficit equivalent to 3 percent of total gross income. As a companion in deficits, the lumber industry seems to have outranked even the railroads.

Generally speaking, lumber production is like the long-term liquidation of a crop. Sufficient timber is usually purchased or otherwise assured to warrant the construction of plant facilities. The heaviest part of the investment may be made long before profits begin. Timber is subject to destruction by fire but is not insurable against that hazard. With the liquidation of timber and amortization of plant some gain or loss accompanies the return of capital. Other things being equal, the invested capital declines per dollar of profit with passage of time so that an operation nearing its close has normal volume of shipments, subnormal capital, and higher yield in relation to capital.

The business is extremely competitive, as its nature prevents ready adjustment to subnormal volume especially of property carrying cost and other overhead. Those producing lumber mainly for home build-

ing, such as western pine, are affected by the widely fluctuating volume of home building. This is confirmed by table C, which is the last sheet before you. The earnings, like the consumption, usually vary in cycles of several years each. When the volume of home building and other consumption is good in relation to the overhead burden, then the producers must earn enough to carry them through the inevitable lean years which follow. That many have been unable to do this is evidenced by notable receiverships and default in obligations. Normalcy was not measured by results from 1936 to 1939, inclusive, nor can it be measured by a few other years. Of course, there is great variation between individual sawmills in the same year, depending upon local situations, for this business is seriously affected by weather and by the kind, quality, and location of the timber converted into lumber in any year.

I have verified the following figures covering a large western-pine operation, which, after accumulating a comfortable surplus, showed the following results for the past 12 years:

Labor paid	$15,483,480
Federal income tax	396,582
Other direct taxes	1,400,790
Total taxes	1,797,372
Net profit after income tax	373,304
Cash dividends paid	2,138,755

Of course, the reason Federal income tax exceeded the net profit after income tax was that the corporation paid tax when it had income but obtained no refund or offset after it had losses. The recent provision for carrying 2 years' losses forward against income is insufficient where losses continue for more than 2 successive years. For the western-pine operation referred to, labor cost is about 54 percent of total cost. It is well known that the lumber industry is a large employer of labor, and no argument is needed to emphasize the importance of leaving sufficient earnings to that industry in good years to permit continued operation and employment in such lean years as have always followed the good ones.

In 1918 the World War excess-profits tax of 30 percent applied to the earnings which ranged from 8 to 20 percent of invested capital, above which the tax was 65 percent. A higher rate of war-profits tax applied after the exemption determined by the higher of (1) pre-war income or (2) 10 percent of invested capital. However, the normal tax rate was then 12 percent compared with the 30 percent now proposed. In a business so hazardous and unstable as the lumber industry, we cannot label as excessive exemption the 7- to 8-percent credit upon invested capital, which Ways and Means Committee said on page 24 of its report was equivalent to 4.9- to 5.6-percent credit after deducting normal tax and surtax. Persons familiar with business and investment will agree those rates are low in relation to average risk and too low for many kinds. Is it just to renege on that exemption from excess-profits tax to the extent of an extra 10-percent tax on the excess of that allowance over the poor and subnormal base-period years?

The last question is inseparable from a provision in section 713 (a) (1) (C) for reduction of base period income as invested capital is

reduced. As already stated, it is in the nature of timber liquidation to repay investors the capital plus any net earnings with the gradual cutting of the timber. The average earnings credit is reduced by 6 percent of amounts paid in retirement of capital stock. These reductions increase the amount subject to the 10-percent tax, so long as the invested capital credit exceeds the earnings subject to excess-profits tax.

Added to 30-percent normal tax, the extra 10-percent tax becomes serious since it falls most heavily upon those who earned the least in the base period in relation to invested capital credit or current earnings. That is best illustrated by table A, which is the second from the last sheet before you. The worst tax is that which gives one competitor an advantage over another and this tax helps the one who earned the most in the base period to eliminate the competitor who then earned the least. The total tax burden is extremely heavy as most States collect taxes upon corporate income besides which corporations bear other heavy direct and indirect taxes. Unstable businesses which have long cycles of gain or loss must accumulate surplus in good years to permit operation and employment in lean years. To erroneously assume that four arbitrarily selected years were normal and that all profit increases thereafter were excess profits and deserving of penalty taxes is to do the gravest kind of injustice. It would be impracticable to correct that by relief provisions because thousands of things cause variation of profits between years, including weather, accidents, and dislocation of economic and human relationships.

The 10 percent penalty tax further increases the tax upon corporate income which individual stockholders absorb before they bear the full individual tax rates upon dividends received. That violation of equity and ability to pay is borne by poor and rich stockholders alike in proportion to their holdings. Nevertheless, taxing of corporate income has become such an important part of tax collection that it appears impracticable to now eliminate duplicate tax upon investors' income, levied both when it is earned by the corporation and when it is received by the stockholders.

In effect, section 201 (2) of the bill levies an extra 10-percent tax on what will undoubtedly be the major part of earnings of those taxpayers who during the base period realized poor earnings in relation to their invested capital.

Senator WALSH. I don't want to interfere with your presentation, but I think you sum up your whole case admirably on page 10. The balance is in the record.

Mr. LARSEN. Yes; I intend to skip page 9 and come to the conclusion.

Others who were more fortunate in their base-period earnings are in effect exempted at higher rates upon invested capital or by the still higher rate of base-period earnings.

You were advised by representatives of the Treasury that many corporations which are the principal beneficiaries of the defense effort, and whose 1940 profits were many times larger than in any base-period year, paid little or no excess-profits tax; also, that "the Treasury recommended, and the bill provides, that a flat 10 percent should be applied in such cases to that part of the current profits that exceeds the base-period earnings but does not exceed the invested-capital credit." Such a tax exempts those taxpayers whose profits were above normal in the base period and penalizes those taxpayers who had what was de-

scribed as "especially poor earnings during the base period," on page 1338 of the report of the hearings before the Ways and Means Committee. The same report, on page 1335, records that the Treasury representative emphasized the fact that however severe the tax burdens may have to be they should rest fairly and justly upon all individuals and all businesses. That principle should govern. But, in justification of the proposal to which I take exception, the following was said, according to page 1336 of the report of that hearing:

> In many cases it is not possible to identify with precision the additional profits due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to assume that, in general, increases in profits during this period are due to defense. Inability to measure defense profits precisely should not discourage us from subjecting them to special taxation even at the risk of hitting some income not derived from the defense program.

Because some defense profit is included in the current income of some corporations, whose base-period income was below the 7 to 8 percent invested-capital credit, does not justify the imposition of a 10-percent-penalty tax on all profit above subnormal base-period years of other taxpayers. If time does not permit the working out of a bill which would fairly and equitably segregate and subject to a special tax the defense profit not otherwise subject to excess-profits tax, it would be fairer to raise the additional revenue needed by raising taxes of individuals or increasing regular excess-profits-tax rates rather than to penalize those whose earnings, due to conditions beyond their control, were below 7 or 8 percent of invested capital.

The lumber industry, with which I have become thoroughly familiar while employed in it during more than the last 25 years, will be unjustly discriminated against if section 201 (2) as it passed the House of Representatives is enacted into law. On much of its current income it will pay an extra 10-percent tax merely because it suffered from subnormal earnings during the base-period years, and, therefore, will be denied the full exemption on its capital which the law allows except for the unjust proposal in section 201 (2).

I sum up the objections stated to the new 10-percent tax proposed in section 201 (2) as follows:

1. Statistics cited prove great variation in profits between years, industries, and companies before the 1940 defense program. The profit variation due to each of the innumerable reasons for such variation cannot be measured so as to adjust to normal what was not normal in the base period. The assumptions that the base period was normal and that earnings above that level are excess or defense profits are so incorrect as to justify exemption from excess-profits tax measured by either the invested capital credit or base-period earnings.

2. Inability to identify indirect-defense profits should not subject nondefense profits to excess-profits tax except as they exceed both of the optional exemptions.

3. The inequity of the excess-profits tax should not be increased by applying an extra 10-percent tax on the amount by which invested capital credit exceeded subnormal earnings in the base period. The exemption based upon invested capital is so low in relation to busi-

ness hazards, and in relation to those using base-period earnings, that such capital exemption should not carry a penalty tax.

4. The provisions for reducing base-period income by capital reductions have unreasonable application to wasting asset industries unless section 201 (2) is eliminated.

For the reasons stated I urge elimination of paragraphs (2) and (3) of section 201 in order to avoid the extreme and unnecessary discrimination therein provided.

The CHAIRMAN. Any questions by any member of the committee? If not, Mr. Larsen, we thank you for your appearance. Your whole brief is in the record.

(The tables referred to by Mr. Larsen are as follows:)

TABLE A.—*Illustrating how the 10-percent tax proposed in section 201 (2) discriminates against corporations having subnormal income in the base period*

To simplify illustration of tax discrimination resulting from the special 10-percent tax proposed, assume the following:

(1) Two corporations compete in the same line of business in the same State.

(2) Both companies had the same invested capital in the base period as well as in 1941.

(3) In 1940 both companies had income subject to excess profits, so there was no unused excess-profits tax credit.

(4) Both corporations had taxable income of $600,000 in 1941.

(5) Base period net income was:

	Corporation A	Corporation B
1936	$100,000	$300,000
1937	200,000	600,000
1938	100,000	100,000
1939	200,000	400,000
4 years	600,000	1,400,000
Average	150,000	350,000
	Percent	*Percent*
Average earned on capital	3	7

The reasons for A's lower income in base period were: 1936, heavy snowfall curtailed but did not stop production. 1937, lower than average grade of natural resource was converted and sold. 1939, longer haul of natural resource to factory.

Those differences between A and B reduced the earnings of A below normal (or true average) but the resulting tax disadvantage to A in 1941 would not be relieved by such provisions as section 722 (2) of Internal Revenue Code.

The normal tax and graduated excess-profits tax would be the same in 1941 for the two corporations. The 10 percent proposed by section 201 (2) would be five times as much for A as for B, according to the following computation:

	Corporation A	Corporation B
Invested capital for 1941	$5,000,000	$5,000,000
	Percent	*Percent*
Average earned on capital in base period	3	7
Capital for 1941 multiplied by rate earned in base period	$150,000	$350,000
Excess-profits credit based on current capital—8 percent of $5,000,000	400,000	400,000
The latter exceeds the former by	250,000	50,000
On which the 10 percent special tax is	25,000	5,000

TABLE B.—*Sawmills and planing mills, per income returns*

Corporations reporting net income—	Number of returns	Gross income	Net income	Percent net of gross income
1926	2,104	$1,256,708,000	$96,920,000	7.71
1927	1,769	934,595,000	62,233,000	6.66
1928	1,934	1,014,746,000	70,798,000	6.98
1929	1,876	991,829,000	70,940,000	7.15
1930	940	303,198,000	16,572,000	5.47
1931	507	83,506,000	2,981,000	3.57
1932	186	21,379,000	722,000	3.38
1933	582	131,293,000	6,058,000	4.61
1934	734	170,029,000	9,776,000	5.55
1935	1,024	309,415,000	16,020,000	5.18
1936	1,321	541,342,000	39,493,000	7.30
1937	1,362	679,522,000	52,674,000	7.75
1938	1,029	385,220,000	19,951,000	5.18
1939	1,297	617,338,000	38,288,000	6.20

Corporations reporting no net income—	Number of returns	Gross income	Loss	Percent loss of gross income
1926	1,726	$472,860,000	$46,267,000	9.78
1927	1,683	545,309,000	56,540,000	10.37
1928	1,597	464,710,000	45,817,000	9.86
1929	1,646	472,296,000	38,580,000	8.17
1930	2,425	734,968,000	89,326,000	12.15
1931	2,493	535,650,000	121,867,000	22.75
1932	2,633	363,448,000	124,803,000	34.34
1933	2,252	321,408,000	51,885,000	16.14
1934	2,081	320,208,000	47,431,000	14.81
1935	1,915	310,070,000	34,614,000	11.16
1936	1,449	262,295,000	24,426,000	9.31
1937	1,428	259,740,000	14,085,000	5.42
1938	1,908	368,463,000	32,362,000	8.78
1939	1,552	307,070,000	20,888,000	6.80

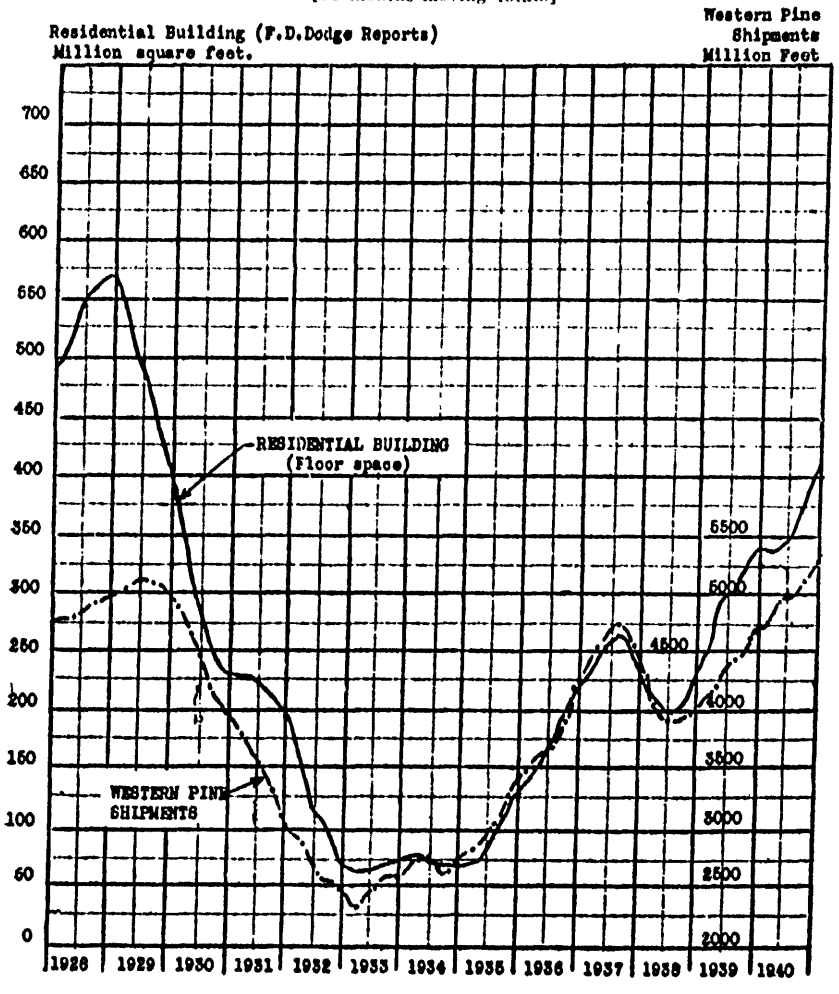
All corporations reporting (combined)—	Number of returns	Gross income	Net income or loss	Percent net income or loss of gross income
1926	3,830	$1,729,568,000	$50,653,000	2.93
1927	3,627	1,479,904,000	6,693,000	.38
1928	3,718	1,479,456,000	24,980,000	1.69
1929	3,768	1,464,125,000	32,360,000	2.21
1930	3,551	1,038,166,000	[1] 72,753,000	[1] 7.01
1931	3,168	619,146,000	[1] 118,886,000	[1] 19.20
1932	2,946	384,829,000	[1] 124,081,000	[1] 32.24
1933	3,045	452,701,000	[1] 45,827,000	[1] 10.10
1934	2,989	490,237,000	[1] 37,655,000	[1] 7.59
1935	3,072	619,494,000	[1] 18,594,000	[1] 3.00
1936	2,872	803,637,000	15,067,000	1.87
1937	2,923	939,262,000	38,589,000	4.11
1938	3,095	753,683,000	[1] 12,411,000	[1] 1.65
1939	2,973	924,408,000	17,400,000	1.88

[1] Loss.

Source: U. S. Bureau of Internal Revenue, which changed classification slightly in 1938.

TABLE C.—*Trend of residential building and western-pine shipments*

[12 months moving totals]



The CHAIRMAN. Professor Fairchild?

Mr. ALVORD. Mr. Chairman, I would like, if I may, to make a preliminary statement. The committee on Federal finance, United States Chamber of Commerce, will be represented by three witnesses, among whom the testimony has been divided.

Professor Fairchild, of Yale University, who will discuss Federal expenditures and principles of taxation; Mr. Roy Osgood, of Chicago, who will discuss the proposed changes in the estate and gift taxes of the House bill, and I will discuss the House bill and our recommendations with respect thereto.

Written statements have been prepared by each of us, and I ask that these written statements be incorporaed in the record.

The CHAIRMAN. The briefs will be entered in the record. You say Professor Fairchild will proceed first?

Mr. ALVORD. Yes.

STATEMENT OF PROF. FRED R. FAIRCHILD, NEW HAVEN, CONN., MEMBER OF THE COMMITTEE ON FEDERAL FINANCE OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Professor FAIRCHILD. My name is Fred R. Fairchild. I am professor of economics of Yale University. I am a member of the committee on Federal finance, Chamber of Commerce of the United States. I believe the members of the committee have before them now the typewritten statement of the testimony I propose to give. On the first page there appears an outline which is followed throughout the statement and which I shall follow in my presentation in order to trench as little as possible on your time. I propose to follow in my spoken argument rather closely the typewritten statement which you have before you.

I. *Amount of taxes in relation to expenditures.*—Few will differ with the idea that the Federal Government should obtain substantial additional revenues to meet the enlarged defense expenditures. Our chamber committee advocates additional taxation, although, as will appear from subsequent testimony, it makes a somewhat different approach to the problem from that of the House bill.

1. *Ratio of taxes to borrowing.*—We do not believe it is feasible to set up an automatic "measuring stick" of the amount of revenues which should be obtained. The amount depends upon such factors as the total of expenditures, the probable national income, its distribution, the sources and methods of taxation used, and the impacts of the new and increased levies upon the national economy. No exact ratio of taxes to total expenditures has any validity in and of itself. It is evident that the two-thirds formula is not realizable for the fiscal year 1942, and its feasibility with respect to 1943 is at least open to question.

2. *Determining the amount of taxes.*—On the contrary, the practical method in such an emergency as the present is: (1) Determine the amount of nondefense expenditures at the lowest practicable level, (2) estimate as nearly as may be the sum of defense expenditures, (3) settle upon a tax program that will produce the maximum revenue possible without impairment of the economic and political structure, and (4) depend upon borrowing for the balance.

I am assuming that the maximum levies under the conditions stated would still, under present conditions, not be sufficient to produce all necessary revenue and that some degree of borrowing would be necessary.

In such manner the actual ratio of taxes is determined, as the conclusion rather than the premise, and it is generally recognized that the higher this ratio, the stronger is the Government's financial position.

3. *Large deficits inevitable.*—Judging from the estimates of revenue under existing law, huge annual deficits are in prospect. Even with the addition of three to four billion dollars of revenue, the deficits will still be large. Any calculation only serves to reinforce the conclusion that large additional revenues must be sought. The amount that might be sought retroactively from 1941 incomes and the total amount that might be made available in the current fiscal year are to be dealt with by another chamber witness.

4. *Curtailment of nondefense expenditures.*—If additional taxes are to be levied with the idea of obtaining the largest practicable amount of revenues, then it would appear obligatory upon the administration and upon the Congress to reduce the nondefense expenditures by the largest practicable amount. An "all out" tax program to finance an "all out" defense effort should be accompanied by "all out" economy in nondefense spending. The taxpayers may be expected to submit to increased demands with much more cheerfulness if they can be assured that the money they contribute will not be spent on unnecessary objects or wasted.

Secretary Morgenthau has proposed that nondefense expenditures be reduced by at least a billion dollars. He first made this proposal when testifying before the House Ways and Means Committee last April 24, and he reiterated it before your committee last week.

Before the Ways and Means Committee, he said he did not know of anything that would help the Treasury more when it is going to the country and inviting the people to invest in defense savings bonds than for the Congress itself to take a strong position on economizing in nonessential and nondefense items.

Secretary Morgenthau suggested, as a general guide, that particular attention be given to agricultural aids, the C. C. C., the N. Y. A., and Public Works.

We support the Secretary's proposal but do not believe it goes far enough. Scrutiny of the expenditures he mentioned and of other nondefense items would, it is believed, reveal that reductions amounting to about $2,000,000,000 could be made.

In the first place, we suggest the suspension—in large part in some instances and entirely in others—of activities instituted to relieve unemployment and economic distress; such disbursements are less necessary now due to changed economic conditions. In this connection, in addition to the billion dollars that might be saved by following Secretary Morgenthau's suggestion to curtail the agricultural program, the C. C. C., the N. Y. A., and Public Works activities, there should be reconsideration of the W. P. A. and a few other emergency activities. This might easily justify the addition of three-quarters of a billion or more to the proposed savings.

Senator VANDENBERG. May I ask whether, in making that observation, your committee has taken into account that the application of priorities and curtailment under the present summary formulas that have been used will probably cause more unemployment than we had at the height of the depression?

Professor FAIRCHILD. We are not of the opinion that taking everything together—priorities and other defense arrangements—the amount of unemployment is going to increase.

I have, in fact, every reason to believe that the present industrial activity, caused by defense enterprises and otherwise, will cause unemployment to definitely decrease.

Senator VANDENBERG. I hope you are a good prophet, but your prediction is not so far borne out by what is happening in Michigan by reason of the decimation of small businesses as a result of these summary curtailments and priorities.

Professor FAIRCHILD. I have never undertaken to bear the mantle of a prophet, but I think the facts before us are sufficient to warrant the assumption that these activities should result in less, rather than greater, unemployment. That is why I take the position that certain activities established to combat unemployment and the depression may now safely be curtailed, greatly reduced, or altogether ended.

In the second place, from a review of the 1942 Budget estimates, it is apparent that there are numerous regular old-line or less emergent activities which, without elimination in any case, could safely be reduced in scope. If these were cut back to levels somewhere between the high and low points of the past 5 years, additional savings of some $300,000,000 would be possible.

5. *Avoidance of waste and extravagance in all Government expenditures.*—While we advocate a reduction of nondefense expenditures to the minimum, consistent with efficient performance of essential activities, we admit the necessity of bearing the cost of whatever may be required for national defense.

In making this distinction, however, between defense and nondefense expenditures, it should be recognized that there is no more excuse for waste and extravagance in national defense than in other Government service. Furthermore, an expenditure of doubtful necessity cannot be justified simply by tagging it with the defense label. We urge, therefore, that all governmental activities be examined as to the efficiency and economy of their performance. Any such examination would obviously be so detailed and searching that it is impracticable to estimate the magnitude of savings that could be obtained by this means. Nevertheless, such savings are believed to be substantial.

Senator WALSH. Who should take the initiative, in your opinion, in cutting these nondefense expenditures and effecting these economies?

Professor FAIRCHILD. It seems to me that that is a task which should be undertaken by all branches of the Government; the legislative and the executive.

Senator WALSH. Don't you think that it requires "must" legislation to get reductions in appropriations as much as it does to get "must" legislation to get the appropriations themselves?

Professor FAIRCHILD. I am sorry; I did not quite hear that.

Senator WALSH. Don't you think it requires force from the administrative departments of the Government who come here and ask for these appropriations, and show how the money can be procured to effect these economies?

Professor FAIRCHILD. I think certainly an interest in economy and effort to bring it about by the administration would be most desirable. On the other hand, Congress is the final authority for making appropriations and has in its hands the spending policy of the Government.

Senator WALSH. Don't you think the agencies who come here asking for this money should also come here with a program for these economies?

Professor FAIRCHILD. I think that all agencies of the Government should do so.

Senator WALSH. Have you seen any such program?

Professor FAIRCHILD. I have mentioned the suggestions made by the Secretary of the Treasury.

Senator WALSH. It has been my experience that without the active support of these agencies who appear here requesting the money, unless they get behind the program of economy, there never will be any.

Professor FAIRCHILD. I subscribe to that statement; and I, of course, as an outsider here, can do nothing more than offer suggestions.

Senator WALSH. Yes; what I had in mind is that there is a disposition to say Congress ought to do it, but unless there is some leadership in the force that asks us to get the money, there is going to be, in my opinion, no program of economy.

Senator VANDENBERG. I want to apologize, but I have now to leave and go over to the Senate where I could give you an excellent example of what happens to one when he tries to save a little money and promptly gets his throat cut.

Professor FAIRCHILD. It must be recalled that, no matter how difficult it is to raise additional tax revenues, money is easy enough to spend. A dollar saved in Government outgo is just as good for financing defense as a dollar of new taxes. The significance of the sum of $2,000,000,000 becomes apparent when it is realized that this figure is one-fourth more than the original 1942 Budget estimate for individual income-tax collections and probably exceeds the total of such collections that is now expected under present law. It is about equivalent to the yield from the corporate income tax as estimated last January and equivalent to the revenue expected from liquor taxes and manufacturers' excise taxes after adding the increases of the pending bill.

6. *Congressional Budget agency.*—Whether or not it proves practicable to curtail expenditures for the current fiscal year by such a substantial sum, we firmly believe that the indicated reductions in nondefense spending could be made for the fiscal year beginning July 1, next, for which the Budget is now in preparation.

In this connection it is to be recalled that on various occasions the national chamber has advocated, and Secretary Morgenthau has proposed, that Congress adopt devices to protect itself from pressure for increased expenditures. Specific procedure to this end must be left to Congress to decide, but we support the Secretary's proposal for closer association between the appropriating and money-raising committees of both Houses of Congress in cooperation with representatives of the executive branch. Without attempting to specify a method, we believe that the whole procedure with respect to congressional action on the Budget should be reexamined in the light of present needs.

In past years we have advocated that a device such as a budget committee be used to establish a ceiling on the total of Federal expenditures. We recognize that there are limitations, in present circumstances, as regards defense outgo, but we still believe that such method should be used to fix a definite total for nondefense expenditures and that it would be most helpful in reaching a careful estimate of expenditures for defense.

Such a device would have distinct values not only in determining a wise spending program in connection with existing activities but should result in more careful weighing of proposed spending for new activities which under existing conditions should be foregone or at least deferred.

In addition to other benefits, this plan would have the merit of relieving the pressure upon individual Congressmen exerted by various groups, official and unofficial, for appropriations for nondefense purposes.

II. *Limitations upon further tax increases.*—While our committee, as I have said, is convinced that, in the present emergency, the greatest possible share of essential governmental costs should be met by taxation, there are certain considerations indicating clearly that there are limits beyond which taxation cannot be pushed without threat to our existing economic and political institutions.

1. *Taxation in relation to national income.*—The increases in taxes contemplated under the pending bill may be expected to bring the total burden of Federal taxes (for the present purpose I include the social-security taxes) up to about $12,000,000,000 in the 1942 fiscal year and to about $14,000,000,000 in the first full year of operation, depending upon the level of economic activity. State and local Governments are taxing at the rate of a little more than $9,000,000,000 a year, which would make the total national tax burden about $21,000,000,000 in 1942 and $23,000,000,000, or more, in the first full year of operation.

Nobody can say exactly what the national income for 1942 will be. Assuming for the sake of the calculation that it will be somewhere between 90 and 95 billions, the taxes will be between 22 and 23 percent of the national income in the fiscal year 1942. With the prospect of still more taxes, it would seem that for some years the American people will be called upon to pay taxes amounting to about a quarter of the national income.

While this may to some appear moderate in the light of the threat of war and the consequent possibility of still further tax increases, it should be recalled that even during the World War peak in 1919 and 1920 Federal, State, and local taxes took only 12 to 13 percent of the national income and in the worst year of the immediate post-war depression (1921) the ratio of taxes to national income was less than 16 percent. The World War peak amount of Federal taxes was $6,700,000,000 in 1920, or $63 per capita. Total per capita taxes that year were $85; 1941 per capita taxes were approximately $125, and by 1943 they are expected to be around $170.

A comparison of our total tax burden with that of the United Kingdom of Great Britain and Northern Ireland is significant. Despite the high income-tax rates imposed by Great Britain on corporations and individuals, the per capita tax burden in the United States surpassed that of Great Britain in the fiscal year 1940. In the last completed fiscal year 1941 and in the current year 1942 as estimated, including both the recent increases in British taxes and the proposed increases in our pending bill, the tax burden in the United States is just about equal to the British tax burden, whether measured as a per capita burden or as a percentage of national income.

These are the two bases that show most accurately comparative tax burdens. A form of comparison that is frequently used in current popular discussion, based on relative rates of corporation and individual income taxes in this country and Great Britain, is altogether unsound and meaningless.

2. *Effects on State and local revenues.*—If, as has been suggested, the national tax program should have regard to the preservation of our existing political institutions, then it is evident that the Federal Government, in seeking opportunity to extend its own taxes, should have regard to the repercussions upon the revenues of the States and their local subdivisions.

Many of the forms of taxation used by the Federal Government are also relied upon by the State and local governments.

It is significant, for example, that 33 States rely extensively upon receipts from individual income taxes for State revenues. From this source they derive about $220,000,000 a year. Twenty-three of these States permit their income taxpayers to deduct Federal income-tax payments from their net taxable income for State income-tax purposes. By so doing they permit the State taxable base to be reduced by an amount equivalent to the Federal tax. Under the rates of the proposed bill these reductions would be about doubled, amounting in many States to as much as a quarter of the State taxable base—in some States to even more. Revenue shrinkage will, of course, be even greater in proportion because the amounts of income subject to the higher rates will be reduced.

Corporation income taxes, to the extent of about $140,000,000, are also levied by 32 States. Twenty-one of these States allow a deduction similar to that permitted for Federal individual income taxes, and because of this their revenue loss is again considerable.

The estate tax policy of the Federal Government in recent years has caused a rapid absorption by it of this source of revenue, which it would be proper to relinquish to the States. The proposed rates, lacking any additional credit for taxes paid a State government, would accelerate this absorption. Our position in the matter of death taxation will be presented by Mr. Osgood. I fully agree with his statement as to the loss of future revenue because of present high rates, the injustice from continual shifting in the basis of a capital levy, and the resulting discouragement to saving.

Considerable overlapping of Federal and State tax systems has grown up as the result of a natural development and is doubtless bound to continue. While not necessarily harmful under ordinary conditions, this overlapping becomes a cause of serious danger to the States when their citizens face not only heavy increases in Federal tax rates, but also State budgetary difficulties and the possibility of additional State taxes because of the loss resulting from Federal tax increases. Moreover the States are injured when changes in Federal taxes are made without allowance of sufficient time for the States to make appropriate adjustments in their own taxes on the same objects or without proper consultation and cooperation between Federal and State taxing authorities.

With Federal taxation of incomes, estates, and gifts, and commodities as high as they now are, further increases are certain to present serious restrictions upon the power of the States to secure their customary adequate revenues.

Senator DAVIS. Mr. Chairman, I have to leave to go over to the Senate. I would like to have in the record a communication from Mr. Charles R. Hook, president of American Rolling Mills Co.

The CHAIRMAN. You may put it in after Professor Fairchild's testimony. The committee will sit until Professor Fairchild has finished, and will then recess.

Professor FAIRCHILD. I have almost finished.

Eventually the result might be the loss of the financial integrity of the States. Once financial independence is lost, political sovereignty cannot long endure. The Congress, in considering the additional Federal taxes, needs therefore to be watchful of the effects upon the States and the possible threat to their financial solvency and their continued existence as sovereign units in a federal form of government.

III. *The primary purpose of taxation.*—Although few would fail to recognize that the primary purpose of taxation is to raise revenue for the Government, there is frequently the temptation to make the tax system serve also certain other ends, such as the redistribution of national wealth, the equalization of incomes, the curbing of profits, the checking of inflation, etc.

It is submitted that the present interests of defense and sound national finance will best be served if tax legislation is devoted strictly to the primary purpose of obtaining revenue to meet the costs of defense. To a certain extent most of the incidental purposes which I have mentioned will be accomplished anyway by a tax system whose objective is revenue. That is well enough. To go beyond this and seek to modify the tax system in order to accomplish one or more of these other ends would lead into a field in which we have no very clear guideposts either of theory or of practical experience. The doubtful advantages that might be obtained are not likely to be worth the consequent weakening of the tax system as a producer of revenue.

In particular, there is grave danger in the proposal to use the tax system as a means for controlling inflation. While there is reason to believe that, under certain circumstances, taxation might be employed so as to produce beneficial results along this line, the subject is an extremely complicated one. It is quite possible, for example, that income taxes employed for this purpose might have more effect in reducing savings than in reducing consumer demand for goods. On the other hand, there is no certainty that excise taxes imposed upon certain commodities whose consumption is to be checked or whose prices are to be kept down would not result in practice in checking the demand for quite different commodities. After all, the consumer has the choice of the particular expenditure he will curtail in order to meet the new tax. A normal effect of excise taxes is to raise the prices of the taxed articles. To the extent that this results, the taxes are directly inflationary. Taxation aimed to limit consumer purchasing may adversely affect production of consumer goods and so offset by reduced supply the intended effect of reduced demand. Even if the result should be neutral as to price, it is a far less healthy and beneficial adjustment than the natural correction of increased consuming power through increased supply of consumers' goods.

It is futile to place our trust in a dubious use of taxation to prevent inflation in the face of the various inflationary policies which are being followed by the Government itself. For example, the wage policy, some forms of Government spending, the measures taken to increase agricultural prices, the credit and monetary policies, including the

continued purchase and monetization of silver, some of the fiscal practices which contribute to the creation of enormous excess bank reserves, the powers to devalue the dollar and print greenbacks, and other aspects which might be mentioned. If the Congress desires to prevent inflation, it is in the modification of such policies that it can find opportunity for really effective action.

This is only a brief sketch of some of the reasons which lead the chamber of commerce committee to feel that at the present time the Federal taxes should be enacted with the clear purpose of raising revenue to meet the cost of defense rather than to accomplish other social or political ends.

Senator BAILEY. You mentioned those possible causes of inflation, but is not the principal cause of this threat of inflation the fact that we have had for years, and will continue to have an irredeemable character of currency, plus the deficit financing? Are not those the main causes of inflation?

Professor FAIRCHILD. I think those are important causes.

Senator BAILEY. What else is there?

Professor FAIRCHILD. I would rather rest on the statement these are very important causes, along with other causes. It is difficult to appraise the relative importance of the various factors involved.

Senator BAILEY. Can we hope to get rid of our tendency toward inflation until we get rid of our system of irredeemable currency and deficit financing?

Professor FAIRCHILD. It is my opinion that a return to a redeemable standard of currency based on the gold standard would be most beneficial for many reasons.

Senator BAILEY. How would taxation head off inflation?

Professor FAIRCHILD. Could I just finish my answer to your previous question?

Senator BAILEY. Yes.

Professor FAIRCHILD. Deficit financing has been, for a decade or more, I think, an important cause of inflation, or threat of potential inflation. Now, to say that we should get rid of deficit financing at this time is, of course, a counsel of perfection which I would not care to urge upon this committee. As I said, we are bound to face deficits as long as this program goes on, or at least for the next 2 or 3 years. Nevertheless, I agree with you that any diminution of the deficit is most desirable. Any step toward an approach to a balanced budget is anti-inflationary.

Senator BAILEY. I agree with you as to the necessity for deficits for at least 2 years, but the threat of inflation is now here. Now, is the remedy in taxation against that threat, or is the remedy in a redeemable currency?

Professor FAIRCHILD. I think the remedy lies in what you say, making the deficit as little as possible and, in addition, in a great many other policies which are largely inflationary being stopped. I would place the remedy not in one or two of these, but on the correction of a great number of policies which are inflationary in their general effect.

Now, as to taxation: I am aware that one thing taxation can do is to reduce the incomes available to consumers, as anyone recognizes.

Senator BAILEY. Well, the money is expended; it doesn't take the money out of the economy; the money continues in the economy?

Professor FAIRCHILD. But it reduces the deficit financing; the more you get from taxation, the less deficit financing is necessary.

Senator BAILEY. But you can't get rid of that anyway for 2 years, you say.

Professor FAIRCHILD. I also said that, while you can't get rid of it, any reduction is in the right direction.

Taking money from consumers in taxation, thereby reducing the deficit financing of the Government is antiinflationary.

Senator BAILEY. It has really got to greatly increase for the coming 2 years, next year will be $9,000,000,000 more than the revenue.

Professor FAIRCHILD. Certainly.

Snator BAILEY. And the year following that will probably be $12,000,000,000; so you are not getting rid of deficit financing by taxation. Then you must find another remedy.

Professor FAIRCHILD. No; I said that you cannot entirely avoid deficit financing. While you cannot get rid of the deficit, any reduction is antiinflationary. Now, I don't want to be put in the position of overemphasizing the efficacy of taxation to prevent inflation. There has been a tendency to exaggerate the efficacy of taxation as a means of preventing inflation. It is a complicated matter. It is difficult to appraise, and overtaxation could be used to prevent inflation, while not accomplishing other unfortunate results.

My own opinion of the place where taxation would be most effective would be as it falls on the incomes of those who are not now generally paying income tax; those who were receiving less and who doubtless will, as a result of defense activities, very largely increase their income.

Now, there is a point where I am inclined to think that Federal taxation measures will probably have a considerable antiinflationary effect. I am not hopeful of a wide progrom of attack upon inflation by taxation, and also, as will be more clear as I proceed, this antiinflationary effect of taxation would, I think, be produced anyway if you set out to construct and set up a sound system of taxation for one purpose and only for the one purpose of raising revenue, which means that attention in framing tax measures should be primarily directed to the problem of producing revenue to meet current costs. Such advantageous effects on inflation as might result will result incidental to that program, even though it were not specifically directed to removing inflation.

Does that answer the question?

Senator BAILEY. I am not clear that inflation is permanent. I just hear that there is for the first time in the country, a considerable fear of inflation and I cannot help but think that taxation is not the remedy in the first instance. It is agreed that you are not to get rid of your deficit financing for 2 or possibly the next 10 years.

Professor FAIRCHILD. I would have no hesitancy in saying that taxation alone cannot remove the threat of inflation.

The CHAIRMAN. You may proceed.

Professor FAIRCHILD (continuing):

IV. *A balanced revenue system.*—The present revenue bill proposes to obtain 3¼ billion dollars of additional tax revenue. Two-thirds of this total is to come from income taxes on corporations and individuals. Having in mind the great heights to which the Federal taxes upon incomes, corporate and individual, have already attained, there is

grave danger to the Government and to the economy of the Nation in any such reliance upon income taxation. Taxation of incomes as heavy as this has a profound effect in reducing the supply of capital available for production, checking savings and discouraging investment and business enterprise.

A study of income statistics indicates that incomes in the high savings brackets have been considerably reduced, due not only to taxes but also to declining interest rates and other conditions. Even in the lower income brackets a number of influences have combined to discourage savings.

It is well known that the building of an estate, due again to high taxes, low interest rates, and uncertainty of values, is much more discouraging than in times past.

At a time like the present, when the demands of defense require that national production be stepped up to the utmost, it would be suicidal to enact revenue measures which tended to reduce production by discouraging investment and business enterprise.

The heavy reliance of the present bill upon income taxes is not only a discouragement to savings. It fails also to meet the test of equitable distribution of the cost of defense. More than one-fourth of the total yield proposed is to come from the individual income tax. Moreover, the persons who pay individual income taxes would also bear the bulk of the burden of the corporation income tax, the capital-stock tax, and the estate and gift taxes. These taxes together are called upon to furnish nearly three-fourths (almost 73 percent) of the total additional tax revenues which this bill is estimated to produce. And even the remaining 27 percent, coming from excise and miscellaneous taxes, is heavily weighted on the luxury side and so aimed at the same group of people. This bill thus proposes to place the major part of the burden of new taxation upon the same group that already contributes the bulk of the Federal taxes.

This class now consists of about 7,000,000 people, individual income taxpayers. If we allow for other members of the families of taxpayers, we may estimate roughly that some 20,000,000 people, or about 15 percent of the population, are to be called upon to contribute the bulk of the 3¼ billion dollars of tax revenue which this bill calls for. The obvious injustice of this distribution is further emphasized by the fact that a very large portion of the increased national income which is being predicted as the result of defense activity will inure to the other 85 percent of the people, who do not bear the burden of the income and similar taxes. This proposal departs far from the purpose expressed by Secretary Morgenthau, "that all sections of the people shall bear their fair share of the burden."

In addition to its injustice, the choice of taxes of the present bill is woefully weak as a revenue measure. If we are going "all out" to raise the maximum from taxation, we shall have to give up the idea of relying chiefly on the 5 or 6 percent of the people who now pay income taxes. This class probably receives about one-third of the national income. Of the increased national income which is expected to justify our estimates of future tax capacity it is likely that this class will receive far less than one-third. It should be apparent that any real emergency-tax program must be composed of taxes that place reasonable burdens upon all recipients of the national incomes. We must go out after the money where it is. New incomes and new increases

in incomes flowing to the great mass of nonincome taxpayers should be considered, with provision for some form of collection at the source, much along the lines of a withholding tax, such as is in force in Canada, with or without devices for credits against income tax. Future increases in effective rates of income taxes should be accompanied by removal of a number of inequitable provisions of the Internal Revenue Code that bear with special hardships upon incomes derived from savings. Specific suggestions on these points, with reference to the terms of the pending bill, will be presented in later testimony.

Senator BYRD. I would like to say that Professor Fairchild has made a fair and very able statement. I want to compliment him on it.

Professor FAIRCHILD. Thank you.

The CHAIRMAN. Any questions? Professor, we thank you.

(Following is a memorandum presented by Senator Davis from Mr. Charles R. Hook, president of the American Rolling Mills Co.:)

The injurious action of the provision 204 (3) in the 1941 revenue bill should be remedied by either the entire elimination of this language or by restricting it to taxable years beginning after December 31, 1940.

1. 204 (e) relates to the excess-profits credit carry-over and applies in a retroactive manner not only to the full year 1941 but also to any "taxable year beginning in 1940." This new provision would substantially nullify the constructive action of Congress a few months ago when it enacted the excess-profits tax amendments of 1941 in March.

2. The proposed section 204 (e) discriminates against a company which could not take the benefit of its excess-profits credit in 1940. Such a company would have to pay a heavier tax on its average earnings for the 2 years 1940 and 1941 than a company which could take full advantage of its 1940 credit.

3. Companies guided by the March enactment of excess-profits tax amendments have gone forward with plans for necessary plant expansion to meet national-defense needs on the basis that last year's unused credit has been finally determined. The proposed drastic revision of such credit would severely penalize such companies acting in good faith on recent congressional action.

Recommended.—Either strike out 204 (e) from the pending bill or substitute for the words " in 1940" the words "after December 31, 1940."

The CHAIRMAN. The committee will recess until 2 o'clock this afternoon.

(Whereupon, at 12:10 p. m., a recess until 2 p. m. this afternoon was taken.)

AFTERNOON SESSION

(Pursuant to adjournment the committee met at 2 p. m.)

The CHAIRMAN. The hour for reconvening has arrived. Due to a situation in the Senate, most of the Senators are over on the floor—that is, most of the members of this committee—because of the difficulty of holding a quorum over there.

While I dislike to do it, the committee is almost in the position where, in view of the heavy schedule of today and all next week, it will have to proceed, I regret to say, at this time, and I will not make a further announcement. It is possible we will carry the hearings over tomorrow, although the committee had not intended to have a Saturday session.

I would be willing for the committee to meet in the morning if we could have a reasonable number of the members of the committee here to hear such witnesses as would rather go over until tomorrow.

Dr. Anderson, would you prefer to go on this afternoon?

Dr. ANDERSON. Just as you please, Senator.

The CHAIRMAN. Under the circumstances—you see the situation now—other members of the committee may be coming in before you can finish your testimony, but I am not sure how many of them can get here because of the situation in the Senate. If you care to proceed, I will be very glad to have you proceed.

STATEMENT OF DR. BENJAMIN M. ANDERSON, LOS ANGELES, CALIF., PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Dr. ANDERSON. All right, sir. It is a privilege to talk to you, at all events.

The CHAIRMAN. I regret very much that we have not the other members of the committee here, because I would like the committee to hear your statement. I, of course, would be glad to have it in the record as a part of the record in the case.

As is usually the case, when the Senators are not able to be present to hear the testimony, they always read that part of the testimony in the record anyway.

Dr. ANDERSON. Yes, sir.

Our congressional system, under which the details of legislation dealing with economic topics are worked out by separate committees, is doubtless very necessary from the standpoint of careful draftsmanship and efficient legislative procedure.

I have been very much impressed this morning with the sympathetic attention that the committee has given to technical points raised by individuals who claim hardship, but this system has one immense disadvantage. The different aspects of our economic life are, in fact, intimately interrelated.

Under our system one committee will deal with one segment, and another committee with another segment, and another committee with another segment, and it is difficult, in the extreme, to get the senatorial mind on an economic problem as a whole. It is highly important that what is done by one committee should be coordinated with what is done by other committees if sound general economic policy is to be followed.

Concretely, the immense problem of preventing a ruinous inflation will involve the following elements, only two of which can certainly be dealt with by the Finance Committee—though a third may be—but all of which can be dealt with by the members of the committee in their capacity of Senators, and all of which ought to be in the minds of the committee as it deals with the problems of Government finance.

To hold down prices, we wish, on the one hand, to reduce the demand for goods and we wish to, on the other hand, do what can be done to increase the supply of goods.

One tremendously effective way of reducing the demand for goods is adequate taxation of the incomes of those who buy goods, and this is one of the central problems you have to consider in passing on the pending tax bill.

But another vital point in holding down the demand for goods is the borrowing policy of the Government, and this is very definitely in the province of the Finance Committee of the Senate. If the Government, with its desire to borrow as cheaply as possible, continues to take advantage of the great artificial cheapness of bank money, and continues to borrow primarily from the banks instead of offering its long-

term bonds at rates that will attract investors' money, relying on the bank expansion rather than on the savings of the people, we are going to have very great difficulty, indeed, in holding prices down by price fixing or by any other measures.

Again, if the Government continues unchecked its nondefense expenditures, competing with itself in the markets of the country, it will force up prices much more rapidly than would be the case if the Congress asserted its powers by amendment to the pending tax bill, providing a mandatory reduction of nondefense expenditures.

The English Parliament in the old days knew how to hold down an extravagant king. The Congress of the United States should assert its powers. It is one of the most precious legislative powers, deciding how much money shall be spent.

It is, of course, a pity that we have separate committees for appropriations and for finance. We shall have no adequate budgetary control unless the Congress sees fit to prepare revenue measures and appropriation measures in one document, worked out in the same committees. But I think that a provision requiring the reduction of nondefense expenditures from existing appropriations might well be germane to a tax bill.

The question of the monetary policy of the Government is, of course, very closely related to the question of inflation control, and very closely related to the question of the Government's borrowing policy, the latter being in your jurisdiction. I venture to urge the members of this committee who are members also of the Committee on Banking and Currency, as well as all members of the committee in their capacity of Senators, to give very serious attention indeed to the recent unanimous recommendation of the Board of Governors of the Federal Reserve System, the 12 presidents of the Federal Reserve banks and the Federal Advisory Council that the Federal Reserve authorities be given power to raise the reserve requirements for the member banks of the Federal Reserve System. If I were presenting this to the Banking and Currency Committee, I should wish to go into some technicalities here, but I content myself with making the observation that the maximum increase proposed by the Federal Reserve authorities would put the reserves of the great banks of Chicago and New York at 52 percent, which is too high for the flexibility of banking, and that the maximum ought not to exceed 40 percent.

There is another major factor on the supply side which is outside the jurisdiction of this committee but which I wish to mention here because of its tremendous importance.

Senator Bailey was raising questions this morning about the element in this problem of controlling commodity prices. I think heavy emphasis should be put on that. Production in the United States is handicapped by the 40-hour-week legislation with its requirements of 50 percent for overtime after 40 hours.

We should find a very great slack revealed in our industrial capacity if this 40-hour week were abrogated for the period of the war emergency. It will not do, if we are trying to hold down prices, to say that we can get the extra labor time by paying the extra 50 percent for overtime. If we do that generally, we shall have forthwith a great rise in prices. We are doing it on a substantial scale in defense industries where the Government is paying the bill. But if we apply it generally, we do it only at the expense of a general rise

in prices—to be followed by a further rise in wages, making a new hurdle in the 50 percent for overtime, and with the further certainty of much higher commodity prices than would otherwise prevail. The theory of the 40-hour week is not that it is harmful to the health of men to work for more than 40 hours; it is rather that there are not enough jobs and that we want to spread the work. This theory has no place in time of great national emergency when we are trying to use all our resources.

There are yet other aspects of this inflation problem. But I have imposed upon the patience of this committee enough in trying to present the major phases.

It is certain that if we do not control the underlying forces that make for higher prices, the efforts at price fixing under the bill now pending before the House of Representatives would be a ghastly fiasco. General price fixing, in any case, must be a ghastly fiasco. The place for price fixing is where you have a great scarcity of commodities vitally needed by Army and Navy, where the Government is itself an immense dominating purchaser and where there is not enough to go around for the new defense purposes and the ordinary civilian purposes. And the further place where price fixing is justified is in the case of some necessity of life, like bread or fuel.

When you fix a price, you must provide substitutes for the work that the free price would otherwise do. Prices have work to do. When supply is short and demand is strong, a rising price operates to check demand and to increase supply. The less pressing demand drops out, new sources of supply come into the market, and an equilibrium is reached. If we are going to fix a price, we must take control of supply and demand; you must ration out the supply, giving priorities to the most important needs, or in the case of civilian goods, see to it that, even though nobody gets all he wants, on the other hand nobody shall be entirely without what he needs. This is a tremendous job. It calls for close study of the supply situation and of the need situation.

We did this in the last war for a very limited number of commodities. We did not at all undertake it for commodities in general. We let the prices of nonessentials take their own course and we let the prices of a great many comforts take their own course.

We fixed the prices of certain essential foods and fuels, rationing out supply, limiting the amount which any one purchaser could buy. We made no effort to fix the price of silk stockings. We curtailed automobile production drastically, reducing it to 25 percent, but we did not undertake to fix the price of automobiles and we did not undertake to fix priorities among the consumers of automobiles. It was possible, with sugar, to say that one purchaser would get only 2 pounds at a time, to make a scant supply go round so that all had some sugar. But I don't know how it would be possible, with anything like justice, for the Government to undertake to ration the supply of pleasure automobiles. Who could say that I should have one and that my neighbor should not have one? We left that question to the market in the last war. A great many people who would have liked to buy new automobiles refrained from doing so because they cost too much, while men whose automobiles were most nearly worn out bought new ones.

Incidentally, I raise the question of the equity or justice of taking away essential supplies from an industry, compelling it drastically to

curtail its activities, and, at the same time, saying to it that it must not raise its prices on what it does produce.

Overhead costs rise rapidly when volume is curtailed. The rising price of the scant output is justified from the standpoint of costs, and the desirability of having a solvent industry when the emergency is over would suggest the desirability of allowing an industry to recoup part of its losses by higher prices.

In the last war, we did not undertake to control retail prices at all, except in the matter of food and fuel. I quote from War Industries Board Price Bulletin No. 3, Government Control Over Prices, by Paul Willard Garrett, assisted by Isador Lubin and Stella Stewart; Washington, Government Printing Office, 1920, page 550:

> The great bulk of regulation over prices administered by the Federal Government during the war pertained to producer or wholesale prices. There was no real attempt to save in food and fuel, to control prices at retail. The task of controlling retail prices was undertaken in a comprehensive manner by the Food Administration after its wholesale control was well underway.

The price-fixing legislation and price-fixing policy apparently contemplated in the legislation pending in the House is far more ambitious than anything we undertook in the last war, and even such things as we did undertake in the last war, unless buttressed by adequate action with respect to taxation, Government borrowing policy, and the other things I have referred to, would have been almost impossible.

With this background, I turn to the pending tax bill. You are concerned with getting revenue so that you can pay as much as possible of the new defense expenditures out of taxes rather than with borrowing. And you are concerned with this both from the standpoint of maintaining the solvency of the Government and from the standpoint of preventing a ruinous rise in prices and costs. These two purposes are harmonious so far as the measures to be considered are concerned. To get revenue for the Government out of the incomes of the people, you must go where the income is. And to prevent a rapidly rising income of the people (growing out of war expenditures) from competing with Government, you must take that part of the income which is most rapidly rising. Where is the income of the country?

I call your attention to figures drawn from the Statistical Abstract of the United States for 1940, page 314, which gave, for the years 1929, 1938, and 1939, a classification of the income paid out. I read the figures here only for 1939, but I offer the table for your record, which gives the same figures for 1929 and 1938 also.

National income paid out, by types of payment

	Amount (millions of dollars)			Percent distribution		
	1929	1938	1939	1929	1938	1939
Income paid out, total	80,611	65,007	68,600	100.0	100.0	100.0
Compensation of employees, total	52,776	44,301	46,768	65.5	68.2	68.2
Entrepreneurial withdrawals	12,620	10,473	10,826	15.6	16.1	15.8
Dividends	5,945	3,370	4,124	7.4	5.2	6.0
Interest	5,906	4,888	4,832	7.3	7.5	7.0
Net rents and royalties	3,364	1,975	2,050	4.2	3.0	3.0

Compensation of employees, 68.2 percent of total income paid out. Entrepreneurial withdrawals, 15.8 percent. (Entrepreneurial withdrawals means money taken out of unincorporated businesses by the owners or partners to live on.) Dividends, 6 percent of total national income. Interest, 7 percent of total national income. Net rents and royalties, 3 percent.

Now, a regrouping of these figures will make it clear that far over 70 percent of the total national income paid out is labor income. From the 68.2 percent compensation of employees, we must make a minor subtraction for large salaries, and, on the other hand, we must make a major addition for that part of entrepreneurial withdrawals, which represents labor income rather than profits.

The biggest element in entrepreneurial withdrawals is found in agriculture, where the farmer takes his profits when the harvest is made. But the farmer, although a businessman and the recipient of business profits, is also a workingman, and the greater part of the income of the farm owner, taking the country as a wh e, is not business profits, but rather, compensation for labor.

The same is true of the great bulk of unincorporated businesses. The boss barber and the master mechanic in a garage do not receive regular salaries. They take their income out of the business, but it is far more wages than it is profits that they take out of the business. I estimate that not less than half of entrepreneurial withdrawals constitute true labor income, and that we must, therefore, add 7.9 percent to the 68.2 percent of compensations of employees in getting at labor income.

I have indicated above that we must make a subtraction from that figure also for large salaries. Large salaries have been conspicuous in individual cases, but the total is small.

The total compensation of corporation officials in the United States was $3,337,000,000 in 1929, and was $2,171,000,000 in 1934. But there are over 475,000 corporations in the country and, when 3,000,000,000 is divided by 475,000, the average is $6,300 per corporation. And most corporations have more than one officer, while the large corporations have many officers. A very large part of the total salaries of the officials of corporations is essentially labor income. The salary of the president of a small mercantile corporation who is himself behind the counter and does part of the bookkeeping, and of the numerous minor executives, even in large corporations, are a true part of labor costs. The few conspicuous big salaries are altogether swallowed up in the totals for corporate salaries. We do not need to make any large subtraction from the percentage of labor income to take account of them.

I conclude that anyhow 74 percent of the total income of the country is labor income. What percentage of the income of the country represents the income of property and of business enterprise? To get this, I add the following items:

Dividends, 6 percent; interest, 7 percent; rents and royalties, 3 percent; and the one-half of entrepreneurial withdrawals, which represents profits rather than wages, adding another 7.9 percent. We thus get a total of 23.9 percent as representing all the income received for property ownership and business enterprise.

If I were giving a different table, based on income produced rather than income paid out, I should have to take account of another factor, namely, profits left in the business and corporate profits added to surplus. This was a negative factor in 1938, but was a small positive factor in 1939, and it amounted to about 1 percent of the total national income of 1940.

(See table, Survey of Current Business, U. S. Department of Commerce, June, 1941, p. 15.)

This factor of business savings is far too small, and does not appreciably affect the figure I have given above, based on the tables for income paid out.

Now, you need extra income for the Government; you need more tax money. Where are you going to get it? The answer, I think, is startlingly clear. You have already overtaxed the large incomes. You are already taxing corporate earnings to a point which I regard as very dangerous. I believe that the corporations ought to be allowed to make some profits and to keep some profits in this time of activity, if only that they may have something to fall back upon to protect their solvency when reaction comes. They made a lot of money in the last war, and in the postwar crisis it was extremely helpful. I watched it then as a banker and I saw corporations, desperately short of cash in the postwar liquidation readjustment, still able to get credit from the banks to carry on and do what business was to be done, and to make new plans, and start plans for new things, by virtue of the fact that their surpluses were large enough to stand the losses and to leave their capital unimpaired.

You have already terribly overtaxed the 23.9 percent that represents income from property and from business enterprise. You have already gone as far as I think you would feel there is any justification for going in taxing large salaries.

The head of a great institution, with a salary of $100,000, when he has paid his Federal income tax and his New York income tax, will have a little over $40,000, if the schedules in the bill before you stand. And if you take all the rest of his salary, you would do the Government very little good indeed, because there are so few men in his position. You must go where the income is.

The mercantile world has learned long since that there are not enough rich people to make profitable customers for many businesses. The great, successful businesses are, in general, those dealing with the great body of the people, not getting very much from any one of them, but getting a very large business in the aggregate. I think that the framers of tax legislation will do very well to consider that same principle. Relatively modest amounts taken from the recipients of 74 percent of the income of the country will bring you far more than taking all that is left from the recipients of the 23.9 percent.

I offer you some other figures bearing on this same point, drawn from the Statistical Abstract of the United States for 1940, on page 316. These figures are not as dependable figures as they would be if they had been prepared by the Department of Commerce alone. They relate to the 12-month period from July 1935 through June of 1936. These figures show that 69.10 percent of all the income of the country was received by families and individuals with incomes of $3.000 and less, and that over 80 percent of the total income of the country was received by individuals and families with incomes of $5,000 and less. Over 90 percent of the total income of the country was received by individuals and families with incomes of less than $15,000.

And finally, I offer one other set of figures to show where the most rapid increase in income is to be found. The following figures for pay rolls are taken from the Conference Board Economic Record, published by the National Industrial Conference Board of July 11,

1941. They are index numbers for pay rolls with a base of 100 in 1929.

1929	100	1940: January	90.4
1936	77	December	110.0
1937	92.8	1941: January	109.3
1938	71	April	122.1
1939	83	May	128.5
1940	95		

The figures for June and July I cannot give you exactly, but the rapid increase has continued.

I would, therefore, emphasize that, both from the standpoint of getting revenue and from the standpoint of holding down the growing income of the people, so that they may not compete too heavily in the purchase of goods with the Government, you should put heavy emphasis upon increased taxation of small incomes. I would support heartily the proposal that the exemptions for individuals be lowered to $750 and that the exemption for families be lowered to $1,500. I would urge you to consider how much more revenue could be got by putting these exemptions still lower.

I do not go into the technical points as between lowered income-tax exemptions and a withholding tax. There are men on this committee far better informed than I with respect to the technical problems of tax administration. My emphasis is on the general proposition that you should get a great deal out of incomes that have been so far untaxed, and out of incomes that have been so far untaxed, and out of incomes that have so far been lightly taxed; first, because you can make no real contribution to the Government's need for money by squeezing still dryer the larger incomes and incomes from property and business enterprise, and second, because taxation of these smaller incomes is vitally needed as part of an anti-inflation program.

The CHAIRMAN. Thank you very much, Doctor.

Dr. ANDERSON. I thank you for the opportunity of being heard.

The CHAIRMAN. Mr. Osgood. Mr. Osgood, we were thinking of adjourning the committee hearings to a room on the floor with the Senate chamber level, that is, the Military Affairs Committee, but if you prefer to go on here, under the circumstances, I would be very glad for you to proceed. We could go over there and after some 15 minutes reconvene and give you an opportunity to come on the witness stand there.

Mr. OSGOOD. Just as you prefer. I imagine, from what you say, the removal to the other place would be more convenient to you.

The CHAIRMAN. It would be very much more convenient and would probably enlarge the presence of some of the other senators. Fifteen minutes later would give you an opportunity to make your presentation and take your train or plane as you desire.

Mr. OSGOOD. Thank you very much.

The CHAIRMAN. The committee will adjourn to reconvene in 20 minutes in the Military Affairs Committee room, and all the witnesses who are to appear on today's schedule, we will be very glad to have you come to the Military Affairs Committee room.

Under the circumstances, it is necessary to do that in order to have present any of the members of the committee outside of the chairman.

(Whereupon, at the hour of 2:35 p. m. the committee adjourned and

reconvened at 3 p. m. in the Military Affairs Committee room in the Capitol.)

The CHAIRMAN. Gentlemen of the committee, Mr. Osgood, of Chicago, vice president of the First National Bank; the committee on Federal finance, United States Chamber of Commerce, had begun his statement when we recessed to this room. Mr. Osgood will now proceed.

STATEMENT OF ROY C. OSGOOD, CHICAGO, ILL., VICE PRESIDENT, FIRST NATIONAL BANK; COMMITTEE ON FEDERAL FINANCE, UNITED STATES CHAMBER OF COMMERCE

Mr. OSGOOD. Mr. Chairman and gentlemen of the committee, I am Roy C. Osgood, vice president of the First National Bank of Chicago and in charge of its trust department. I have been administering trusts in the bank for 35 years, and dealing with tax problems in connection with them. I appear here, however, as a member of the Committee on Federal Finance, Chamber of Commerce of the United States.

In connection with the work of various national and local organizations, and in various official and unofficial conferences, it has been necessary for me to give attention to legislation relating to estates and inheritances and the administration of such legislation by Federal and State officials.

My testimony will deal with the estate and gift tax aspects of the bill. This will be given in brief and I would like to file with the committee a supplemental memorandum presenting in detail the points outlined here.

A. GENERAL

1. *Estimated yields.*—The estate and gift tax revisions are estimated to yield approximately $152,000,000 in addition to the yield of the last year of $355,000,000, or a total of $507,000,000. This would increase the yield from this source 43 percent, but the increase would not be substantially effective until 1943. On the basis of the Treasury estimates of a tax system producing $12,606,000,000, estate and gift taxes would produce about 4 percent, and the increased rates about 1.2 percent.

The provisions of the House bill are a great improvement over and much sounder than the original Treasury proposals made last April to the Ways and Means Committee. However, when Mr. Sullivan appeared before your committee on August 8 he recommended changing the estate and gift tax rates in the House bill to those originally proposed by the Treasury and to reduce the specific exemptions and exclusions from $40,000 to $25,000. This change he estimated to produce an increased yield of $347,000,000. This is over $200,000,000 disproportionately too high in relation to estimated yields from other increases when compared with the proportionate yield from this particular tax source. The House bill recognized this and reduced it to $152,000,000. We realize the need of increased revenue production but like the Ways and Means Committee we think the total yield from this source proposed in the bill approaches a fairer sense of proportion.

2. *Sound temporary policy would propose no increase.*—The bill's proposed increase in rates, though producing only 1.2 percent of the estimated revenues, will, even as it stands, have a wholly disproportionate effect on our social economy. On the assumption that the present rates and exemptions are fair to our economy, as a sound temporary fiscal policy this increase should not be proposed.

3. *Sound permanent policy would reduce rates and increase exemptions.*—As a matter of fact, the present rates and exemptions are not fair to our economy. Sound permanent fiscal policy, if the estate and gift taxes are to remain as sources of Federal revenue, would require even the present rates to be reduced and the present exemptions increased.

B. ESTATE TAX CHANGES

1. *Estimated yields and rate increases.*—The estate-tax increased yield is estimated at $136,000,000. This is obtained by increasing the estate-tax rates. The 10-percent defense tax applicable to estates is made permanent. The $40,000 exemption remains unchanged. On a net estate of $50,000 (before exemption) the tax is increased from $220 to $550, an increase of $330, or 150 percent. On $100,000 it is increased from $4,620 to $9,570, an increase of $4,950, or 107.1 percent. On $400,000 it is increased from $63,780 to $99,530, an increase of $35,750, or 56.1 percent. On $1,000,000 it is increased from $228,780 to $308,090, an increase of $79,310, or 34.7 percent. The percentage of increase in the effective rates gradually reduces until at $100,000,000 the new rate is 1.8 percent higher than the present rate.

2. *Major increase falls on smaller estates.*—The last available Treasury report on estate taxes is for returns filed in 1938. This shows taxpayers reporting under $100,000 comprised 51 percent of the total; those reporting between $100,000 and $500,000 were 42 percent; and those over $500,000 were 7 percent. Assuming the year 1938 to be fairly representative, the new rates increase taxes on the estates of 93 percent of estate taxpayers from 150 percent to about 50 percent; and on 7 percent of the taxpayers from 50 percent to 1.8 percent. The major impact of the increase will fall upon 93 percent of estate taxpayers.

C. GIFT TAX CHANGES

1. *Estimated yields and rate increases.*—The gift tax increased yield is estimated at $16,000,000, beginning in the fiscal year 1942. The gift tax has been effective since 1932 and there have been changes in rates relative to the changes in estate-tax rates. The total tax collections in the 5½ years through 1937 were $280,000,000 or an average of $51,000,000 a year. At the existing rates the Budget estimate for last year was $31,300,000. Like the present law the new rates are three-quarters of the new estate-tax rates. The specific exemption of $40,000 and the exclusion of $4,000 per year for each donee remain unchanged.

2. *Major increase falls on smaller gifts.*—Inasmuch as the increases in the rates are relative to those of the estate tax, the major impact of the increase will fall upon the smaller taxpayers.

3. *No proper correlation of gift and estate tax and income tax.*—The lack of correlation, between the gift-tax law and the estate-tax

law and with certain provisions of the income-tax law, which calls for remedial legislation, remains unjust to taxpayers. The new gift-tax law not only does not remedy the situation, but makes the injustices more acute by increasing the rates. This will be referred to later in the testimony.

D. ESTATE-TAX PROPOSALS VIOLATE PRINCIPLES OF EQUALITY AND JUSTICE

1. *Death-tax laws and rates should be stable.*—One of the vital principles of death-tax legislation should be stability of laws and rates. Federal estate taxes have not been stable in the past. In the last 25 years there have been at least nine changes in the effective rate of the estate tax and four of these have occurred within the last 9 years.

2. *Federal estate-tax laws have been unstable.*—With this record of instability, equality among individual taxpayers was impossible. If A inherited a $200,000 estate in 1926 he would have paid $1,500 in Federal death tax. If B inherited the same amount in 1933, he would have paid $9,500 in tax. If C had inherited the same estate early in 1935, the tax would have been $12,800. D, inheriting the same in 1937, would have paid $19,800; E, inheriting the same estate after the Revenue Act of 1940, would have paid $21,600; F, inheriting the same estate under the act of 1941, would pay $38,270.

3. *Present proposals continue unsound principles.*—All of these changes have taken place in the short space of 14 years and are in addition to other changes in the law, which required readjustment in the plans of every person, so that many estates suffered heavily because of inability to plan payments. The new law makes another change and adds to the record of unstable tax policy.

4. *Instability of policy makes equality among taxpayers impossible.*—Equality among individual taxpayers is a prime requisite of any tax law. In the case of death taxes, equality cannot be had without stability in effect and rates. A death tax is different from other types of taxes in that the impact of death tax comes only at death. The ordinary forms of taxation, such as the income tax, are imposed annually. Thus, every year the taxpayer finds himself subject to the impact of this tax. Any change in rates affects all taxpayers alike. On the other hand, changes in the death-tax law and particularly those affecting the impact of the tax; that is, changes in rates, result in unequal imposition on the heirs of different persons dying at different times. On the ground of tax-paying ability, of justice, of obligation to support the Government, each estate should stand equal before the law. Any system of taxation which makes the amount of contribution of the different citizens depend upon such fortuitous circumstances as death is not in harmony with sound principles of taxation.

5. *Estate owners entitled to long-range planning.*—Every citizen should have the opportunity to plan his business, his investments, and the disposition of his property after his death according to his best judgment. If the citizen during his lifetime cannot know what will be the rates of taxation imposed upon his estate at death, he is denied this right.

6. *Instability of estate-tax policy makes planning impossible.*—Modern death taxes are substantial capital obligations which must be

paid out of the capital of the estate of decedent after death. With a stable rate of tax, even though high, the decedent during his lifetime can adjust his plans to consider the tax which will be payable at death. Continuous changes in laws and rates make it impossible to foretell even approximately what the tax will be when death occurs.

7. *Federal policy of instability causes inequality and injustice.*—If uniformity and equality as between individual taxpayers, prime requisites of any just tax, are to be obtained in death taxation, the laws and rates must be stabilized and placed on a more permanent basis. So long as the laws and rates are changed with the varying moods of Congress, inequalities and injustices will prevail.

8. *Estate-tax-rate increase of small effect on current policy.*—The raising of estate-tax rates cannot affect materially the current fiscal policies of the Government. As previously pointed out, most other types of taxes recur at regular intervals, normally once a year. The rates of such taxes are determined naturally, by consideration of the tax base and the amount of revenue to be raised to meet the needs of the Government. Rates will normally be subject to frequent change, in harmony with changed and unforeseen conditions. In such cases there is no long-range inequality among taxpayers produced by such changes in rates.

9. *Estate taxes are not adapted to accomplish elasticity of the tax sytem.*—The estate tax, on the other hand, occurs irregularly so far as the taxpayer is concerned, and is more or less irregular even from the standpoint of the Government. There is no direct relation between the needs of the Government and the estate-tax rates for the reason that there is no predictable tax base. Citizens die without regard to the needs of the Government, and deaths are not subject to the control of the tax collector. Obviously, therefore, the estate tax by its very nature is not adaptable for use as a flexible base to accomplish elasticity in the tax system. Other forms of revenue must be utilized to meet the expanding and contracting needs of the Government. The estate tax should be kept stable.

E. ESTATE-TAX RATE PROPOSALS VIOLATE PRINCIPLES OF MODERATION

1. *Basic principles of rate structure.*—In attempting to determine the rates to be used in estate taxation, they may reasonably be considered higher than the rates of an anually recurring tax on property; and the principle of progression is reasonable if reasonably applied; that is, the rates should not be excessive.

2. *Reasonable exemption for dependents should be allowed.*—From the standpoint of the decedent and his dependents, the rates of tax must not be so high as to make impossible or discouragingly difficult reasonable provision for the family and dependents. This principle indicates liberal exemptions from the standpoint of the common welfare.

3. *Law should consider family's economic position.*—It is a well-established principle of probate law that a widow's exemption and a child's exemption for at least a year for the purpose of debt priority should be sufficient to afford them support and maintenance in the manner of life to which they have been accustomed. A $100,000 Federal estate-tax exemption is about the minimum that ought to be

granted under a sound theory of exemptions. A liberal exemption makes the effect of the first rate or the first few rates both progressive and distinctly moderate as applied to the first brackets above the exemptions.

Those of you who are particularly familiar with the application of the present estate-tax law know we have not touched the basic exemption of $100,000 applied under the 1936 rate. That was reduced to $40,000, and has gone on ever since, except, as you know, the Treasury elected to have it reduced at this time to $25,000.

4. *Increased administration costs constitute increased tax burden.*—One other matter in connection with the exemptions involves the increased cost of doing business of those engaged in settling decedent's estates. With an exemption of $100,000, there are naturally fewer estates which require the difficult and technical task of preparing Federal estate-tax returns. When the exemption was reduced to $40,000 the time and work in settling estates between $40,000 and $100,000 was immeasurably increased. And now the Treasury would reduce the exemption to $25,000.

5. *Rates should not be so high as to stimulate evasion.*—Death-tax rates should not be so high as to stimulate avoidance and evasion. So long as death-tax rates are relatively low, the individual taxpayer finds it uneconomic to attempt to engage in activities resulting in avoidance or evasion of the tax. The rewards are not worth the cost or the risk involved. However, the higher the tax becomes the more profitable and attractive the avoidance or evasion appears to the taxpayer. When tax rates become confiscatory, every dollar or property included in the gross estate becomes important. Minor defects in the law are magnified and injustices become real.

6. *Law should not cause adverse social and economic effects.*—The adverse economic and social effects of high estate-tax rates deserve special consideration. The rates must be regarded from the social and economic point of view with respect to the effect of the tax upon industry. High rates are capable of producing a variety of results harmful not only to the persons called upon to bear the tax burden but also to the industry of the Nation. First of all there is the danger of large forced sale of assets. Few estates include large amounts of liquid assets. I think the general estimates are about between 10 and 11 percent.

At death, therefore, in order to meet heavy tax payments it frequently becomes necessary to sell a considerable part of the assets of the estate. The sale of these assets in time to meet the requirements of the law has a tendency to depress the market and to cause a decline of prices. Such sales, therefore, may be and frequently are, difficult except at a considerable sacrifice.

7. *In effect, the tax constitutes a demand loan payable at maker's death.*—Heavy taxes at time of death of a sole or principal owner of a business are also likely to result in forced alterations in its control through compelling the sacrifice of holdings by those into whose hands the control of the business would normally come following the death of such an owner. A heavy tax may compel the sale of enough stock to cause the loss of such control and the impairment of both the incentive and valuable management policies that have made the business

successful. In some cases the sale of the stock is impossible, and actual liquidation of the business is necessary. When a tax requires of an estate payments greater than can be met from cash resources on hand those in control of a closely owned business comprising substantially their entire resources may seek to avoid sale of assets by borrowing, and may be thus forced to make engagements so heavy as to impair the credit of the concern.

All of the foregoing effects, whether forced sale of assets, forced change of control, or strain upon credit, are made doubly serious because of their appearance at the very time when the enterprise is least able to stand the strain on account of the loss of personal management resulting from the death of the former head.

Senator GERRY. Have not you had some cases where the forced sale meant that the tax was greater than the whole value of the estate?

Mr. OSGOOD. Yes; of course, Senator Gerry, that was particularly true during the depression period, as we know. We had some very curious situations there, where a forced sale of the assets would not even produce the tax, let alone leave anything for the estate itself.

The injurious effects upon industry of excessive estate taxes are unfortunately not confined to the particular company involved in the estate. All who are engaged in such enterprise, and also many who are engaged in other enterprises related to those which are directly affected by the tax, are subjected to insecurity which is demoralizing and impairs the productive capacity of the community as a whole.

I might say that the First National Bank 2 years ago was made executor and trustee under the will of Louis Comiskey, the owner of the White Sox. The assets of the estate, the grandstand and the ball player investments, were not liquid. It took a great deal of maneuvering to keep the whole estate in the hands of the family, and the ball club in the hands of Comiskey's son, which was the third generation. We were just about able to do it.

8. *Sound fiscal policy demands moderate rates.*—Can we afford in such a period as now exists, no matter what may be advanced in the way of argument as to immediate revenue needs or other justification, to discourage the enterprises of living people, cause shut-downs of active businesses or violent changes in ownership through forced transfers? Under all these considerations a sound fiscal policy demands moderate rates.

F. EXCESSIVE RATES HARMFULLY DEPLETE FUTURE TAX BASE

1. *Rates should not harmfully deplete future tax base.*—We should be just as concerned with future tax capacity as with present revenues. The estate tax is essentially a capital tax, and if capital is dissipated through excessively high estate-tax rates, the tax base, that is, the capital which produces income subject to taxation may be lost in future generations. While it is important to have our present tax plans designed so that the present generation will pay for as much of the defense expenditures as possible, future generations will have their burden in paying for those portions of such expenditures as are financed by Government borrowings. Estate taxes force the second generation to pay twice: First, through loss of income on the capital levy involved in the estate tax and, second, in that generation's proportionate share of current taxes imposed at some future date.

2. *Excessive rates harmfully decrease productive wealth.*—If through excessively high income taxes the building of wealth through productive enterprise is prevented and if through excessively high death taxes such wealth as has already been accumulated is removed from productive enterprise, there will come a time when there is no wealth in productive enterprise. The final result will be a complete drying up of tax revenues from all sources which have productive wealth as their base.

If the committee is interested, I can furnish for the record some very interesting figures on the effect of what that would be.

The CHAIRMAN. We will be glad to have you do so.

Mr. OSGOOD (continuing).

G. SHOCK OF HIGH ESTATE TAXES SHOULD BE CUSHIONED

1. *Present cushion now inadequate.*—The only cushion now provided against the shock of the tax is the possibility of extensions of time up to 10 years in which to pay estate taxes. The present postponement carried 4-percent interest, and current income is less than 4 percent.

I might say I think this committee was largely responsible in reducing that rate from 6 to 4 at a previous period when we testified on the same subject.

Senator BYRD. Mr. Osgood, is that a matter of right? Has the taxpayer got a right to ask for that extension and get it?

Mr. OSGOOD. Yes; he has. He did have to pay 6 percent, and now he has to pay 4 percent.

Senator BYRD. I mean it is not subject to discretion?

Mr. OSGOOD. It is subject to a certain amount of discretion, Senator Byrd, because certain things have to take place. We practically have to prove to the Commissioner that we have to borrow to pay the tax in order to get a postponement. I might say most executors and trustees do not like postponements, because they like to get the thing out of the way if it is possible to do so.

2. *More adequate cushion should be made.*—Since estate taxes should fall as lightly as possible upon the actual capital of an estate, the taxes should, so far as possible, be payable as are other taxes, out of income. Under the present law, any postponement of the tax carries with it interest in excess of the earning capacity of capital itself. Obviously, practical considerations should reduce the interest rate upon extensions to at least 2 percent in order to allow an estate to meet some part of death taxes out of income.

H. RESERVES FOR ESTATE TAX

1. *Need for adequate tax-free reserve.*—Even with the existing high estate tax rates, some means should be provided whereby the shock of the estate tax upon noncash assets may be lessened and the Government assured the prompt payment of the tax. In this connection some form of tax-free reserve should be authorized.

We do not suggest any specific method as the best or only possible one, but suggest for your consideration two general methods for providing essential relief. It is believed that some combinations of these

two methods, which may be denominated (1) "self-insurance," and (2) "purchased insurance," may provide the most practical solution.

2. *Self-insurance method.*—This plan involves setting up a trust specifically for estate-tax purposes. If deemed desirable, the statute might limit the types of assets which could be placed or kept in such a trust, such as, for example, Government bonds, securities listed on the New York or other recognized exchanges, and the like. It is suggested, however, that no such special limitations be imposed, in order to avoid discrimination between investments, since the trust instrument would ordinarily contain provisions as to liquidity.

In the interests of simplicity and prevention of possible income-tax avoidance, such trusts should be permitted to be revocable, except that, after the settlor's death, the assets would be specifically earmarked for estate-tax payment and no prior distributions could be made till such tax liabilities were liquidated. The trust instrument could provide for the disposition of earnings prior to the settlor's death either by way of accumulation or distribution to him. In either event, the trust income would be taxable to the settlor. The instrument might also require as a guaranty of liquidity that the trust be liquidated within a relatively short time after the due date of the estate tax.

Whatever portion of the trust assets are required to pay estate taxes should be made exempt from such taxes, and any excess should be subject to tax. There should be no tax on the privilege of creating such trusts.

The principle of not taxing such portion of the estate as is required to pay the tax accords with the result now reached under the gift tax where the tax is paid by the donor out of the estate remaining to him after a gift. The tax so paid is not taxed as a part of the gift and operates to reduce the estate passing at death and subject to estate tax.

3. *Purchased insurance.*—Past proposals in this field have usually taken the form of exempting from estate tax the proceeds of life insurance, definitely earmarked in some way for the purpose, to the extent such proceeds are required to pay estate-tax liabilities with any excess added to the corpus and subject to tax.

The great advantage of this plan is its simplicity. On the other hand, a limitation of relief to this plan alone may be deemed objectionable because it may discriminate between taxpayers, since all taxpayers are not insurable. For these reasons it is believed that some form of both plans should be recognized by the statute, leaving the taxpayer to select the form best adapted to his own circumstances.

I might say that Kansas is one State in the Union that has such insurance provisions on this tax, and most of the Canadian Provinces have had them for years.

I. PROPOSALS ADVERSELY AFFECT STATE TAXES

1. *Decrease of States' share of death taxes.*—Under present law the maximum possible State share of combined death duties under the 80-percent-credit system ranges from 3.1 percent of the combined death duties on a net estate of $100,000—after exemption—to 21 percent on an estate of $50,000,000. In the proposed bill the amount would be reduced to 1.55 percent on an estate of $100,000 and to 20.23 percent on an estate of $50,000,000.

2. *Recoupment of State loss impracticable.*—Increase of State revenues from death taxes through an increase in State rates would be very difficult because of the shrinkage in funds available after deduction of Federal death taxes.

3. *Certain States would suffer direct losses.*—Those States which do not make specific legal provision for taking the maximum Federal allowance would suffer a loss of revenue. Those States having inheritance taxes based upon principles of consanguinity, and not utilizing a supplementary estate tax, would find the available taxable base greatly reduced.

4. *Eventual shrinkage of State death tax base.*—Reduction of the corpus of estates through the imposition of heavy Federal death taxes will result in eventual shrinkage of State revenues from death taxes on these estates in succeeding generations.

5. *Adverse effect on State income and property taxes.*—Future taxation of incomes derived from estates will yield less revenue to the States, due to depletion of the invested capital base from which such income is derived. Existing and proposed heavy Federal income-tax rates render it difficult, if not impossible, to restore depleted capital through savings.

J. DEATH-TAX FIELD SHOULD BE RETURNED TO STATES

1. *Death-tax field belongs to States.*—Death taxes are not technically a levy on the estate but are excises imposed upon the transfer of the property and are merely measured by the size of the estate. However, rights of transfer are determined wholly by State laws, and the Federal Government has no jurisdiction over them.

2. *Continuance of present rates first step toward return.*—It is recognized that the immediate repeal of the estate tax is impractical. However, the objective should be toward returning this field of taxation to the States. A step in that direction would be a continuance of the existing rates.

The effect on State revenues is a matter of considerable concern. The position of the States was expressed by Gov. H. Lehman, of New York State, in a letter to Senator Harrison, chairman of the Senate Finance Committee, in connection with the Revenue Act of 1938.

Governor Lehman wrote:

> The independent sovereignty of the States is threatened by Federal taxing policy. This country was organized on the theory and has prospered under a system of independent States with exclusive authority in many fields and with independent taxing power, a power not second to, but on a parity with, the Federal Government itself.
>
> Under such conditions if one of two governments, having equal concurrent jurisdiction to levy a tax, actually monopolizes the field to the exclusion or the near exclusion of the other, it may follow that that other government will be destroyed or at least starved into impotency.
>
> The extent to which the Federal Government has been and is ignoring the rights of the States in the income (personal and corporate) and estate-tax fields, and virtually monopolizing those fields to the exclusion of the States is truly alarming. The result is that the bulk of State and local revenue is shouldered on real property and that many of the States and their localities have been forced to enact tax laws not suited to State and local use and uneconomic in their effects.

That was written in 1938, of course, before the act of 1940 became effective and before the proposed rates became effective, and it would be even more pertinent today.

3. *Program should contemplate return to States.*—Having in mind the fact that the Federal-estate tax was primarily an emergency measure, that it is a field of taxation traditionally reserved to the States, and that the present high rates already deprive the States of a much-needed source of revenue, it must be concluded that any sound tax program will contemplate the eventual return of this tax source to the States. As a further step in this direction, a decrease in the present Federal estate-tax rates is recommended.

K. GIFT AND ESTATE TAXES NEED CORRELATION

1. *Estates handicapped by provision for gifts in contemplation of death.*—You recall that the gift-tax law, which I think was the first gift-tax law that was ever enacted in any English-speaking country, was made in 1932 and was a sort of policeman principle for the estate tax.

Senator GERRY. There was a gift-tax law previous to that, it is my recollection.

Mr. OSGOOD. There was in 1924. You are right.

Senator GERRY. In 1924?

Mr. OSGOOD. In 1924. We were the first English-speaking country, at least, to adopt the gift-tax statute. The present law provides for including in the gross estate all gifts made "in contemplation of death." The law also provides that any gift made by the decedent within 2 years of the date of his death shall, unless shown to the contrary, be presumed to have been made "in contemplation of death." The intent of the law was to place the burden upon the Government of proving that gifts made prior to the 3-year period were "in contemplation of death." As to gifts made within the 2-year period, the intent of the statute was to place the burden upon the taxpayer of proving that such gifts were not made "in contemplation of death."

This legislative policy is being greatly defeated by the present attitude of the Treasury Department. Recent experience has shown that it is the policy of the Government to assert that all gifts in any substantial amounts were made "in contemplation of death," regardless of when made. As a result, the taxpayer is practically forced to litigate every case.

2. *Overlapping provisions cause double taxation.*—Certainly the problem could be eased by administrative action which recognizes the position presently taken by our courts. A better solution would be to change the law.

There is no reason why, now that the Government has both laws, it should not be required to choose whether it will subject a particular transaction to a gift tax or an estate tax. The two laws, to whatever extent they overlap, result not only in double taxation but subject the taxpayer to the uncertainty and very probably also the annoyance and expense of litigation.

3. *Law should eliminate existing complications.*—Section 811 (c) should be changed. Certainly it would be sound tax policy to repeal all of section 811 (c) except the provision with respect to gifts

strictly in contemplation of death, leaving all other gifts to be taxed under the gift-tax law.

By the way, my supplemental statement goes into the technical details as to the suggested language for the amendments.

The CHAIRMAN. That is all right, Mr. Osgood.

Mr. OSGOOD (continuing):

4. *Return of death tax to States would eliminate need of gift tax.*—Of course, many of the perplexing problems in the gift-tax law could be avoided entirely if the gift-tax law were repealed in its entirety. Certainly if the Federal Government would, as it should, leave the field of death taxation to the States, there would be no need for any Federal gift-tax law. The only justification for any Federal gift tax is to correlate with the Federal estate tax. The present gift-tax law does not provide this necessary correlation, since there are many instances of gifts being subject to both gift tax and Federal estate tax. A program looking toward the eventual return of the death tax to the States and elimination of the Federal gift tax is sound in principle.

L. CORRELATION OF ESTATE AND INCOME TAX NEEDED

1. *Estate-tax valuation for income tax needs correlation.*—We recommend an appropriate amendment to section 113 (a) (5) of the code which will definitely establish, as the basis for income-tax purposes, the valuation of property transmitted at death which was used in the computation of the Federal estate tax.

There is a serious lack of correlation between the estate tax and the income tax at this point under the existing law.

2. *Present provisions cause unfair discrimination.*—Moreover, code section 811 (j) allows the executor or administrator to elect between valuation at the date of death or 1 year thereafter for estate-tax purposes, with a proviso that if value at the later date is elected, then as to assets in the gross estate distributed or sold during the year, value at the date of distribution or the sale price shall be used. Yet section 113 (a) (5) of the code has never been amended so as to correlate with section 811 (j).

That also, Mr. Chairman, is referred to in detail in the supplemental statement.

The CHAIRMAN. All right, Mr. Osgood.

Mr. OSGOOD (continuing).

M. LAW CONCERNING GIFTS IN TRUST UNFAIR

1. *Gifts in trust require $4,000 exclusion.*—Prior to the Revenue Act of 1938, gifts in trust enjoyed the benefits of the annual exclusion of $5,000 to the same extent as gifts made in other ways. The only exception was gifts of future interests, whether by trust or otherwise. Section 505 of the Revenue Act of that year reduced the annual exclusion to $4,000, and denied its benefits altogether to gifts in trust. This caused unfair discrimination between outright gifts and gifts in trust. The reason for the change was caused by certain court decisions and has now disappeared. It is recommended that the present unwarranted inequalities be corrected by appropriate amendments to section 1003 (b) of the code.

That also is dealt with technically in the supplemental statement.

N. EXEMPTION OF SECURITIES OF NONRESIDENT ALIENS FROM ESTATE AND GIFT TAXES SHOULD BE PROVIDED.

Under the existing law nonresident aliens are subject to estate and gift taxes only with respect to property situated within the United States. However, the Internal Revenue Code provides in respect of both taxes that stock of a domestic corporation shall be considered property situated within the United States, no matter where the stock certificates are physically located. No similar inconsistency exists in the case of bonds, which are usually taxed in the place where the bonds are physically located.

We recommend that bonds and other securities of foreign corporations owned by nonresident aliens be specifically exempted from estate and gift taxes. This recommendation is based solely upon practical considerations. There are many good reasons for encouraging nonresident aliens to keep their securities, whether foreign or domestic, in American custodian accounts.

The existing law defeats its own purpose, viz, maximum revenue, by creating a tax incentive to foreigners to keep their foreign securities outside the United States. For these reasons, it is confidently believed that appropriate amendments to sections 863 and 1030 of the code would benefit the revenue.

Thank you very much, sir.

The CHAIRMAN. Now you wish the supplemental statement to follow your original statement?

Mr. OSGOOD. I would like to have the supplemental statement made a part of the record.

The CHAIRMAN. Following your remarks?

Mr. OSGOOD. Yes, sir.

The CHAIRMAN. That will be done.

Mr. OSGOOD. Thank you, sir.

(The supplemental statement of Mr. Osgood is as follows:)

SUPPLEMENTAL STATEMENT OF ROY C. OSGOOD

Mr. Chairman: I am Roy C. Osgood, vice president of the First National Bank of Chicago and in charge of its trust department. I have been administering trusts in the bank for 35 years, and dealing with tax problems in connection with them. I appear here, however, as a member of the Committee on Federal Finance, Chamber of Commerce of the United States.

In connection with the work of various national and local organizations, and in various official and unofficial conferences, it has been necessary for me to give attention to legislation relating to estates and inheritances and the administration of such legislation by Federal and State officials.

My testimony will deal with the estate- and gift-tax aspects of the bill.

A. GENERAL

1. *Estimated yields.*—The estate- and gift-tax revisions are estimated to yield approximately $152,000,000 in addition to the yield of the last year of $355,000,000, or a total of $507,000,000. This would increase the yield from this source 43 percent, but the increase would not be substantially effective until 1943. On the basis of the Treasury estimates of a tax system producing $12,606,000,000, estate and gift taxes would produce about 4 percent, and the increased rates about 1.2 percent.

2. *Sound temporary policy would propose no increase.*—This proposed increase in rates, even though producing only 1.2 percent of the estimated revenues, will have a wholly disproportionate effect on our social economy. On the assumption

that the present rates and exemptions are fair to our economy, as a sound temporary fiscal policy this increase should not be proposed.

3. *Sound permanent policy would reduce rates and increase exemptions.*—As a matter of fact, the present rates and exemptions are not fair to our economy. Sound permanen fiscal policy, if the estate and gift taxes are to remain as sources of Federal revenue, would require even the present rates to be reduced and the present exemptions increased.

B. ESTATE TAX CHANGES

1. *Estimated yields and rate increases.*—The estate tax increased yield is estimated at $136,000,000. This is obtained by increasing the estate-tax rates. The 10-percent defense tax applicable to estates is made permanent. The $40,000 exemption remains unchanged. On a net estate of $50,000 (before exemption) the tax is increased from $220 to $550, an increase of $330, or 150 percent. On $100,000 it is increased from $4,620 to $9,570, an increase of $4,950, or 107.1 percent. On $400,000 it is increased from $63,780 to $99,530, an increase of $35,750 or 56.1 percent. On $1,000,000 it is increased from $228,780 to $308,090, an increase of $79,310, or 34.7 percen. The percentage of increase in the effective rates gradually reduces until at $100,000,000 the new rate is 1.8 percent higher than the present rate.

2. *Major increase falls on smaller estates.*—The last available Treasury report on estate taxes is for returns filed in 1938. This shows taxpayers reporting under $100,000 comprised 51 percent of the total; those reporting between $100,000 and $500,000 were 42 percent; and those over $500,000 were 7 percent. Assuming the year 1938 to be fairly representative, the new rates increase taxes on the estates of 93 percent of estate taxpayers from 150 percent to about 56 percent; and on 7 percent of the taxpayers from 50 percent to 1.8 percent. The major impact of the increase will fall upon 93 percent of estate taxpayers.

C. GIFT TAX CHANGES

1. *Estimated yields and rate increases.*—The gift tax increased yield is estimated at $15,000,000, beginning in the fiscal year 1942. The gift tax has been effective since 1932 and there have been changes in rates relative to the changes in estate-tax rate. The total tax collections in the 5½ years through 1937 was $280,000,000 or an average of $51,000,000 a year. At the existing rates the Budget estimate for the last year was $31,300,000. Like the present law the new rates are three-quarters of the new estate-tax rates. The specific exemption of $40,000 and the exclusion of $4,000 per year for each donee remain unchanged.

2. *Major increase falls on smaller gifts.*—Inasmuch as the increases in the rates are relative to those of the estate tax, the major impact of the increase will fall upon the smaller taxpayers.

3. *No proper correlation of gift and estate tax and income tax.*—The lack of correlation, between the gift-tax law and the estate-tax law and with certain provisions of the income-tax law, which calls for remedial legislation, remains unjust to taxpayers. The new gift-tax law not only does not remedy the situation, but makes the injustices more acute by increasing the rates. This will be discussed in detail later in the testimony.

D. ESTATE TAX PROPOSALS VIOLATE PRINCIPLES OF EQUALITY AND JUSTICE

1. *Death-tax laws and rates should be stable.*—One of the vital principles of death-tax legislation should be stability of laws and rates.

Federal estate-tax rates have not been stable in the past. The 1916 law imposed rates ranging from 1 percent on net estates from $50,000 to $100,000 to 10 percent on net estates in excess of $5,000,000. By an amendment of March 3, 1917, the rates were increased by 5 percent and the Revenue Act of 1917 further increased the rates to a maximum of 25 percent. The Revenue Act of 1918 reduced the rates of tax in the lower brackets. The 1924 act instituted a credit of 25 percent for State inheritance taxes paid and increased the rates. The 1926 act reduced the rates of tax and increased the exemption and the credit for State inheritance taxes. In 1932 an additional estate tax was imposed over and above that imposed by the 1926 law, the exemption was decreased from $100,000 to $50,000 and in effect the credit for State inheritance taxes was decreased. The 1934 and 1935 acts both increased the estate-tax rates and in 1940

the additional 10-percent defense tax was imposed. The exemption was reduced to $40,000.

2. *Federal estate-tax laws have been unstable.*—With this record of instability, equality among individual taxpayers was impossible. If A inherited a $200,000 estate in 1926 he would have paid $1,500 in Federal death tax. If B inherited the same amount in 1933, he would have paid $9,500 in tax. If C had inherited the same estate early in 1935, the tax would have been $12,800. D, inheriting the same estate in 1937 would have paid $19,800; E inheriting the same estate after the Revenue Act of 1940, would have paid $21,660; F inheriting the same estate under the act of 1941 would pay $38,270.

3. *Present proposals continue unsound principles.*—All of these changes have taken place in the short space of 14 years and are in addition to other changes in the law, which required readjustment in the plans of every person. Obviously, in many cases the changes came so fast that many estates suffered heavily because of inability to plan payments. The new law makes another change and adds to the record of unstable tax policy.

4. *Instability of policy makes equality among taxpayers impossible.*—Equality among individual taxpayers is a prime requisite of any tax law. In the case of death taxes, equality cannot be had without stability in effect and rates. A death tax is different from other types of taxes in that the impact of the death tax comes only at death. The ordinary forms of taxation, such as the income tax, are imposed annually. Thus every year the taxpayer finds himself subject to the impact of this tax. Any change in rates affects all taxpayers alike. If the tax is low this year and high next year, each taxpayer gains the advantage of the low rate this year and suffers the penalty of the high rate next year. On the other hand, changes in the death-tax law and particularly those affecting the impact of the tax, that is, changes in rates, result in unequal imposition on the heirs of different persons dying at different times. For example, to take 5 percent of the estate of one person who happens to die when one law is in effect, and merely because the lawmaking body in its wisdom has seen fit to change the death-tax rates, to take 10 percent of the estate of another owning the same amount of property, who might live until after another law has been enacted, is unjust and should be avoided as far as possible. On the ground of tax-paying ability, of justice, of obligation to support the Government, each estate should stand equal before the law. Any system of taxation which makes the amount of contribution of the different citizens depend upon such fortuitous circumstances as death is not in harmony with sound principles of taxation.

5. *Estate owners entitled to long-range planning.*—Every citizen should have the opportunity to plan his business, his investments, and the disposition of his property after his death according to his best judgment. If the citizen during his lifetime cannot know what will be the rates of taxation imposed upon his estate at death, he is denied this right. Certainly the continual changing of rates of death-taxes leaves little room for individual planning.

6. *Instability of estate-tax policy makes planning impossible.*—Modern death taxes are substantial capital obligations which must be paid out of the capital of the estate of decedent after death. Frequently it becomes necessary to sacrifice assets of the estate in order to raise a sufficient sum to pay such taxes. With a stable rate of tax even though high, the decedent, during his lifetime, can adjust his plans to consider the tax which will be payable at death. A person should be able to determine with some degree of accuracy the amount which his estate will be called upon to pay, so as to be able to protect his estate by making suitable provision before death for its payment. Continuous changes in laws and rates make it impossible to foretell even approximately what the tax will be when death occurs.

7. *Federal policy of instability causes inequality and injustice.*—If uniformity and equality as between individual taxpayers, prime requisites of any just tax, are to be obtained in death taxation, the laws and rates must be stabilized and placed on a more permanent basis. So long as the laws and rates are changed with the varying moods of Congress, inequalities and injustices will prevail.

8. *Estate-tax rate increase of small effect on current fiscal policy.*—The raising of estate-tax rates cannot affect materially the current fiscal policies of the Government. As previously pointed out, most other types of taxes recur at regular intervals, normally once a year. The rates of such taxes are determined naturally, by consideration of the tax base and the amount of revenue to be raised to meet the needs of the Government. Rates will normally be subject to frequent change, in harmony with changed and unforseen conditions. In such cases there is no long-range inequality among taxpayers produced by such changes in rates.

9. *Estate taxes are not adapted to accomplish elasticity of the tax system.*—The estate tax, on the other hand, occurs irregularly so far as the taxpayer is concerned, and is more or less irregular even from the standpoint of the Government. There is no direct relation between the needs of the Government and the estate-tax rates for the reason that there is no predictable tax base. Citizens die without regard to the needs of the Government, and deaths are not subject to the control of the tax collector. Moreover, because of the delays in administering estates and the consequent delays in determining the tax, changes in the estate-tax laws usually do not materially affect the revenues for at least 1 year after the changes are made. This is confirmed by the statement of John L. Sullivan, Assistant Secretary of the Treasury, before the Committee on Ways and Means of the House of Representatives on April 24, 1941, when he stated in connection with the present proposal to increase the estate-tax rates: "The estate-tax changes, however, would not begin to yield revenue until the fiscal year 1943." Obviously, therefore, the estate tax by its very nature is not adaptable for use as a flexible base to accomplish elasticity in the tax system. Other forms of revenue must be utilized to meet the expanding and contracting needs of the Government. The estate tax should be kept stable.

E. ESTATE-TAX-RATE PROPOSALS VIOLATE PRINCIPLES OF MODERATION

1. *Basic principles of rate structure.*—In attempting to determine the rates to be used in estate taxation, there are certain basic principles to be considered:

(*a*) The rates of death tax may reasonably be considered higher than the rates of an annually recurring tax on property.

(*b*) The principle of progression has won general acceptance and is reasonable if reasonably applied. In estate taxation progression is according to the size of the estate.

(*c*) The reasonableness of the progression is the third basic principle of death taxes; that is, the rates should not be excessive. This is the most important principle.

2. *Reasonable exemption for dependents should be allowed.*—From the standpoint of the decedent and his dependents, the rates of tax must not be so high as to make impossible or discouragingly difficult reasonable provision for the family and dependents. This principle indicates liberal exemptions from the standpoint of the common welfare. The amount of the exemption should be the sum the income from which would provide a support for dependents sufficient to prevent them from becoming a charge upon the public. There generally would be common agreement that there should be exempted from tax an amount of capital sufficient at least to provide an annual income for the support of a widow and one child. Probably there would also be agreement upon a larger exemption in the case of two or more children, and the normal family would doubtless consist of a widow and two children. Under the income-tax proposals the exemption of $2,000 for the head of a family, plus $400 for each dependent, is not disturbed. This is a minimum normal exemption of $2,800, though, of course, if one of the children is of an age to receive the individual exemption of $800, the total exemption might be $3,200. Thus, roughly speaking, the income-tax exemption for the average family will run between $2,400 and $3,200, irrespective of dependents of more remote relationship. When the present estate-tax exemptions were adopted, a fair average income on capital was 5 percent. Then the estate-tax exemption, plus the gift-tax exemption, would have proved adequate (5 percent of $80,000 equals $4,000). In the past few years, however, the average income yield from suitable investments has dropped to 3½ percent, so that to produce the same income there would be required an investment of over $115,000. Even this leaves no margin for investment costs, losses, income fluctuations, and other forms of taxation. A 20-percent margin of safety would raise the capital required to about $140,000.

3. *Law should consider family's economic position.*—Even this is the minimum and does not consider the economic status to which the family have been accustomed. It is a well-established principle of probate law that a widow's exemption and a child's exemption for at least a year for the purpose of debt priority should be sufficient to afford them support and maintenance in the manner of life to which they have been accustomed. The payment of these allowances takes precedence over the debts of the decedent or other distributions out of his estate. Much the same principle should be applied and has been applied in determining the priority of the exemptions for widows and children in death-tax statutes. Certainly a $100,000 Federal estate-tax exemption is about the minimum that

ought to be granted under a sound theory of exemptions. From the standpoint of the beneficiaries the matter of exemption is a consideration of first importance. A liberal exemption makes the effect of the first rate or the first few rates both progressive and distinctly moderate as applied to the first brackets above the exemptions.

4. *Increased administration costs constitute increased tax burden.*—One other matter in connection with the exemptions involves the increased cost of doing business of those engaged in settling decedent's estates. With an exemption of $100,000, there are naturally fewer estates which require the difficult and technical task of preparing Federal estate-tax returns. Formerly an estate of $100,000 or less could be closed in the probate court within 1 year, but now only estates under $40,000 may be so closed, and under the present law such estates must remain open in the probate court for at least 15 months with the increasing expense and delay of administrative action. When the exemption was reduced to $40,000 the time and work in settling estates between $40,000 and $100,000 was immeasurably increased. Experience has shown that the lowering of the exemption to $40,000 placed an undue burden on the smaller class of estates. On the other hand, the compensation of those engaged in settling decedents' estates has not been, and in most cases cannot be, increased to compensate for the additional service rendered.

5. *Rates should not be so high as to stimulate evasion.*—Death-tax rates should not be so high as to stimulate avoidance and evasion. It is unquestionably true that the more burdensome a tax the less compunction the individual feels in seeking to escape payment, and regardless of how carefully a statute may be drawn, experience has demonstrated that it is almost impossible to make its provisions absolutely inescapable. A heavy estate tax holds out a strong temptation to use every legal and illegal means of avoidance and evasion. As long as death-tax rates are relatively low, the individual taxpayer finds it uneconomic to attempt to engage in activities resulting in avoidance or evasion of the tax. The rewards are not worth the cost or the risk involved. However, the higher the tax becomes the more profitable and attractive the avoidance or evasion appears to the taxpayer. When the tax rates become confiscatory, every dollar of property included in the gross estate becomes important. Minor defects in the law are magnified and injustices become real.

6. *Law should not cause adverse social and economic effects.*—The adverse economic and social effects of high estate-tax rates deserve special consideration. The rates must be regarded from the social and economic point of view with respect to the effect of the tax upon industry. High rates are capable of producing a variety of results harmful not only to the persons called upon to bear the tax burden but also to the industry of the Nation. First of all, there is the danger of large forced sale of assets. Few estates include large amounts of liquid assets. At death, therefore, in order to meet heavy tax payments it frequently becomes necessary to sell a considerable part of the assets of the estate. The sale of these assets in time to meet the requirements of the law has a tendency to depress the market and to cause a decline of prices. Such sales, therefore, may be and frequently are difficult except at a considerable sacrifice.

7. *Tax constitutes a demand loan payable at maker's death.*—Heavy taxes at time of death of a sole or principal owner of a business are also likely to result in forced alterations in its control through compelling the sacrifice of holdings by those into whose hands the control of the business would normally come following the death of such an owner. To illustrate, assume a corporation conducting a business built over a long period through family group control by the ownership of a slight majority of stock. A heavy tax may compel the sale of enough stock to cause the loss of such control and the impairment of both the incentive and valuable management policies that have made the business successful. In some cases the sale of the stock is impossible and actual liquidation of the business is necessary. When a tax requires of an estate payments greater than can be met from cash resources on hand, those in control of a closely owned business comprising substantially their entire resources may seek to avoid sale of assets by borrowing and may be thus forced to make engagements so heavy as to impair the credit of the concern.

All of the foregoing effects, whether forced sale of assets, forced change of control, or strain upon credit, are made doubly serious because of their appearance at the very time when the enterprise is least able to stand the strain on account of the loss of personal management resulting from the death of the former head.

The injurious effects upon industry of excessive estate taxes are unfortunately not confined to the particular company involved in the estate. All who are engaged in such enterprise, and also many who are engaged in other enterprises related to those which are directly affected by the tax are subjected to insecurity which is demoralizing and impairs the productive capacity of the community as a whole.

8. *Sound fiscal policy demands moderate rates.*—Can we afford in such a period as now exists, no matter what may be advanced in the way of argument as to immediate revenue needs or other justification, to discourage the enterprise of living people, cause shut-downs of active businesses or violent changes in ownership through forced transfers? Under all these considerations a sound fiscal policy demands moderate rates.

F. EXCESSIVE RATES HARMFULLY DEPLETE FUTURE TAX BASE

1. *Rates should not harmfully deplete future tax base.*—We should be just as concerned with future tax capacity as with present revenues. The estate tax is essentially a capital tax and if capital is dissipated through excessively high estate-tax rates, the tax base, that is, the capital which produces income subject to taxation may be lost in future generations. While it is important to have our present tax plans designed so that the present generation will pay for as much of the defense expenditures as possible, future generations will have their burden in paying for those portions of such expenditures as are financed by Government borrowings. Estate taxes force the second generation to pay twice: First, through loss of income on the capital levy involved in the estate tax, and second, in that generation's proportionate share of current taxes imposed at some future date.

2. *Excessive rates harmfully decrease productive wealth.*—If through excessively high income taxes the building of wealth through productive enterprise is prevented and if through excessively high death taxes such wealth as has already been accumulated is removed from productive enterprise, there will come a time when there is no wealth in productive enterprise. The final result will be a complete drying up of tax revenues from all sources which have productive wealth as their base.

G. SHOCK OF HIGH ESTATE TAXES SHOULD BE CUSHIONED

1. *Present cushion now inadequate.*—Certainly with any increase in Federal estate taxes and probably even with the present rates, there should be enacted a better cushion against the shock of the estate-tax requirements. The only cushion now provided is the possibility of extensions of time up to 10 years in which to pay estate taxes. The present postponement carries 4 percent interest. Tax rates are so high that tax requirements cannot be paid out of cash resources on hand or out of current income which is less than 4 percent.

2. *More adequate cushion should be made.*—Since estate taxes should fall as lightly as possible upon the actual capital of an estate, the taxes should, so far as possible, be payable as are other taxes out of income. Under the present law any postponement of the tax carries with it interest in excess of the earning capacity of capital itself. Consequently, the present provisions are inadequate. Obviously, practical considerations should reduce the interest rate upon extensions to at least 2 percent, in order to allow some opportunity to the estate to meet death taxes out of income, at least to some extent.

H. PROVISION SHOULD BE MADE FOR TAX-FREE FUNDS FOR ESTATE-TAX PAYMENTS

1. *Need of adequate tax-free funds.*—It is recommended that appropriate provisions be written into the Federal estate tax statute which will permit the owners of estates to build up reserves or funds the proceeds of which are earmarked for the payment of estate taxes at death, which proceeds shall be exempted from estate taxes to the extent they are applied to the payment of such taxes.

We believe that such provisions are urgently needed under the existing law and that they are absolutely imperative if the radical revision in the rate schedule should be enacted into law, in whole or in part. High progressive estate-tax rates have already created acute problems for executors and administrators in finding funds to pay these taxes without disastrous forced liquidation of assets at sacrificial prices. This problem is especially acute where all or a major part of the estate consists of the ownership of a going business or of real estate or

other nonliquid assets. The artificial pressure for liquidity created by the present law is a serious obstacle to the movement of enterprise capital into new business ventures which the general welfare demands.

It is respectfully submitted that the merits of this recommendation cannot be determined on the basis of actuarial estimates of the possible short-run effects of its adoption upon the number of estate-tax dollars collected. These effects may be easily exaggerated. In any event, it is believed that they will be far outweighed by other and beneficial effects upon the economy and the productivity of the revenue system as a whole. Collection of estate taxes will be speeded up. Losses, due to sacrificial liquidation of estates, which are costly to income-tax revenues, will be greatly reduced. The depressing influence on market values generally of such liquidations will be minimized. Most important of all, businessmen will be able better to plan their affairs and will be encouraged to embark upon new enterprises, when the pressure to maintain a high degree of liquidity in their assets is materially reduced. The estate tax, of all taxes, should be constructed from the point of view of its long-run effects, if the hens that lay golden revenue eggs are to be preserved.

We do not suggest any specific method as the best or only possible one, but suggest for your consideration two general methods for providing essential relief. It is believed that some combination of these two methods, which may be denominated (1) "self-insurance" and (2) "purchased insurance" may provide the most practical solution.

2. *Self-insurance method.*—This plan involves setting up a trust specifically for estate-tax purposes. If deemed desirable, the statute might limit the types of assets which could be placed or kept in such a trust, such as, for example, Government bonds, securities listed on the New York or other recognized exchanges, and the like. It is suggested, however, that no such special limitations be imposed, in order to avoid discrimination between investments, since the trust instrument would ordinarily contain provisions as to liquidity.

In the interests of simplicity and prevention of possible income-tax avoidance, such trusts should be permitted to be revocable, except that, after the settlor's death, the assets would be specifically earmarked for estate-tax payment and no prior distributions could be made till such tax liabilities were liquidated. The trust instrument could provide for the disposition of earnings prior to the settlor's death, either by way of accumulation or distribution to him. In either event, the trust income would be taxable to the settlor. The instrument might also require as a guaranty of liquidity that the trust be liquidated within a relatively short time after the due date of the estate tax.

Whatever portion of the trust assets are required to pay estate taxes should be made exempt from such taxes, and any excess should be subject to tax. Some special provision may be necessary, in the event of such an excess, to prevent introducing algebraic complications into the computation of the tax, but there are several ways in which resort to alebra can be obviated by proper draftsmanship. There should be no tax on the privilege of creating such trusts.

The principle of not taxing such portion of the estate as is required to pay the tax accords with the result now reached under the gift tax where the tax is paid by the donor out of the estate remaining to him after a gift. The tax so paid is not taxed as a part of the gift and operates to reduce the estate passing at death and subject to estate tax.

(2) *Purchased insurance.*—Past proposals in this field have usually taken the form of exempting from estate tax the proceeds of life insurance, definitely earmarked in some way for the purpose, to the extent such proceeds are required to pay estate-tax liabilities, with any excess added to the corpus and subject to tax. Here also some special provision is necessary to obviate the use of algebraic formulae, when such an excess is present.

The great advantage of this plan is its simplicity. On the other hand, a limitation of relief to this plan alone may be deemed objectionable because it may discriminate between taxpayers, since all taxpayers are not insurable.

For these reasons it is believed that some form of both plans should be recognized by the statute, leaving the taxpayer to select the form best adopted to his own circumstances.

I. PROPOSALS ADVERSELY AFFECT STATE TAXES

1. *Decrease of States' share of death taxes.*—Under present law the maximum possible State share of combined death duties under the 80-percent credit system ranges from 3.1 percent of the combined death duties on a net estate of

$100,000 after exemption to 21 percent on an estate of $50,000,000. In the proposed bill the amount would be reduced to 1.55 percent on an estate of $100,000 and to 20.28 percent on an estate of $50,000,000.

2. *Recoupment of State loss impracticable.*—Increase of State revenues from death taxes through an increase in State rates would be very difficult because of the shrinkage in funds available after deduction of Federal death taxes.

3. *Certain States would suffer direct losses.*—Those States which do not make specific legal provision for taking the maximum Federal allowance would suffer a loss of revenue. Those States having inheritance taxes based upon principles of consanguinity, and not utilizing a supplementary estate tax, would find the available taxable base greatly reduced.

4. *Eventual shrinkage of State death tax base.*—Reduction of the corpus of estates through the imposition of heavy Federal death taxes will result in eventual shrinkage of State revenues from death taxes on these estates in succeeding generations.

5. *Adverse effect on State income and property taxes.*—Future taxation of incomes derived from estates will yield less revenue to the States, due to depletion of the invested capital base from which such income is derived. Existing and proposed heavy Federal income tax rates render it difficult, if not impossible, to restore depleted capital through savings.

J. DEATH TAX FIELD SHOULD BE RETURNED TO STATES

1. *Death tax field belongs to States.*—Death taxes are not technically a levy on the estate, but are excises imposed upon the transfer of the property, and are merely measured by the size of the estate. However, rights of transfer are determined wholly by State laws, and the Federal Government has no jurisdiction over them.

Traditionally, the death tax field has been reserved to the States as distinguished from the Federal Government. In the past, Federal death taxes were imposed purely as a temporary measure. In 1779 the Federal Government resorted to this method of raising revenue only under pressure of emergencies caused by the war, and the law was repealed in 1802. A second Federal statute was in force from 1862 to 1870, again an emergency period. A similar statute was in effect from 1898 to 1902, a third emergency period. The present Federal estate tax law originated with the enactment of the statute of September 8, 1916, and was an emergency measure based upon the expenditures that were likely to follow American participation in the first World War. At the conclusion of the World War efforts were made to abandon the tax because of its emergency character, and under the Revenue Act of 1926 the Federal estate tax as such became more or less nominal because of the 80-percent credit granted for the payment of State death taxes. In 1932—another emergency period—the additional estate tax was enacted, and in years following the amount of the tax increased beyond all original concepts.

2. *Continuance of present rates first step toward return.*—It is recognized that the immediate repeal of the estate tax is impractical. However, the objective should be toward returning this field of taxation to the States. A step in that direction would be a continuance of the existing rates.

The effect on State revenues is a matter of considerable concern. The position of the States was expressed by Gov. H. Lehman, of New York State, in a letter to Senator Harrison, chairman of the Senate Finance Committee, in connection with the Revenue Act of 1938. Governor Lehman wrote:

"The independent sovereignty of the States is threatened by Federal taxing policy. This country was organized on the theory, and has prospered under a system of independent States with exclusive authority in many fields and with independent taxing power, a power not second to but on a parity with the Federal Government itself.

"Under such conditions, if one of two governments, having equal concurrent jurisdiction to levy a tax, actually monopolizes the field to the exclusion or the near exclusion of the other, it may follow that that other government will be destroyed, or at least starved into impotency.

"The extent to which the Federal Government has been and is ignoring the rights of the States in the income (personal and corporate) and estate tax fields, and virtually monopolizing those fields to the exclusion of the States, is truly alarming. The result is that the bulk of State and local revenue is shouldered on real property, and that many of the States and their localities have been forced to enact tax laws not suited to State and local use and uneconomic in their effects."

The dollars and cents value to the States is illustrated by the following data for the State of Illinois:

Death-tax collections from Illinois

Year	State	Federal	Year	State	Federal
1933	$9,122,785.42	$4,077,217.70	1936	$3,868,877.59	$11,645,213.03
1934	3,739,093.57	6,575,492.10	1937	4,839,910.65	13,007,801.24
1935	5,577,415.86	11,381,091.91	1938	8,407,274.75	29,720,467.80

It should be borne in mind that the Federal estate tax is a deduction from the estate before the State taxes are imposed. Thus, in 1938, the Federal Government took nearly $30,000,000 of the State of Illinois' tax base. The figures in other States are equally startling.

3. *Program should contemplate return to States.*—Having in mind the fact that the Federal estate tax was primarily an emergency measure, that it is a field of taxation traditionally reserved to the States, and that the present high rates already deprive the States of a much-needed source of revenue, it must be concluded that any sound tax program will contemplate the eventual return of this tax source to the States. As a further step in this direction, a decrease in the present Federal estate tax rates is recommended.

K. GIFT AND ESTATE TAXES NEED CORRELATION

1. *Estates handicapped by provision for gifts in contemplation of death.*—The present law provides for including in the gross estate all gifts made "in contemplation of death." The law also provides that any gift made by the decedent within 2 years of the date of his death shall, unless shown to the contrary, be presumed to have been made "in contemplation of death." The intent of the law was to place the burden upon the Government of proving that gifts made prior to the 2-year period were in contemplation of death. As to gifts made within the 2-year period, the intent of the statute was to place the burden upon the taxpayer of proving that such gifts were not made in contemplation of death. This legislative policy is being greatly defeated by the present attitude of the Treasury Department. Recent experience has shown that it is the policy of the Government to assert that all gifts in any substantial amounts were made "in contemplation of death" regardless of when made. As a result the taxpayer is practically forced to litigate every case.

The lack of success of the Government in litigating these cases is well known. Apparently the policy of the Government is to continue to litigate these cases in hope that the courts will finally adopt a policy of holding all gifts to be in contemplation of death unless the evidence is overwhelmingly to the contrary.

The executor of a decedent's estate is, of course, seriously handicapped. In all of these cases the testimony of the decedent is unavailable. Oftentimes he left no record of his motive for making the gifts in question. In other instances the evidence of that motive is of such a nature as to be legally inadmissible in evidence. Even if the evidence is clear and convincing, the attitude of the Government forces the executor to litigate. This means expenditure of additional funds in attorneys' fees and other costs to determine a question which in most cases is perfectly clear. It means that estates cannot be closed until this litigation is settled, and, of course, there is the hazard of an unfavorable decision in the lower courts which must be appealed.

Many such cases have been compromised in the past simply because of the difficulties involved in any litigation. There is no question but what the Treasury Department has used this section of the law to exact tax payments which would not have been sustained by the courts.

The problem is admittedly difficult and the attitude of the Government is perhaps understandable. The taxpayer would probably not admit that any gift was made in contemplation of death. On the other hand, the Government seems to insist that all gifts were made in contemplation of death. Probably neither is correct in its position.

2. *Overlapping provisions cause double taxation.*—Somewhere between these two extremes lies the proper answer. Certainly the problem could be eased by administrative action which recognizes the position presently taken by our courts. A better solution would be to change the law.

When this section of the law was last amended by joint resolution of Congress on March 1, 1931, immediately following the decision of the Supreme Court in the case of *May* v. *Heiner and others*, there was no Federal gift-tax law. It is submitted that upon the enactment of the Federal gift-tax law on June 1, 1932, no adequate recognition was given to the purport of the above-mentioned section 811 (c) of the Federal estate-tax law, although as above stated, this section deals entirely with gifts inter vivos also covered by the gift-tax law. The adoption of the Federal gift-tax law it is believed was not only for the purpose of providing a source of revenue on transfers that otherwise were escaping the estate tax, but also was for the purpose of encouraging the making of substantial gifts inter vivos by offering the taxpayer certain tax savings for so doing, which tax savings, from the Government's point of view, were offset by the advantage of having an immediate source of revenue on certain transfers without the ultimate burden of proving that such transfers were subject to the estate-tax law. In other words, as expressed by Mr. Justice Holmes in the Guggenheim decision, the gift-tax law and the estate-tax law are in pari materia, and it is felt that it was intended that one should pick up where the other one leaves off, the critical test being if the transfer is inter vivos it is covered by the gift-tax law and if the transfer is testamentary it is covered by the estate-tax law.

There is no reason why, now that the Government has both laws, it should not be required to choose whether it will subject a particular transaction to a gift tax or an estate tax. The two laws, to whatever extent they overlap, result not only in double taxation, but subject the taxpayer to the uncertainty and very probably also the annoyance and expense of litigation. This in many cases is more burdensome than the amount of tax ultimately collected. The only excuse for this injustice is to afford the Government an opportunity to collect the greatest amount of revenue.

3. *Law should eliminate existing complications.*—Section 811 (c) should be changed. Certainly it would be sound tax policy to repeal all of section 811 (c) except the provision with respect to gifts strictly in contemplation of death, leaving all other gifts to be taxed under the gift-tax law. There is no reason why the Government should lose by such a policy. If the provisions of the present gift-tax law with respect to such gifts are inadequate they can be revised, but the taxpayer would be enormously benefited by knowing that the tax he pays at the time of a gift is all he would have to pay; but if the Government is unwilling to go even this far, it should at least provide that any transfer inter vivos upon which a gift tax has been paid and which shall not have been reimbursed by the Government to the taxpayer within 2 years after the payment of such tax, shall be excluded from the taxable estate of the donor for Federal estate tax purposes. It is believed that such an amendment would overcome the uncertainties that presently exist in the application of section 811 (c) of the Federal estate-tax law to gifts inter vivos. It would give some meaning to the 2-year presumption of contemplation of death found in that section, would reduce the great amount of litigation which works against the interest of the Government as well as the taxpayer inasmuch as the expenses of such litigation are deductions for estate tax purposes. It would also enable a taxpayer during his lifetime to arrange his affairs with a much greater degree of certainty, without fear of both tax laws being applicable to his transfers inter vivos, and would make the two laws more consistent with the purposes for which we understand they were enacted.

4. *Return of death tax to States would eliminate need of gift tax.*—Of course, many of the perplexing problems in the gift-tax law could be avoided entirely if the gift-tax law were repealed in its entirety. Certainly if the Federal Government would, as it should, leave the field of death taxation to the States, there would be no need for any Federal gift-tax law. The only justification for any Federal gift tax is to correlate with the Federal estate tax. The present gift-tax law does not provide this necessary correlation, since there are many instances of gifts being subject to both gift tax and Federal estate tax. A program looking toward the eventual return of the death tax to the States and elimination of the Federal gift tax is sound in principle.

L. CORRELATION OF ESTATE AND INCOME TAX NEEDED

1. *Estate-tax valuation for income tax needs correlation.*—We recommend an appropriate amendment to section 113 (a) (5) of the code which will definitely

establish as the basis for income-tax purposes, the valuation of property transmitted at death which was used in the computation of the Federal estate tax.

There is a serious lack of correlation between the estate tax and the income tax at this point under the existing law. While the valuation of property used for estate-tax purposes is prima facie evidence of its value at the date of death, it may be challenged by either commissioner or the heir, devisee, or legatee in a subsequent income-tax proceeding. This fact creates an incentive to change of position and litigation which should be removed. Section 3801 of the code does not operate to discourage such inconsistency since it does not apply where the estate tax is involved in one year and the income tax in the other.

2. *Present provisions cause unfair discrimination.*—Moreover, code section 811 (j) allows the executor or administrator to elect between valuation at the date of death or 1 year thereafter for estate-tax purposes, with a proviso that, if value at the later date is elected, then as to assets in the gross estate distributed or sold during the year, value at the date of distribution or the sale price shall be used. Yet section 113 (a) (5) of the code has never been amended so as to correlate with section 811 (j). It continues to define as the basis of property transmitted at death its value at the date of death. The result, in cases where the benefits of section 811 (j) are elected, is that the income-tax basis will usually, as a matter of law, be lower than the valuation used in computing the value of the taxable estate. This result is an unfair discrimination against other taxpayers, which should be corrected.

The proper remedy is believed to be to amend section 113 (a) (5) of the code so as to provide that the basis of property transmitted at death shall be the value at which it was included in the gross estate of the decedent (under sec. 811 of the code), in the determination of the estate tax. Where the property formed a part of an estate too small to require the filing of an estate-tax return, the income-tax basis will continue to be its value at the date of death.

M. LAW CONCERNING GIFTS IN TRUST UNFAIR

1. *Gifts in trust require $4,000 exclusion.*—We recommend appropriate amendments to section 1003 of the Internal Revenue Code to accomplish the following results:

(a) Restore to gifts in trust of other than future interests the benefit of the annual exclusion from the tax base of the first $4,000 given to any particular donee during the gift-tax year.

(b) Treat as gifts of present interests (in proportion to the beneficiaries' interests), entitled to the benefits of such exclusion, gifts in trust for the benefit of one or more minors, whether the income is to be distributed or accumulated, if both principal and income are payable only to or for the benefit of such minors or their estates.

Prior to the Revenue Act of 1938, gifts in trust enjoyed the benefits of the annual exclusion of $5,000 to the same extent as gifts made in other ways. The only exception was gifts of future interests, whether by trust or otherwise. Section 505 of the Revenue Act of that year reduced the annual exclusion to $4,000 for gift-tax years beginning on or after January 1, 1939, and denied its benefits altogether to gifts in trust.

The effect of the 1938 amendment will appear from a simple illustration. D has two children, one of them a minor, 12 years of age, and the other an adult. He makes a gift of $14,000 outright to the adult child in 1940. Of this amount, only $10,000 is subject to tax. Desiring to treat his children equally, but knowing his other child is a minor and without legal capacity to manage his own affairs, he sets aside $14,000 irrevocably in trust for the benefit of such child. The entire amount of gift is subject to tax, even if the trust provides that the income from the trust be distributed currently to the child or applied for his benefit. As a practical matter, however, it is difficult to make such gifts to minor children outright. Hence, such trusts, other than those established to provide for maintenance and support, commonly provide that the income be accumulated for the child until he reaches his majority.

2. *Removal of exclusion produced unfair discrimination.*—If this discrimination necessary? The report of the Senate Finance Committee (p. 32) justified this discrimination on the ground that it was a practical measure to protect the revenue by minimizing the abuses growing out of such decisions as *Wells* v. *Commissioner* (88 F. (2d) 339 (1937)), where it was held that the trust entity was the donee in the case of a gift in trust. This decision severely restricted the scope of the exception of future interests from the annual exclusion and

encouraged the creation of multiple trusts for the same beneficiary in order to obtain a $4,000 exclusion for each trust.

3. *Reason for present provision has vanished.*—This reason for the 1938 amendment has vanished by reason of the recent decision of the Supreme Court in *Helvering v. Hutchings* ((March 3, 1941) 61 S. Ct. 653), which held that the donee of a gift in trust is not the trust entity but the beneficiary, thereby overruling the *Wells case* in principle. On the same day the Court ruled in *United States* v. *Pelzer* (61 S. Ct. 659), that, where a trust provides for accumulation of income during the minority of a beneficiary and the beneficiary's right to receive the accumulated income and corpus is contingent upon his surviving until he reaches his majority or other specified age, the interest given to the minor is a future interest and the annual exclusion does not apply. This decision is squarely contrary to the *Wells case*. The case in which there is no contingency and the minor or his estate are absolutely entitled to receive the accumulated income at a future date was not directly ruled upon, but the reasoning of the Court suggests that the rule of the *Pelzer case* would still apply.

We believe that the reason justifying the exception of future interests, viz, the uncertainty as to the identity and number of the donees of the remainder interests, does not apply to a case in which there is a present gift of the entire interest, with only the actual enjoyment of the income postponed during the minority of the beneficiary.

In order to correct these unwarranted inequalities, we urge the adoption of appropriate amendments to section 1003 (b) of the Internal Revenue Code.

N. EXEMPTION OF SECURITIES OF NONRESIDENT ALIENS FROM ESTATE AND GIFT TAXES SHOULD BE PROVIDED

Under the existing law nonresident aliens are subject to estate and gift taxes only with respect to property situated within the United States. However, the Internal Revenue Code provides in respect of both taxes (sec. 862 (a); sec. 1030 (b)) that stock of a domestic corporation shall be considered property situated within the United States, no matter where the stock certificates are physically located. In accordance with this theory, it is suggested that the statute should specifically enact the rule stated in the present regulations (regs. 80, art. 50, and regs. 79, art. 18) that stock of a foreign corporation shall be deemed to be property without the United States, regardless of the physical location of the certificates.

No similar inconsistency exists in the case of bonds, which are usually taxed in the place where the bonds are physically located.

We recommend that bonds and other securities of foreign corporations owned by nonresident aliens be specifically exempted from estate and gift taxes. This recommendation is based solely upon practical considerations. There are many good reasons for encouraging nonresident aliens to keep their securities; whether foreign or domestic, in American custodian accounts. Employment and income are provided to numerous persons handling such accounts. The presence of these accounts facilitates the collection of other taxes due from the owners thereof. The transactions consummated by the custodians in American markets yield revenue in the form of stamp taxes and otherwise.

The existing law defeats its own purpose, viz, maximum revenue, by creating a tax incentive to foreigners to keep their foreign securities outside the United States, thereby in some measure defeating the policy of the changes in the income-tax law made in 1936 (see code, sec. 231 (a)) which exempted nonresident aliens from tax on their capital gains realized by transfers on American securities exchanges. Also, since most persons prefer to keep all their securities in a single account, the result is that many accounts of such aliens are kept in Canada or elsewhere, which might otherwise be maintained in the United States. For these reasons it is confidently believed that the adoption of the foregoing recommendation would in the net, benefit the revenue. Also, it is thought that the estate and gift tax revenue derived from such nonresident alien securities is so small as to be negligible.

For these reasons, we recommend that paragraph (b) of section 863 of the Internal Revenue Code be amended by changing the period at the end thereof to a semicolon and adding the word "and," and that a new subsection be added reading as follows:

"(c) *Foreign securities.*—Stock in, and securities of, a foreign corporation or of a foreign government or political subdivision thereof, owned and held by

a nonresident not a citizen of the United States, without regard to the physical location of the certificates or other physical evidences representing such stock or securities at the time of the decedent's death."

The adoption of this recommendation should be accompanied by the addition to section 1030 of the Internal Revenue Code of a new subsection (c) with a text identical with that of the foregoing proposed section 863 (c).

STATEMENT OF ELLSWORTH C. ALVORD, WASHINGTON, D. C., CHAIRMAN, COMMITTEE ON FEDERAL FINANCE OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. ALVORD. Mr. Chairman and gentlemen of the committee, I desire first to congratulate this committee and the Congress upon the real opportunity which is confronting you. You have an opportunity to improve the fiscal position of the Treasury, not by the three and one-half billion amount suggested by the Secretary of the Treasury, but by a minimum of $6,500,000,000. Before I discuss the details of that amount, however, I would like to refer generally to the use of the taxing power for other than revenue purposes. I believe quite firmly that tax statutes should have as their primary objective the raising of revenue. I think that many persons, as was said this morning, overestimate the effect of the use of the taxing power upon the promotion of other objectives. At the same time, I think your taxing policies, designed primarily to raise revenue, must at the same time be devised so that they will not conflict with your other very desirable objectives.

For example, the country is immediately confronted with the necessity for more speed in the production of defense goods; more speed in the production of tanks and guns, ships and planes.

You are also confronted with the shadows of a very serious civilian depression. Likewise, unless something is done, there may very well be complete annihilation of small businesses which are unable to convert and participate in the defense program.

It is a further fact that we must bear in mind that some day this emergency is going to end. We shall have the millions of persons now dependent upon the defense program returned to civilian life. We shall have, I presume, somewhere between two to four million men from our military and naval forces released again for civilian life. If your present policies can do something to permit those gentlemen to return to their old jobs or to build new jobs or businesses for themselves, they will be well worth while.

We hear very much about the threat of inflation. I don't want to repeat what has already been said before your committee, but I merely outline what seem to me to be the available methods to control or prevent unchecked inflationary price increases. Apart from monetary and credit controls, there are, I would say, four methods by which inflation can be checked somewhat. Two of them we hear about frequently; the other two I have not heard related to the inflation problem.

The first and obvious method is price control. My only comment is that effective price control will require the complete regimentation which totalitarian governments have found necessary. I doubt seriously whether that type of price control will be enacted by Congress.

Second, we hear about the possibilities of siphoning off or with-

drawing substantial amounts of consumer purchasing power. That may be done by either or both of two methods: One is by taxation; the second is by borrowing. There may be some question as to the second, because I have sometimes heard it asked whether Congress is going to tax all our income or will leave a portion of it for the Treasury to borrow. These two methods are very frequently discussed. There are, however, two additional methods which I think should be considered seriously at the present time.

For example, it would seem to me that instead of pumping purchasing power out of the stream once it has entered, it would be at least as effective if not more so, to keep the stream from overflowing. It is possible and practicable, gentlemen, to reduce the nondefense expenditures of your Government by at least $2,000,000,000.

Quite apart from its fiscal effect, you will then have kept out of the stream of consumer purchasing power the same $2,000,000,000, and the job of reducing our overexpanded consumer purchasing power will be to that extent relieved.

We have a fourth method, the one I desire to stress before you this afternoon. That fourth method is the real, sincere encouragement of expansion in the production of goods, particularly the production of civilian goods. The more goods there are to buy, the less danger there is of uncontrolled bidding which pushes prices up. Your tax policies have a most direct effect upon the expansion of civilian production.

I also want to point out that the expansion of civilian production; the encouragement of research; new products; substitutes, and so forth, will lessen the problem of civilian depression and the problem of annihilation of small businesses, to which I have referred. Perhaps of even greater importance, expansion of civilian production will give you a base after the emergency is over for a return to our normal process of free enterprise under a democratic form of government. Jobs should be available for those leaving defense production to go back into civilian life, and opportunities should be available for those leaving our military forces to come back into our civilian life.

Unfortunately, the House bill, in my opinion, does not touch any of the problems I have discussed except in an adverse manner. That is true notwithstanding the declaration of the Secretary of the Treasury that two of the purposes of his recommendations were to help in the control of inflation, and to spread the burden equitably throughout the country. The House bill, on the contrary, fails to accomplish either purpose. It does raise some $3,200,000,000, according to estimates, for the first full year of its operation. The revenue-raising potentialities appear to have been the prime consideration in the adoption of the House bill by the Ways and Means Committee and the House of Representatives. At the same time, I desire to commend the Committee on Ways and Means for its overwhelming defeat of the Treasury proposal with respect to the excess profits tax.

Let me discuss the House bill briefly from the point of view of the excess-profits tax. You gentlemen last year decided—most wisely, in my opinion and, I think, in the opinion of the country—that an excess-profits tax should be confined to taxation, at very high rates, of true excess profits; that normal profits derived from normal activities, even though those profits have increased considerably, should not be subjected to the high rates of an excess-profits-tax law. The House

bill now proceeds in precisely the opposite direction. For example, the 8 percent return on invested capital, which you gentlemen fixed last year as an appropriate measure of normal profits, is cut very considerably. First, it is reduced to 7 percent on invested capital in excess of $5,000,000. I read the report of the Committee on Ways and Means most carefully in an effort to determine what the committee considered to be the justification for that cut. So far as I could find, nothing was said in its justification. I conclude that nothing can be said in justification of it; there is no justification. Not only that, the House bill—solely, I am convinced, because of revenue considerations—reversed the deductions for taxes under the law which you enacted last year. The committee report states that this has the effect of reducing the invested-capital credit from 8 percent on the first $5,000,000 to 5.6 percent; and from 7 percent on capital over $5,000,000 to 4.9 percent.

In determining excess profits you said: "Certainly, the funds used for the payment of normal taxes should not be considered excess profits and subjected to an excess-profits tax." You permitted the deduction of normal tax in computing the net income to which the excess-profits tax was to be applied. The House bill reverses that deduction. It says: "We shall subject to the excess-profits tax the amount of money which you are required to pay into the Treasury of the United States as a normal tax," and then goes on to say that, of course, in computing your normal tax you may deduct the amount of your excess-profits tax. If by any stretch of the imagination the amounts necessary to pay to the Government in normal taxes were excess profits; if they were not in exactly the same class as ordinary business expenses, then I would agree with the House bill, because something over $300,000,000 is involved; but on neither of those tests is the House bill correct. Only the great skill of the draftsmen, to which I gladly pay tribute, avoided the necessity of resort to algebraic formulae in computing the normal tax, as the result of this reversal of the deductions. Even their skill was unable to avoid several pages of additional verbiage in the bill in accomplishing the result. I seriously urge that you go back to the principle of subjecting to the excess-profits tax only excess profits, fairly determined.

The House bill has another provision which to me is very objectionable. It is the first step, as I see it, in the enactment of the Treasury excess-profits-tax plan. It says, "We shall impose a tax of 10 percent upon the income of corporations using the invested-capital base to the extent that their current incomes exceed their average-earnings credit but do not exceed their invested-capital credit." The only conceivable justification for that is additional revenue. The explanation in the committee report is completely unsatisfactory. One would believe, after reading the report, that the 10-percent tax applies only to corporations which pay no excess-profits tax, but I find no such provision in the bill itself. There is no justification for singling out corporations which happen to have been unfortunate in the making of profits during the pre-war period, that is, 1936, 1937, 1938, and 1939, and saying, "You gentlemen shall pay more taxes than corporations who did make reasonable earnings during the base period."

Another provision in the House bill says this: Pursuant to the insistence of the Senate conferees last October there was written into the law, by amendment last March, a provision stating that if you don't use all your excess-profits-tax credit this year, you may carry the unused portion of the credit over until next year, thus permitting you to make additional profits next year before the high excess-profits tax applies. If not absorbed in the first year, you can carry the excess over for a second year.

What does the House bill do with this? Solely, I am convinced, as a first step in whittling away that very proper provision, they say, "No; you don't do that, now. You don't compute your unused excess-profits credit for 1940 under the 1940 act, which you used to compute your excess-profits-tax liabilities. You now compute the credit for 1940 under the 1941 act." If, as you can readily see, there are substantial changes in the computation and imposition of those liabilities for 1941, as compared with 1940, that credit is, to that extent, whittled away.

Senator TAFT. You mean you have to go back and figure the 1940 tax all over again as if the present law was in effect?

Mr. ALVORD. For this purpose; yes.

It seems to me that we must continue to safeguard normal profits. I think it would be most wise for this committee to recommend several necessary changes in the existing excess-profits-tax law, not only in the substantive provisions, but also in what we usually call the administrative or technical provisions, which have just as much effect upon tax liabilities as the rates themselves. Normally, when we want to correct these so-called technical provisions in the statute, we are met by the Treasury with the objection that such a change will cost a large amount of revenue. I urge this committee to adopt a tax system which will permit necessary changes in technical and administrative categories to be made equitably without fear of the effect on the revenue. We are actually in this situation today: The Treasury not only may oppose the retroactive correction of an admitted error in the law, on the ground that it will cost too much, but it also may oppose an amendment to correct the error even for the future, on the same grounds.

I think you can devise a tax system which will permit you to enact several very necessary changes, substantive, technical, and administrative. For example, we recommend, as I told you in the beginning, an improvement in the fiscal position of the Treasury, not by the 3½ billions recommended by the Secretary of the Treasury, which we think is woefully inadequate, but by 6½ billions. Those inadequate measures are the things that cause you gentlemen to sit here a month or two twice a year writing and rewriting a tax bill. I would much prefer to see you adopt a plan based on what might be called maximum revenue possibilities and stop. Then, you might say "This is the law we shall have in force during the period of the emergency; but it shall cease to be in force immediately following the emergency."

My 6½-billion figure is reached quite simply; I think soundly; I think equitably. First, I say reduce the nondefense expenditures of your Government by 2 billions. That can be done; it must be done.

Next, impose increased taxes upon corporations and individuals of about a billion and a half. That is in lieu of the 2.4 billion of the tax bill.

Next, collect about a billion dollars in sales or excise or miscellaneous taxes, and finally—tied squarely into the objectives I have discussed before—impose a withholding tax based upon all wages and compensation of all kinds, all dividends and interest paid to individuals, effective, I should say, as of January 1 next year. A low rate of about 3 percent will yield at least 2 billions of dollars. Those 2 billions, moreover, will come from the places where increased purchasing power now rests, so that it does permit the raising of revenue consistent with the necessary prevention of inflation.

The CHAIRMAN. What do you figure the individual income: Half a billion?

Mr. ALVORD. I would say the individual income tax—apart from the withholding tax—half a billion; and the corporation income and excess-profits taxes, a billion.

Senator TAFT. I notice this morning that the Treasury suggested an additional tax on pay rolls for social security. Your tax would have something of the same effect?

Mr. ALVORD. Yes, to some extent; but there are important differences. The social-security tax is a tax on both employer and employee, so that it is only partially a withholding tax. Furthermore, it applies only to wages and salaries under $3,000, and not to dividends or interest. Even in the field of compensation, there are very broad exemptions—farm and domestic labor, professional fees, etc. Owing to the limited area of its operation, I think it would be a very ineffective medium for the application of a withholding tax, both from the standpoint of revenue and possible effect on inflation. Furthermore, I object strenuously to the use of social-security payments to finance the ordinary expenditures of our Government.

The withholding tax I propose is on wages, compensation, and also on dividends and interest, and is collected at the source. That tax could go on immediately; produce revenue beginning January 1, 1942. By February 15 the funds would be flowing into the Treasury; you would not have to wait until March for collection in quarterly installments; you would not compel persons to file these very complicated income tax returns in the lower brackets; you would not have to worry about them saving enough money to pay their tax. My guess is that they wouldn't miss the deduction after the second pay check. I would apply it all along the line, to everybody, with no credits.

The CHAIRMAN. Is that substantially the Canadian system?

Mr. ALVORD. It is; except that the Canadian law allows certain credits. Also, I have not taken the step, which the British have been forced to take, of adding an additional tax under the doctrine of the so-called forced loan.

The CHAIRMAN. Compulsory savings?

Mr. ALVORD. Forced loans to the Government; forced savings for the individual. That is one of the things I would attempt to avoid, if we possibly can; we may have to come to it. If the voluntary borrowing policy of the Treasury, designed to withdraw from the individual his savings does not work, and if the Treasury must continue to finance a substantial portion of its deficit by borrowing from commercial banks, then I think you will have to resort to a forced-loan plan. Otherwise, the basis of the wildest credit inflation will be created.

That sort of a tax system conforms to the President's letter to Chairman Doughton in which the President said:

> I am convinced that the overwhelming majority of our citizens want to contribute something directly to our defense and that most of them would rather do it with their eyes open than do it through a general sales tax or through a multiplication of what we have known as "nuisance taxes."
>
> In other words, most Americans who are in the lowest income brackets are willing and proud to chip in directly even if their individual contributions are very small in terms of dollars. After all, the majority of all Americans are in these lowest brackets.

It conforms to what I believe to be the general desire of the country: it conforms to the Gallup poll which appeared on August 10 in the Washington Post. The poll indicated that the public would be willing to accept the following income taxes:

	What the income tax would be if public wrote the bill	Proposed Federal rates in tax bill passed by House
Family of 4 earning—		
$1,000	$0	None
$1,500	17	None
$2,000	55	None
$3,000	140	$11
$5,000	386	202
$10,000	1,123	998
$50,000	10,000	19,527
$100,000	24,000	52,738

Furthermore, if as the Secretary of the Treasury well says, our price increases continue, we shall find the wage earner all the way along the line most unfortunately squeezed by the increase in his cost of living, and the increase in his tax liability.

In addition to that, if we can prevent the disaster well pictured by the President in his message on the price-control bill, the disaster of uncontrolled inflation, a 3 percent withholding tax is a very small price to pay.

The CHAIRMAN. Would you suggest lowering the base?

Mr. ALVORD. No, sir.

The CHAIRMAN. If you put on those taxes?

Mr. ALVORD. No, sir; it isn't necessary.

The CHAIRMAN. You would really be accomplishing the same purpose, wouldn't you?

Mr. ALVORD. You would do that. It would spread the burden more fully; it would reduce the administrative problem for the Treasury. The taxpayer never has had the money; he hasn't spent it; it has been paid into the Treasury. But under the present system, the taxpayer usually has spent his income; he has nothing but current and future income with which to pay the tax.

The CHAIRMAN. But some of the Treasury people with whom I have discussed the withholding tax have suggested it is impossible to apply it to certain people such as dentists, artists, lawyers, and the like, where the tax could not be withheld at the source.

Mr. ALVORD. I know of no tax plan that is 100 percent effective. But it could be applied to such classes of persons.

Senator TAFT. Couldn't you, on their net income tax return, add a 5 percent on the gross?

Mr. ALVORD. I think the better solution would be to require every individual from whom the 3 percent has not been deducted to file monthly returns and pay it. That would not be very difficult because the chances are that the person will be making withholding returns and collecting withheld taxes in any event.

The CHAIRMAN. Is there much disposition to evade taxes on the part of that relatively small number of people that fall in that class—dentists, artists——

Mr. ALVORD. I thought you were also going to include lawyers.

The CHAIRMAN. I would include lawyers.

Mr. ALVORD. Senator, I don't think so. Bear in mind you will always have tax evasion just as you will always have murders, robberies, and rape, but I don't think the number of tax evaders should determine the sound policy of the tax law. You can have adequate provisions to get them; you do get a great many of them. Criminal enforcement is exceedingly unfortunate but necessary.

Senator GUFFEY. If you withheld at the source, don't you do away with a part of the psychological appeal, the tax consciousness? If withheld at the source, doesn't the fellow lose that consciousness derived from having filed his own tax return?

Mr. ALVORD. There might be some loss in that, but I don't think it would be great; I think everybody would realize that he or she had paid the 3 percent by having it withheld.

Senator GUFFEY. Wouldn't a lot of them think that the employers were holding it out and not turning it in?

Mr. ALVORD. I shouldn't think so.

Senator CONNALLY. It would increase our mail a great deal.

Senator TAFT. Couldn't it be provided that every employer should put in the worker's pay envelope notice to the effect that the tax had been withheld?

Mr. ALVORD. I suspect they would, without the requirement.

Senator CONNALLY. You want a flat reduction regardless of exemptions?

Mr. ALVORD. Yes; without exemptions, credits, or anything else. I think that is the only way a tax of this type can work smoothly. I quite agree with you that we might have to adjourn politics to put this system into effect. If you must provide credits, it could be done, but it is contrary to the principle of this method of taxation. You can provide that an individual shall have a credit for the withholding tax against income tax. Great Britain has done that, and always has. Great Britain's administrative machinery is geared to that sort of administrative work, ours is not. I would much prefer to have it apply to everyone; and then, to the extent you wish, you could adjust the income-tax rates applicable to existing taxpayers so as to reflect, in whole or in part, the 3 percent withheld. I wouldn't take it into consideration; I would apply it generally.

That brings me to a few very important so-called technical amendments. I quite realize that this committee voted yesterday not to consider administrative amendments. The ones that I shall discuss I trust do not fall within that prohibition. First, you gentlemen will remember that your tax is divided something like this: You have the earnings credit based upon pre-war earnings, particularly applicable

to earnings produced by individual effort—genius, hard work, and good luck. You have the invested capital credit: 8 percent on invested capital peculiarly applicable to cases where invested capital rather than individual effort is the controlling factor. You then have a third category which, for want of a better name, we call special relief. One of the provisions in this third category was enacted last March. It is called the normal growth provision, designed specifically to permit corporatons to grow normally, to increase normal profits without subjecting them to your excess-profits-tax rates. I think it was by error that the provision is applicable only to section 713 corporations—single corporations—and is not applicable to our supplement A corporations, which have gone through liquidations, reorganizations, and consolidations. Supplement A, gentlemen, is a most difficult provision to read and I would like to forget it is there. But the normal growth provision most clearly should be applicable to acquiring corporations under that supplement. Then I think also that this normal growth provision should remove from consideration the year 1938, because the year 1938 was an exceedingly bad year. The effect under the present law is that you must have constant growth: 1936, 1937, 1938, and 1939, in order to gain any benefit from the normal growth provision.

The unfortunate corporation which had normal growth going back far beyond 1936, and then happened to be hit by the recession of 1938, is denied the benefits of the provision. This is somewhat similar to the recommendation I made before and which I make again, that it is unfair and improper to use the entire 4 years of the base period in the earnings credit when they include a deficit year. I have repeatedly recommended and the Senate adopted last year the amendment providing that 3 out of 4 years should be used in determining the credit.

Finally, I think that the principle of normal growth should be extended if normal increases in profits in 1941 and subsequent years are to be protected. The present provision allows only for normal growth during the base period. One method of measuring normal growth after the base period might be to project the trend shown by the present computation into future years. Another alternative is the so-called Stiles formula, already discussed before your committee, which would determine the excess-profits credit by applying to the pay roll of the taxable year a percentage based on the ratio of profits to pay roll in the base period. This formula has certain definite advantages which entitle it to serious consideration.

Then I should think that everyone would agree that consolidated returns should be made applicable for both normal-tax purposes and excess-profits-tax purposes. The complications which are going to result otherwise are innumerable and, so far as I can see, to no purpose at all.

In that connection, I might point out that in the event there are changes in the rates or substantive provisions of this bill, it is only fair to provide a new election for filing consolidated returns, so that affiliated corporations may determine on the new basis whether to file consolidated or separate returns. That election, as I read the regulations, does not now exist.

Then I come to the rate schedule. The House bill, like the present law, bases the rates not upon the ratio by which the excess-profits taxes exceed the credit but solely upon dollar amounts. The Senate last year, as you gentlemen know, adopted an appropriate rate schedule. As I read the testimony of Assistant Secretary of the Treasury, Mr. Sullivan, before the Committee on Ways and Means, he now admits the present schedules are wrong. If he had thought that last October, I think the present schedule would have been made to conform to his present opinion. I trust that since he has reached that conviction now, he would approve a change in the schedule in the House bill.

You have heard a great deal about section 734. I won't say much about it except I know there is no one in this room who can read it and have the slightest idea what its effect will be. What it does is to repeal the statute of limitations whenever there is an inconsistent position. I think I can assure you gentlemen that under the present trend of court decisions there will be inconsistencies in practically every position the taxpayer has taken. Section 734 was designed to open up past tax returns only in the case of taxpayers who, after the statute had run, knowingly manipulated the statute to their own benefit by taking inconsistent positions. If that is its purpose, let that purpose be stated in the section.

Then let me invite your attention to the capital-stock excess-profits-tax situation. To the extent you change this present law you change the basis upon which estimates may be made for capital-stock excess-profits-tax purposes. Furthermore, that tax was designed solely for the purpose of raising $100,000,000 in revenue and no more. The yield has been stretched somewhat since. It is now proposed to increase the rate to pick up twenty or twenty-two million dollars. Under the present uncertainty of existing business conditions, no one can predict or guess with any degree of confidence what his income should be for capital-stock purposes.

I think, as I have said before, and repeat, that this tax should be repealed. Especially since the passage of the excess-profits tax, I find no justification for it. I am always met with the contention that repeal would cost $150,000,000 to $175,000,000. My reply is precisely the reply that I made sometime ago about costs in revenue; but if you gentlemen believe that you cannot repeal that tax at the present time, most certainly you can provide for an annual declaration of value, which was in the provision when it was adopted in 1933, but changed in conference. There cannot be much loss of revenue in such a provision. Certainly there is no wrongful loss of revenue in permitting annual declarations of value.

I think, gentlemen, that I have covered substantially all the so-called technical amendments except two. One is the use of cost in the computation of invested capital rather than tax basis. Invested capital normally is considered to be cash paid in for stock, property paid in for stock, accumulated earnings and profits. That is a simple definition of invested capital on which a fair rate of return is permitted. But what value do you take for the property paid for that stock? Suppose this table was given to me in return for capital stock. Under the 1917, 1920, and 1921 acts that table would go into my invested capital at its value on the day turned in, usually computed on the value

of the stock I gave. Under the present law, for some reason which I cannot comprehend, you disregard completely what that table cost me, if I happen to get it in one of the so-called tax-free reorganizations from which I, as the buyer, do not benefit.

Now admitting, contrary to law and fact, that you can readily determine what is a taxable and what is a nontaxable reorganization, I see nothing at all in that factor which should decide the value at which that table goes into my invested capital. It should be cost, with appropriate provisions to prevent tax evasion. Under the present law, you go back not only to the previous owner of the table, but perhaps many years, in order to find cost to somebody. You always have to determine cost to somebody. Why not determine cost to the corporation whose invested capital is being determined.

The last technical provision I wish to discuss is special relief. The present provisions of the law do not include any provision applicable to abnormalities in invested capital. You will remember that section 722½, as it went through the Senate last year, provided for the correction of abnormalities in both earnings and invested capital. The March amendments, however, were applicable solely to the correction of abnormalities in earnings; no provision is made with respect to abnormalities in invested capital. Nor does the present law adequately take care of corporations long in existence which suddenly realize perfectly normal profits for the first time in 1940 or 1941; nor does the present law take care of the new corporations created in 1940 or 1941 and realizing perfectly sound, proper, normal profits. I think the provisions should be expanded to include the three types of cases I have mentioned.

My suggestions are incorporated in a prepared statement. If I may, I would like to file this written statement as part of my remarks. I also have a rather lengthy and detailed comprehensive analysis of a large number of amendments which I recommend should be made to the existing law, not necessarily at the present time. However, there will be, we are told, a bill in October making the necessary amendments to the so-called administrative provisions not only of the tax bill, but also to the Internal Revenue Code. I brought a copy of our recommendations here, and I would like to file it, so that it can be available to the staff of the committee and to other taxpayers.

The CHAIRMAN. Are there any questions by any member of the committee?

Mr. ALVORD. In conclusion, I would like to discuss briefly the subject of amortization. You gentlemen will recall that provision placed in the law last October. At that time there was considerable misapprehension as to just what amortization was. I think before the debate ended that misapprehension was removed. I point out to you that the testimony of the national-defense officials at that time indicated that there are three types of defense contracts. The first type is the normal contract under which the Government buys goods and pays money for them, and that is all there is to it. Any new facilities are financed privately, with no reimbursement provided for in the contract—except, of course, as the cost of all facilities must eventually be recouped from the sale of the articles they produce.

Second is the type where the Government buys goods and agrees with the seller, separately, that he will be reimbursed for the cost of his facilities; and the third type is one where the Government finances the entire enterprise.

Some people were afraid that the second type of contract would not be duly considered, and were afraid that a fellow might get both amortization and reimbursement. The present law has been interpreted in such a way that it applies not only to the second type of contract, for which it was designed, but also to the first type. The result is that only a very limited number of certificates of nonreimbursement have been issued to taxpayers under the present law.

I have definite recommendations to make in that respect. They are contained in more or less detail in my printed statement, which I trust you gentlemen will have an opportunity to examine, whereupon I think you will agree with me.

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

(Mr. Alvord submitted the following prepared statement and supplemental memorandum:)

STATEMENT OF ELLSWORTH C. ALVORD

Mr. Chairman, gentlemen, I am Ellsworth C. Alvord, an attorney, of Washington, D. C. I am appearing as the chairman of the committee on Federal finance of the Chamber of Commerce of the United States.

OUTLINE OF TESTIMONY

Prof. Fred R. Fairchild, of Yale University, has discussed Government expenditures and principles of taxation. Mr. Roy C. Osgood has discussed the proposed changes in the estate tax. Both are members of the chamber's committee. I will discuss the provisions of the House bill and our recommendations with respect to the House bill and the present law.

OBJECTIVES

The problems of financing the defense and nondefense expenditures of the Federal Government cannot be segregated and considered separately. The first consideration must be, of course, the raising of revenue. But at the same time, fiscal policies must not be permitted to conflict with other objectives, such as:

(1) Speeding production for defense.
(2) Stopping the threatened civilian depression.
(3) Preventing the annihilation of small business.
(4) Avoiding the disasters of inflation.
(5) Protecting against post-war deflation.

Furthermore, immediate revenues are of no greater concern than future revenues.

DEMANDS FOR DEFENSE

Adequate defense of the United States must be provided. Demands of the national-defense program must have priority. The period of transition from a peacetime economy to a state of full armament production is not yet completed. Increased production of raw materials, and the acquisition of raw materials not produced within our territory, are essential. More and more production facilities—plants, tools, machinery, power, and transportation—are demanded. Speed is essential. But the problems of financing require solution. When the job is done—and the fight for democracy is won—must all the increased capacity be owned by the Government?

THE THREATENED CIVILIAN DEPRESSION

In the presence of the unprecedented prosperity of our armament boom, we see the shadows of a serious civilian depression. Many civilian industries are being converted into armament production. But even during the period of maximum armament production (extending over the indefinite period of the emergency) most of us will be dependent upon civilian industry. The supply of

raw materials, and the production, distribution, and marketing of products for civilian consumption, must somehow carry on. The processes of research, and the development of new products or substitutes for defense materials must be permitted to continue during the emergency. Normal business activities not related to wartime production, and fair and reasonable profits attributable thereto, must be given the utmost protection during the emergency.

Subject to the demands of national security, we urge recognition of the following principles:

(1) Curtailment of essential civilian industries should be resorted to only in extreme emergencies, after exhaustion of all reasonable alternatives for speeding defense production.

(2) The normal profits of civilian industries, as distinguished from "defense" or "excess" profits, should be protected against unfair or burdensome taxation.

(3) New industries and the development of new products or substitutes should be encouraged.

SMALL BUSINESS

It is particularly difficult to fit small business enterprises in to the defense program. Many of them must exist to serve civilian demands. Priorities are depriving them of essential materials. Importations are severely restricted. Prices and costs are increasing. Debts are owing and must be paid. Cash is scarce. But the annihilation of small business is not necessary.

INFLATION

The causes and consequences of inflation are pictured in the message of the President of the United States transmitted to the Congress in connection with the price-stabilization bill (H. Doc. 332, 77th Cong.).

It is generally conceded that an inflationary price movement is already under way, and that it may assume serious proportions within a short time. This movement is reflected in the wholesale commodity price index, which has increased 13½ percent over the pre-war level, and about 4 percent over the last 2 months. Similarly, the cost of living has moved upward about 4 percent since the first of the year.

The fundamental reason for rising prices is that the Government and private purchasers are competing for a limited supply of goods. The productive machine of the country is unable to turn out enough goods to supply both. Unless effective controls are applied, the price of goods rises to the point where demand is discouraged. The Government suffers through increased cost of armaments. The individual suffers through unchecked increases in his cost of living.

Four methods of curbing inflation have been suggested:

(1) Control of prices and rationing of the product.

(2) Reduction of consumer purchasing power through taxation or by Government borrowing, either voluntary or compulsory, from the savings of private individuals.

(3) Reduction of consumer purchasing power through the elimination of nonessential Government expenditures.

(4) Increases in productive capacity, especially for nondefense goods in which shortages are apparent.

Price control is an important and necessary device, particularly to deal with temporary shortages or "bottlenecks." But a rigid control of all prices is virtually impossible except under a totalitarian system of government. Even then the basic cause of inflation, the pressure of excess purchasing power, remains unremoved.

Under certain circumstances, taxation, properly devised and applied, may help to counteract forces tending toward inflation. At the present time it would seem that the most favorable opportunity for using taxation to accomplish this purpose lies in its effectiveness as a means of drawing off new increases in individual purchasing power. Such application of taxation is quite consistent with the object of raising revenue for defense.

But taxation will be ineffective if it merely imposes heavier burdens on the limited group of persons now subject to Federal income taxes. The average family of four persons has an effective income-tax exemption of $2,800. Studies made by the National Industrial Conference Board indicate that, out of a total of $67,600,000,000 of consumption expenditures in 1937, $46,700,000,000, or almost 70 percent, were made by groups having less than $3,000 annual income.

Studies of the distribution of national income reveal a similar result. Two-thirds of the national income in 1940 consisted of wages and salaries, and 90 percent of those wages and salaries were paid to individuals earning less than $5,000.

A satisfactory solution for the problem of inflation, in our opinion, would require a combination of three factors:

(1) A drastic reduction in all nondefense expenditures of Government. At a time when strenuous efforts are being made to reduce consumer purchasing power, it is the height of folly to maintain in force, without reduction, subsidies and activities created during the depression to stimulate consumer purchasing power. At least $2,000,000,000 of excessive and unnecessary purchasing power can be withdrawn by the application of common-sense principles to Government spending. Furthermore, are sacrifices to be expected and demanded of everyone but the Government? Why should not the Government set the example?

(2) The production of goods and services should be expanded tremendously and at the most rapid rate possible. Encouragement to expansion should be provided, both directly and through fiscal policies. A real increase in the national income and national wealth will result.

(3) Taxation should be imposed which reaches the bulk of consumption expenditures in the lower brackets of income. The recent Gallup poll indicates that the country as a whole supports such a straightforward and necessary step. The objective can be accomplished by a withholding tax collected at the source on all principal elements of individual income, or by broad sales, or excise taxes, or by a severe reduction in the personal exemption and the credit for dependents. A choice of methods depends on the amount which must be raised and considerations of administrative convenience.

THE HOUSE BILL AND INFLATION

The House bill promotes none of these desirable objectives. It appears to be based on the theory that indiscriminate increases in the rates of tax on existing taxpayers will be sufficient to avoid inflation.

No effective consideration was given to the reduction of nondefense expenditures, despite the statement of Secretary Morgenthau before the Ways and Means Committee in April that $1,000,000,000 could be saved out of 1942 appropriations for nondefense purposes.

Far from encouraging, or even permitting, the essential expansion of goods and services, the bill proposes to impose the excess-profits tax on a substantial portion of corporate normal profits. This is in addition to a special surtax of 6 percent on normal profits. By subjecting normal profits to a 60-percent excess-profits tax, it is obvious that normal research, expansion, and development will be effectively prevented.

The full burden of the increases in the individual-income tax is thrown upon the persons now subject to income tax, and particularly those in the $3,000 to $20,000 group. This is the so-called "middle class" composed mainly of families with fixed incomes and fixed liabilities. The Secretary of the Treasury admits that this group is already being "squeezed" by increases in the cost of living. Nevertheless, instead of distributing an additional tax burden of such tremendous proportions over a large segment of the population, it is proposed to concentrate it on about 7,000,000 persons, who, with their families, constitute about 15 percent of the total population and about one-eighth of the gainfully employed. Is "liquidation" of the middle class a part of the plan?

POST-WAR READJUSTMENT

Inadequate time and study has been devoted to the problems of the post-war period. When the present emergency is over we shall inevitably face severe readjustments. The millions who have been engaged in production for defense will find that this livelihood has vanished. Two to four million men in the armed forces will be returned to their homes. Where will their old jobs be, and will they be foreclosed from new jobs and businesses of their own? Have we no solution except to create another W. P. A., to embrace one-fourth of the population?

The severity of the shock will depend on the intelligence with which we now plan to meet it. This much is plain: The preservation of a strong and healthy enterprise system, which can continue to function effectively after the war, is vital.

TAXATION AND BORROWING

Funds to defray the defense and nondefense expenses of the Government must be provided. Taxation and borrowing are the only available sources. But the present and future tasks are tremendously difficult. Our revenue laws are based in large part purely upon political policies, and not upon the production of revenues. They already far exceed, in normal times, the point of maximum return. And we are confronted with a public debt of $50,000,000,000, brought about by a decade of unwieldy and unnecessary deficits.

ADDITIONAL REVENUES

The Secretary of the Treasury has recommended that we should raise $12,700,000,000 by taxation. He reached this total by determining that two-thirds of our Government expenditures should be paid for through current taxes, and one-third should be raised by borrowing. He estimated that the present law would yield $9,200,000,000, and that our total expenditures would be $19,000,000,000. Two-thirds of $19,000,000,000 is roughly $12,700,000,000. Accordingly, an additional $3,500,000,000 (bringing the total yield to $12,700,000,000) would be necessary to meet the mathematical two-thirds formula.

The two-thirds one-third formula is based neither upon logic nor upon precedent. It was outmoded within 30 days of its birth.

We recommended a simpler and more practical rule: Tax as much as you can, then borrow the rest. In determining how much you can tax, we repeat that your tax policies must conform to, and aid in the attainment of our present objectives. In determining the methods of borrowing, we again point out the inflationary results of continued borrowing from banks, and we again endorse the efforts of the Treasury to tap the savings of individuals.

According to official estimates (the Annual Report of the Secretary of the Treasury for the fiscal year ending June 30, 1940, the President's Budget message for 1940, and Treasury statements before the Committee on Ways and Means in April of this year), the present law should yield, at a $90,000,000,000 level of national income which is probable for 1941 without the addition of any new revenues, between $11,200,000,000 and $12,400,000,000. If the national income reaches $100,000,000,000, which appears probable for the calendar year 1942 (assuming that the threatened civilian depression is avoided), the present law should yield at least $14,000,000,000.

The lower yields which are estimated for the fiscal year 1942 (which include in part collections from 1940 incomes and only in part from 1941 incomes) are not a realistic measure of probable revenues or of existing tax burdens.

REVENUE RECOMMENDATIONS

We believe that the Treasury program is again inadequate. An adequate and comprehensive fiscal program should be founded upon the following:

Reduction of nondefense expenditures by at least	$2,000,000,000
Increase in present corporate and individual-income taxes	1,500,000,000
Additional sales, excise, or miscellaneous taxes	1,000,000,000
A withholding tax upon all compensation, dividends, and interest paid to individuals	2,000,000,000
Total annual improvement in Treasury fiscal position	6,500,000,000

In addition, the present unintelligible, complicated, inequitable revenue laws, including both income and excess-profits taxes, should be thoroughly revised to place them upon a reasonable and equitable basis. Unintended inequities and unexpected interpretations must be, and can be, corrected without consideration of the oft-sounded objection of "cost to the Treasury."

We earnestly believe that by the adoption of the above program (and only through the adoption of the above program) will—

(1) The outlined objectives be attained;

(2) Taxation be used as an effective aid in the prevention and control of inflation;

(3) The burdens of the defense program be distributed with reasonable equity among everyone, with due recognition to the principles of ability to pay;

(4) Tax liabilities be determinable with at least some certainty;

(5) The annual tinkering and haphazard efforts to squeeze additional revenues from existing taxpayers, with their necessarily upsetting effects upon both the defense program and the meeting of civilian demands, be unnecessary;

(6) The repeated imposition of retroactive taxes stop; and

(7) Private funds be available for financing a part of the defense program and all of the civilian program.

THE EXCESS-PROFITS TAX

(1) *Purpose.*—The fundamental purpose of the excess-profits tax remains unchanged. That purpose, as expressed by the President and by the Congress, was to prevent unjust enrichment and the creation of new "war millionaires" as a result of the defense program. More broadly, the defense program should create neither prince nor pauper. A true excess-profits tax, designed to carry out such a purpose, must be based on the following principles, which we have repeatedly emphasized:

(*a*) It should be designed solely to prevent or to tax excess profits—and normal profits must not be subjected to the high rates of an excess-profits tax.

(*b*) If additional revenues, rather than control of excess profits, are the objective, they should be sought directly and openly through other available and appropriate sources.

(2) *The present law.*—The excess-profits tax enacted by the Congress last October, and amended in March, in general observes these principles. It provides three alternate bases for determining normal profits not subject to the tax: Average earnings for the period 1936 to 1939, inclusive; a return on invested capital of 8 percent; and "special relief" (although the provisions of the present law are woefully inadequate) in certain specified cases of hardship in the application of the other two bases.

None of these yardsticks, considered independently, is an adequate measure of normal profits for all industries and all types of business. Unquestionably, earnings over a representative period before the war are a fair measure of normal profit. They are the only fair and practical measures wherever normal profits result primarily from the efforts and genius of the individual. This yardstick is simple; it does not discriminate on the basis of size, capitalization, or risk; and it confines the excess-profits tax to profits which have increased after the emergency arose. But average earnings cannot be used in the case of new corporations formed after the base period; and they are inadequate as a measure of normal profits in the case of (*a*) corporations which experienced abnormally low profits in the base period, (*b*) corporations which expand and grow through normal activities; and (*c*) where invested capital is the principal income-producing factor. Hence, a fair return on invested capital is prescribed as a necessary and appropriate alternative to average earnings. There are also certain exceptional cases in which neither average earnings or invested capital provides a satisfactory measure of normal profits. This will be true, for example, of small corporations with an increasing trend of profits not arising from the defense program; corporations engaged in research or development which suddenly realize profits; and many others. Special treatments must be given to such hardship cases on an individual basis.

Each of these credits has flaws and imperfections which should be corrected in order to improve the operation of the law. But the retention of all three basic methods of computing normal profits is essential to the concept of a true excess-profits tax.

(3) *The Treasury proposal.*—The Treasury Department sought to revive in the House, and again seeks to raise before this committee, a proposal which was carefully considered and rejected by both Houses last fall. This proposal is to abandon the average earnings basis, and to use, as the sole measure of normal profits, the average return on invested capital for the 4 years 1936–39, but not more than 10 percent or less than 4 percent. Before the House committee, the Treasury further suggested that an additional 10 percent tax should be applied to that part of the current profits that is in excess of the base period earnings but not in excess of 4 percent of invested capital. A special rate of 8 percent would be allowed for new capital, with 10 percent for new capital under $500,000.

It would seem to require little argument to demonstrate the unsoundness of the Treasury proposal. The average earnings basis is a fair and simple rule for determining normal profits in the majority of cases. It gives effect to all sources of earnings, including the value of good management and the contribution of goodwill and other intangibles to earning power. It recognizes the risk factor in the investment of capital, which an arbitrary return on invested capital ignores. It does not discriminate, as does the invested-capital method, by reason of accidents in the method or time of capitalization. Most important, it limits the excess-profits tax to the increase in profits after the emergency arose, which is the only proper objective of such a tax. All these points were developed fully at the hearings last year and require no further elaboration on my part.

(4) *The House bill.*—In order to satisfy the demands of the Treasury for additional revenue from the excess-profits tax, the Ways and Means Committee adopted certain provisions designed to increase the yield of this tax. These are as follows:

(*a*) *Direct and indirect reductions in excess-profits-tax credit.*—Section 201 of the bill proposes a direct reduction in the invested capital credit from a flat 8 percent on invested capital to 8 percent on the first $5,000,000 of invested capital and 7 percent on the remainder. In addition, section 204 proposes a further substantial reduction in the credit "indirectly" by denying the present deduction of the normal tax in computing excess-profits net income and allowing in lieu thereof a deduction of the excess-profits tax in computing normal tax net income.

The House report offers no justification for the direct reduction in the credit. It attempts to justify this reversal of deductions, however, on the ground that it conforms to the rule of our 1918 act and the present English law and is equivalent, in amount, to the Canadian rule (H. Rept., p. 24). Under the Canadian rule that part of the normal income tax which is computed on income subject to excess-profits tax is allowed as a deduction in computing excess-profits net income. The report states that—

"It seems unfair to allow that part of the income tax which is computed on income which is not subject to the excess-profits tax to reduce the excess-profits net income."

Neither the justification based on precedent nor on fairness supports the proposed reversal of deductions, however. The deduction of the normal tax in computing excess-profits tax net income, prescribed in the present law, was advocated in the preliminary recommendations of the Ways and Means subcommittee on the 1940 bill and was accepted by the Congress and the Treasury as the sound rule. Precedents were not overlooked; they were discarded. Furthermore, there is no justification for the imposition of an excess-profits tax upon income required for the payment of a normal tax. Can the amount paid to the Federal Government properly be treated as "excess profits"? The normal corporate tax, which has been in existence for more than 25 years, is, for practical purposes, just as much a business expense as other taxes paid to the Federal Government and the States. It should be recognized as such for excess-profits tax purposes.

In fact, the House report indicates that the real reason for the proposed reversal is not to return to precedent and "fairness," but because—

"The effect of the reversal of the deduction is that the 8-percent credit on invested capital provided in the bill is equivalent to a credit on invested capital of 5.6 percent after deduction of the normal tax and surtax, and the 7-percent credit on invested capital is equivalent to a credit on invested capital of 4.9 percent after deduction of the normal tax and surtax."

Thus, in substance, the bill proposes an aggregate reduction in the present invested capital credit from a flat 8 percent to 5.6 percent on the first $5,000,000 of invested capital and 4.9 percent on the remainder. And the only real question presented is whether or not any such reduction in the invested capital credit is justified.[1]

Such a reduction would represent a serious departure from the legislative policy adopted last year and embodied in the present law. That policy is that the excess-profits tax should apply solely to profits arising directly or indirectly from the defense program and then only to the extent that such profits are in excess of a fair return on invested capital. The soundness of this policy cannot

[1] The reversal of the deduction also effects a reduction in the income credit, but such reduction is less severe due to a corresponding adjustment in computing base period income.

be questioned. The major purpose of the excess-profits tax is to prevent the creation of a new crop of war millionaires. The extraordinary rates which are required in order to effect this major purpose limit the tax as a revenue measure to the recapture of excess profits realized from the defense program.

In view of the increase in defense program activities, the excess-profits rates proposed by the House bill will result in a very substantial increase in revenue. But the revenue-raising capacity of the excess-profits tax must not be increased still further by subjecting normal profits thereto, whether such profits are from defense program activities or otherwise. A 72-percent tax rate imposed on normal earnings is obviously unfair and destructive. It will jeopardize sound corporate fiscal structures generally and will seriously interfere with the inevitable transition to a peacetime economy at the end of the present emergency. The Congress should be directing its attention toward the perfection of the present credit provisions, in order to safeguard normal earnings, rather than toward a reduction in the present credits and a consequent jeopardizing of such earnings.

(*b*) *Special tax on corporations using the invested capital credit.*—Section 201 (a) (2) (B) of the bill imposes on corporations using the invested-capital credit a special tax of 10 percent on the amount by which the adjusted excess-profits net income computed with the use of the income credit exceeds the adjusted excess-profits net income computed with the use of the invested capital credit.

The House report (pp. 25 and 26) states that the purpose of the provision is to require corporations to pay an additional tax where their income has increased over the base period but where they are nevertheless exempt from excess-profits tax under the invested capital credit. It is claimed that such corporations are enjoying increased earnings by reason of defense expenditures and therefore should contribute some part of such increase to the Government, in addition to the normal tax. An analysis of the provision, however, demonstrates that it is not supported by the justification assigned to it in the report.

In the first place, so far as existing corporations are concerned, no such limitation is found in the provision as is suggested in the report. The tax is not limited to corporations which pay no excess-profits tax. On the contrary, many corporations which are subject to excess-profits tax, because their earnings for the taxable year exceed the invested capital credit, will nevertheless be required to pay a 10 percent additional tax to the extent that their base period earnings are less than the invested capital credit. Thus, the tax will operate to penalize those corporations which, for any reason, had abnormally low earnings during the base period.

In the second place, new corporations are wholly exempt from the tax.[2] What policy can justify penalizing by a special tax on existing corporation having no earnings or abnormally low earnings in the base period, merely because it has enjoyed a moderate increase in earnings attributable, perhaps, only indirectly to the defense program, while a new corporation, formed for the very purpose of handling defense contracts, pays no such tax? Argument is unnecessary to show how great an incentive to tax avoidance through the dissolution of old and the formation of new corporations such a discrimination would create.

The imposition of this tax on new corporations, while it would cure this discrimination, would be equally objectionable for different reasons. It would mean that new corporations, even though formed to carry on nondefense activities, would be subjected to a tax burden running up to nearly 40 percent of their earnings. Such a tax burden would constitute a virtual embargo upon new enterprises vitally needed to preserve the economic health of the Nation.

This analysis of the defects of this tax demonstrates the soundness of the policy adopted last year of allowing all corporations a minimum tax-free return on invested capital. The policy should be adhered to and this penalty tax should be eliminated.

(*c*) *Recomputation of excess-profits credit carry-over.*—Section 204 (c) of the bill adds a provision to the law which requires that, for the purpose of computing the excess profits credit carry-over, the excess-profits credit, and the excess-profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941.

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[2] This is because the tax is imposed only on corporations entitled to use the income credit. This credit is not available to new corporations.

This provision would establish a bad legislative precedent. The unused excess-profits credit for 1940 should in fairness be computed under the law which imposed the tax for that period. The bill, on the other hand, would compel taxpayers, already overburdened by the necessity of making the intricate computations for 1940 required by existing law, to discard these computations and recompute under the 1941 law. Presumably, if this principle is once established and further amendments to the excess-profits-tax law should be made by Congress in 1942, taxpayers would then be compelled to make a recomputation for 1941 and a second recomputation for 1940, in accordance with the 1942 law.

Certainly the Treasury would not propose any such provision in the event the House bill had liberalized the credit provisions. Its purpose, obviously, is to reduce the benefit of the carry-over provision of the present law—not to carry out any sound tax policy.

It is apparent that the cumulative effect of the foregoing changes made by the House bill is seriously to impair the safeguards provided by the existing law against the taxation of normal earnings as excess profits. They should be rejected.

NORMAL GROWTH

There still remains the important problem of providing adequate credits in the statute to cover ordinary everyday normal growth in no way related to the defense program either directly or indirectly—cases where a trend of growth is reflected prior to the inauguration of the defense program. Clearly, normal profits from normal growth should not be subjected to an excess-profits tax.

The normal-growth problem was recognized by Congress in the 1941 amendments and section 713 (f), which was added at that time, affords a partial solution. The formula prescribed by that section is based on a comparison of the last half of the base period with the first half. It produces a credit equal to the average earnings for the last half of the period, plus one-half of the excess of the average earnings for the last half of the period over the average for the first half. A maximum requirement is prescribed equal to the earnings for any 1 year in the base period.

This formula in section 713 (f) is inadequate in the following principal respects:

(1) The arbitrary limitation based on the maximum earnings for any 1 year in the base period is in conflict with the very purpose of the normal-growth provision. In most cases, 1939 will be the largest year in the base period for normal-growth corporations. If the trend in the base period shows a growing earning capacity, it is obvious that the normal earnings for 1940 and subsequent years would exceed the 1939 earnings. Thus the limitation to 1939 earnings has the effect of denying a normal-growth credit for 1940 and subsequent years even to the extent of the indicated increase in normal earnings for 1940.

(2) The formula fails to reflect normal growth, or the true amount of the normal growth, in a majority of cases because of the inclusion of 1938 in the computation. For growing corporations, as well as for others, 1938 was an unusually subnormal year, resulting either in losses or greatly reduced earnings. Its inclusion in the formula prescribed by section 713 (f) distorts the true picture of the growth by concealing the normal trend that would otherwise be reflected if the nontypical year 1938 were excluded.

Congress has already recognized the distorting effect of 1938 in computing average earnings for the entire base period under section 713 (e), although, as pointed out herein, such recognition is incomplete. By the same token, Congress should give recognition to the distortion which 1938 produces in the normal-growth provision of section 713 (f). Its effect is even more aggravated under section 713 (f) because there it plays a part in determining a 2-year average, as distinguished from a 4-year average under section 713 (e), and in addition, operates again to distort the comparison between the first and last halves of the base period.

In order to obtain a clear reflection of normal growth, 1938 should be excluded from the formula and a comparison should be made between 1939 and the average of the first half of the base period.

(3) The foregoing amendment will effect a substantial improvement in section 713 (f). But the principle must be extended if normal increases in profit in 1941 and subsequent years are to be protected adequately from the excess-profits tax and normal growth in peacetime enterprises is to be encouraged. This

is because section 713 (f), even if revised as suggested above, cannot be counted on to measure more than the normal growth of the corporation for the first year after the base period, namely, 1940. While the formula employed points to a trend of increased normal profits into the future, the section fails to translate this trend into corresponding increases in the income credit.

Various alternative suggestions have been offered to meet this normal requirement for 1941 and future years—none of which will accomplish the correct result in all substantial respects. For example, section 713 (f) itself can be further revised so as to provide for projecting the present trend not only into 1940, but into subsequent years, with a uniform step-up in the income credit to cover the indicated normal profit increase. If the actual increase in profit, excluding direct defense profit, is sufficient to substantiate the indicated growth per formula, then the propriety of the credit increase as well as the necessity therefor would be established.

As another alternative, the so-called Stiles formula, which has been presented to the committee during the present hearings, might be accepted as a solution to the future year normal growth problem. Under this formula, the excess profits credit is determined by applying to the pay roll of the taxable year subject to social security tax the percentage representing the ratio of profits to such pay roll during the base period. This formula has certain definite advantages which entitled it to serious consideration. These advantages are set forth in detail in the memorandum accompanying this statement.

(4) Finally, and perhaps most important of all, is the fact that section 713 (f) has never been made applicable to acquiring corporations which compute their average base period earnings under the provisions of supplement A. In order to obtain the benefits of the normal growth provision, such corporations must elect to compute their excess profits credit under section 713 rather than supplement A, and thereby lose the base period income of their component corporations in computing their income credit.

Obviously, there is no good reason for compelling an acquiring corporation to make a choice between supplement A and the normal growth provision. The acquisition of component corporations since 1936, through tax-free liquidations of subsidiaries for example, is a normal and common incident of the trend toward simplification of corporate structures which has been encouraged by Congress. In supplement A, Congress has recognized the necessity of including the base period income of such components, if they are qualified in the base period income of the acquiring corporation, in order to reflect the average base period earnings from the aggregate assets in the hands of the acquiring corporation after the acquisition. In section 713 (f), Congress recognized the necessity for a normal growth allowance in the income credit, insofar as such normal growth is indicated by a trend in the base period. There is no inconsistency between the policy of supplement A and the policy of the normal growth provision. In fact, if the combined income of acquiring and component corporations increased in the latter half of the base period the policy of the normal growth provision demands that such increase should be recognized.

Apparently, the failure to include the normal growth provision in supplement A in the first instance represented a drafting error. The continuation of this error has possibly resulted from the fact that supplement A is defective in several respects and any correction of the provisions of the supplement is being postponed until a complete job can be done. It is submitted that this defect in supplement A is too substantial to continue, that it can be corrected by a simple amendment, and that such correction should be made promptly without awaiting further improvement in the supplement.

Furthermore, since the failure to include the normal growth provision in supplement A is recognized as a defect in the statute and as one that has already created hardship, there is no reason why the correction should not be made retroactive to 1940 and thereby prevent normal growth earnings in that year from being subjected to the excess-profits tax rates.

SPECIAL RELIEF

Since it is not practical to undertake a detailed analysis of the relief provisions of the existing law in this statement, I shall limit my discussion to the major defects in the present special relief provisions which demand an immediate solution.

(1) *Abnormalities in invested capital.*—The existing law contains no provision whatever for relief of abnormalities in invested capital. Section 722 of the 1940 bill contained a provision vesting general authority in the Commissioner to make adjustments necessary to correct abnormalities in invested capital but this provision was eliminated by the March 1941 amendments. The provisions enacted to take its place relate entirely to adjustments of income in the taxable year or the base period. They are utterly inadequate to afford relief in numerous cases where the invested capital credit, as computed under section 714, does not provide even an approximately fair measure of normal profits.

Two common cases of invested capital abnormality may be cited by way of illustration. The first case involves a corporation which has enjoyed a large increase in its earnings in a taxable year due to the successful exploitation of a patent or a secret process. The patent or process had no direct relation to the defense program. The patent may represent only a small addition to the invested capital, so that, without some equitable adjustment, the whole of the profits derived from it will be taxed as excess profits. Unless relief is granted in such cases, a virtual embargo is placed upon the development of new patents and processes, and the public, as well as taxpayers, suffer a serious loss.

The second type of case arises directly out of the use of "tax basis," in lieu of cost, in computing invested capital. The result will be that innumerable taxpayers will be restricted to an invested capital which has no relation either to the value of the assets actually employed in the business, or the actual investment of the current generation of stockholders, but represents only the investment made by predecessors of the taxpayer a generation or more ago. I have urged as the only adequate remedy in these cases the abandonment of "tax basis" and the substitution of the fairer and more realistic rule of cost to the taxpayer. Until this is done, special relief is essential in order to prevent an abnormally low invested capital in many reorganization cases where identity between the parties is lacking. The statute should be amended immediately to provide adjustments in invested capital where and to the extent necessary to remove abnormalities, after which the excess-profits credit and the tax should be computed in the manner provided by the law. The adjustments once made should be effective for future taxable years.

(2) *Abnormalities in income in taxable year.*—The adjustments provided by section 721 are for the purpose of eliminating abnormal items of income in the taxable year. The most substantial deficiency in this section as now drawn is its failure to cover abnormal income resulting from the elimination of a deductible expense in the taxable year which was incurred throughout the base period. A typical situation is one in which the taxpayer during the base period was obligated to make a substantial royalty payment because of its use of a patent. In the taxable year, the patent expires and the taxpayer is freed of the burden of the royalty payment. Any increase in profits directly attributable to the lapsation of the royalty is in no proper sense an excess profit and should not be included in excess-profits net income.

I therefore suggest an enlargement in section 721 which will take care of abnormalities on account of the dropping out of normal items of deduction in the taxable year.

(3) *Abnormalities in the base period.*—Abnormalities in the base period are covered by section 711 (b) and section 722. Section 711 (b) deals with the elimination of separate items of base period abnormality, while section 722 deals with more general changes, such as expansion or curtailment of business, occurring prior to January 1, 1940. Whether or not section 711 (b) adequately provides for the elimination of items of abnormality depends in large part on the administration of the section and the interpretation of the limitations contained in section 711 (b) (1) (k). As the Finance Committee report on the March 1941 amendments frankly recognizes, these and other similar general limitations in section 722 will call for intelligent and sympathetic administration in order properly to carry out their purposes (77th Cong., 1st sess., S. Rept. No. 75, p. 3). I share the hope that the experience and ability of the officials of the Treasury and the Bureau of Internal Revenue will prove equal to the heavy responsibilities imposed upon them.

Section 722 permits the taxpayer to reconstruct its base period income if, prior to January 1, 1940, there have occurred certain specified changes in the character of the business, or interruption or reduction or normal output or operation on

account of some abnormal event. In determining an abnormal event, however, or in reconstructing the base period income in the event of a change in the character of the business, high prices of materials and so forth, low selling prices, or low sales volume due to low demand for the taxpayer's product, are excluded from consideration as abnormalities.

There are, unquestionably, many types of changes in the "character of the business" other than those prescribed in section 722 which would justify a modification of the actual base-period income as a standard of normal profits—changes in management and operating policies, for example, or reduction in costs due to discovery of new sources of supply, technological improvements, and so forth. It is probably as difficult to anticipate the various changes in the character of the business as it is to anticipate all the various classes of abnormal items. Accordingly, a catch-all provision should be included corresponding to the general classification of abnormalities contained in both section 711 (b) and section 721, which would "leave room" for relief in the unforeseen situation.

The most serious deficiency in base period abnormality provisions results from the limitations contained in section 722 preventing adjustments to base-period income on account of high prices of materials and other agents of production during the base period, low selling prices, low volume, etc. Subnormal base-period income on account of these factors should certainly be adjusted. Their existence and effect can readily be ascertained by reference to prior years or, where they occur in 1 or more years in the base period but not throughout the entire base period, by reference to other base-period years. Abnormal business conditions of the type now excluded from consideration by section 722, occurring in a single base-period year, may distort the entire base-period average so that it would utterly fail to reflect average normal earnings. Provision should certainly be made for this type of base-period abnormality.

(4) *New production.*—By far the most serious defect in the so-called special-relief sections is their complete failure to cover the case of the new corporation, or the existing corporation, coming into production after January 1, 1940, and engaged in a business in which invested capital is only a minor income-producing factor.

Under section 713 the new corporation is entitled to no income credit and the income credit of the existing corporation will be nominal. Section 722 affords no relief to either corporation since the event giving rise to income occurs after January 1, 1940. Obviously, therefore, corporations of this type will be left at the mercy of the excess-profits tax unless some special-relief device is inserted in the law to protect their normal earnings. A fair and workable method must be found to enable new peacetime enterprises to develop and enjoy reasonable prosperity without fear of paralyzing excess-profits taxation.

In view of the fact that such corporations have no past experience, it is necessary to construct an income credit therefor by reference to the base-period experience of other corporations in the same industry. The law should be amended to provide for the construction of an income credit in this manner.

THE INCOME CREDIT

There are several defects in the income credit provided by the existing law which are in urgent need of prompt correction in order to make it a fair standard of normal profits.

(1) The present law prescribes an income credit based on an average of the earnings for the 4 years 1936-39, inclusive. It permits the taxpayer to treat 1 loss year as zero but requires the remaining 3 years' income to be divided by four. This method of computing average normal earnings is inadequate. In the first place, the years selected as the base period were not a representative period of normal earnings, for they were merely the culminating years of a period of depression. Many companies operated under depressed conditions for most of that period. The year 1938, in particular, was a bad year for most businesses. The right to treat 1 loss year as zero does not compensate for a year of subnormal earnings, and the necessity of dividing the remaining 3 years' total by four distorts the average for the 3 years.

The Senate amendment to the 1940 bill permitted a corporation to elect any 3 out of 4 years in the base period. This reasonable yardstick for measuring normal profits should be restored in the pending bill.

(2) The existing law takes into account only 95 percent of the average base-period earnings in computing the income credit. This limitation results in subjecting a part of the normal profits to excess-profits tax. There is no justification for this result. Taxpayers should be allowed the full 100 percent of their average base-period earnings in computing the income credit.

(3) Section 721 permits the income of a taxable year to be allocated to another year or years in certain specified cases. Where such income is determined to be allocable to a year or years in the base period, it should be taken into account in computing the income credit. The Senate Finance Committee report (S. Rept. No. 2114, p. 16) specifically stated this to be the result under the existing law. The Regulations (Regs. 109, sec. 30.721–1) have taken a contrary position, in disregard of this unequivocal expression of legislative intent. Section 721 should be specifically amended so as to incorporate the Finance Committee's construction.

USE OF COST IN LIEU OF TAX BASIS IN COMPUTING INVESTED CAPITAL CREDIT

The present excess-profits-tax law provides (contrary to the 1917, 1918, and 1921 acts) that property paid in to a corporation shall be taken into its equity invested capital, not at its cost to the taxpayer, but at its "tax basis" for computing loss upon a sale or exchange. Thus, if the taxpayer acquires property through the issuance of its stock in a transaction in which no gain or loss to the transferor is recognized, it must include the property in its invested capital in an amount based on the cost of the property to the transferor rather than at the cost to itself.

"Tax basis" is merely the device adopted for measuring the gain or loss upon the subsequent disposition of property involved in a "tax-free" reorganization or exchange.

It is utterly unrelated to the amount of the property which the taxpayer has invested in his business. Its use in computing invested capital is neither fair nor logical. It results in serious and indefensible discrimination between taxpayers similarly situated, and opens a loophole of serious proportions. It is neither necessitated nor justified by considerations of administrative convenience.

Property paid in to a corporation for its stock (or as paid-in surplus, or as a contribution to capital), should be included in equity invested capital at its cost to the corporation—i. e., the market value of the corporation's stock issued therefor or (in the absence of market quotations) the value of the property at the time paid in. The necessity for special relief, in order to prevent an abnormally low invested capital in many reorganization cases, has already been discussed.

REVISION OF RATE STRUCTURE

The present law and the House bill base the tax brackets in the rate schedule exclusively upon the dollar amounts of excess profits without regard to the ratio of the excess profits to normal profits.

The rate structure of the earlier excess-profits-tax laws recognized the equitable principle that excess-profits-tax rates should be based primarily upon the ratio between the excess profits and the credit, rather than upon the mere dollar amount of the excess profits. The report of the Ways and Means Subcommittee on August 8, 1940, recommended the adoption of such a rate structure, and it was adopted in section 710 of the 1940 bill as it passed the Senate. The elimination of this section was rightly characterized by Senator George, when the conference report on the 1940 bill was agreed to in the Senate, as representing the abandonment of one of the soundest and most important provisions of the Senate bill (Congressional Record, vol. 86, No. 183, p. 19503). Assistant Secretary Sullivan has in effect conceded the unsoundness of this feature of the present law (hearings, May 19, 1941, p. 1339). Furthermore, the rate schedule as now constructed is responsible for many of the complexities of the existing law, such as the provisions in supplement B relating to the highest bracket amount.

CONSOLIDATED RETURNS

We continue to urge that permission to file consolidated returns for normal and surtax purposes be restored to corporations generally. The requirement of separate returns for a group of affiliated corporations is indefensible, compelling the statement of nonexistent profits and losses on intercompany transactions and distorting the earnings of particular units. The principle of taxing

as a business unit what is in fact a business unit is sound, equitable, and convenient both to the taxpayer and the Government. The Treasury Department has urged the restoration of consolidated returns on several previous occasions, and action should not be longer delayed.

At the same time, a new election to file consolidated returns for excess-profits-tax purposes should be allowed, as a matter of equity and fairness, if substantial changes in the credits and rates of tax are enacted.

ANNUAL DECLARATION OF CAPITAL-STOCK VALUE

I have discussed the declared-value capital-stock tax and its companion excess-profits tax on several occasions in the past before this committee. These are hybrid taxes, arbitrary in their operation, which have no place in a tax system constructed on sound, scientific principles. I renew our recommendation that they be eliminated at the earliest possible date.

If this solution is impracticable under present conditions, I urge the immediate amendment of the capital-stock tax so as to permit an annual declaration of value. The bill, contrary to past legislative practice, does not even provide for a new or amended declaration of value, although it materially increases the capital-stock-tax rate.

There are several reasons of unusual urgency making it imperative to allow an annual declaration at this time. The problem of calculating the future trend of corporate income has always been a very difficult one. Under present conditions it becomes impossible. To all uncertainties present in past years are now added those created by the defense program and the emergency itself. The defense program cuts both ways. To many corporations it means or may mean a decline in profits or no profits at all. The latter include those not enjoying defense contracts, whose sources of materials may be cut off by priority orders. Finally, who can foresee with assurance the rapidity and extent of future price increases due to inflationary factors?

Under such conditions of uncertainty, simple justice demands that taxpayers should not be compelled to hazard a guess as to their future incomes for more than a year in advance. An annual declaration of value is the only fair and practical solution.

AMORTIZATION

A little over a year ago, the problem of providing the physical facilities necessary for defense production was a critical one. Private capital was naturally hesitant to invest heavily in facilities which might have only a temporary usefulness. At the same time, it was desirable that the financial burden upon the Government, in connection with providing the necessary facilities, be kept to a minimum.

In this situation, three plans were developed. They were explained to the Committee on Finance, in detail, by Messrs. Biggers and Henderson, then of the Advisory Commission to the Council of National Defense. The first plan involved the construction of new plants wholly with private funds. In order to encourage the widespread use of this plan, and thus lighten the Government's burden, it was proposed that taxpayers providing plants under the plan be permitted to amortize the cost of those plants over a 5-year period. The plan involved no outlay by the Government, no reimbursement for the cost of the plants. The second plan involved the use of private funds at the outset, with the builder being reimbursed specifically and directly by the Government for his expenditures. After the emergency, the plant was to belong to the Government unless the builder chose to buy it back. The third plan provided for direct and complete financing by the Government, with full Government ownership at all times.

The Second Revenue Act of 1940 added to the Internal Revenue Code a new provision, section 124, which was intended primarily to implement the first plan described above, by permitting taxpayers to amortize, over a 5-year period, the cost of essential new facilities constructed or acquired for national defense.

This special 5-year amortization is not in any sense a subsidy. It is merely a substitute for the regular depreciation deduction allowed under section 23 (l). The regular depreciation deduction permits a taxpayer to recover the cost of his plant over its useful physical life. The amortization deduction allows that cost to be recovered over 5 years, provided the plant is necessary in the interests of

national defense. If the plant is continued in operation after the 5-year period, the taxpayer will not be allowed any depreciation deductions. No part of the cost of any plant may be recovered more than once. In return for increased deductions over the 5-year period, the taxpayer gives up all deductions thereafter. The aggregate amount of deductions is not increased.

Under section 124, a taxpayer desiring to amortize the cost of a facility must apply for a certificate, issued jointly by either the Secretary of War or the Secretary of the Navy and the Advisory Commission to the Council of National Defense, that the facilities proposed are "necessary in the interests of national defense." Such a certificate is known as a "necessity certificate." In the case of a facility acquired or constructed wholly with private funds, the issuance of such a certificate was intended to, and should, conclusively establish the right to the amortization deduction. The service departments and the Advisory Commission have done an excellent administrative job in handling applications for necessity certificates covering thousands of facilities costing many millions of dollars. The applicants who have received certificates should no longer be in doubt as to their rights. Unfortunately, however, even more uncertainty and confusion exists today than existed a year ago.

The current difficulty arises out of the provisions of subsection (i) of section 124. This subsection relates to reimbursement by the United States of the cost of facilities covered by necessity certificates. It provides, in effect, that if the taxpayer is being reimbursed by the United States for the cost of such a facility—a result contemplated only under the second plan mentioned above—amortization will be denied unless the contract providing for reimbursement adequately protects the Government with reference to the "future use and disposition" of the facility. It contemplates that the service departments and the Advisory Commission will issue two types of certificates with respect to individual contracts with the United States: (1) A certificate that the contract does not provide for reimbursement by the United States—a "certificate of nonreimbursement." (2) A certificate that the Government's interest is adequately protected—a "certificate of Government protection."

Obviously, subsection (i) has a logical connection only with the second plan mentioned above, under which the Government actually reimburses the contractor. Nevertheless, its provisions have also been applied in respect of facilities provided under the first, or private, financing plan, so that a particular taxpayer holding a necessity certificate cannot be assured of his right to amortize the cost of the facility covered by the certificates unless and until he is able to obtain either a certificate of nonreimbursement or a certificate of Government protection with respect to every contract he may have with the United States. If he fails to obtain one or the other certificate with respect to a single contract, regardless of the extent, if any, to which the particular facility may be employed in filling the contract, regardless of its date of execution, and regardless of its amount, the possibility remains that the Treasury will deny him his amortization deduction, on the ground that he has been reimbursed, and force him into litigation to prove the contrary.

The provisions of subsection 124 (i) were adopted, it will be recalled, as a substitute for subsections (i), (j), and (k) of the second revenue bill of 1940, as it passed the House. Those subsections required the maintenance of all amortized facilities so long as the Secretary of War or the Secretary of the Navy might require, and imposed severe penalties for any violations. These provisions were vigorously opposed before the Senate Finance Committee by Messrs. Knudsen, Henderson, and Biggers, representing the Advisory Commission, and also by the heads of the service departments. This opposition was founded, first, on the belief that such provisions were illogical and inappropriate in a tax statute, and second, on the confidence of those testifying that the Government could and would be adequately protected by contract provisions.

Subsections (i), (j), and (k) of the House bill were duly eliminated, and were replaced by subsection (i) in its present form. On the basis of its legislative history, the present subsection (i) must be treated as merely a formal guaranty that the Government's contracting officers would follow the course outlined by the Advisory Commission officials; and Congress naturally anticipated that the law would be administered in the light of its background and obvious purpose.

It seems a natural assumption that Congress, in providing for the issuance of certificates of nonreimbursement, anticipated that the contracting officers would know, in the case of any given contract, whether or not they were providing for reimbursement, and that certificates of nonreimbursement would be quickly granted or denied on the basis of that knowledge. In fact, the express wording of the statute, as well as its background, justifies the view that Congress had in mind only such reimbursement as might readily appear on the face of the contract. It is only in such contracts that it would ever be thought proper or necessary to add provisions for the Government's protection. Certainly it was never thought that ordinary supply contracts would involve reimbursement, or require provisions for Government protection.

Had this natural interpretation been adopted, the certifying agencies could have proceeded rapidly with the task of examining and certifying contracts. Instead, another view prevailed, the view that every single contract must be minutely examined from the standpoint of cost elements, amount of profit, etc., and regardless of the actual intention of the parties, as evidenced by the affidavit of the applicant and the report of the contracting officer. No single concept of nonreimbursement exists, the various interpretations of it are vague and uncertain, and as a result, the situation has become hopelessly confused. Only a bare handful of certificates of nonreimbursement and certificates of Government protection have been issued, although thousands of applications, covering many more thousands of contracts, have long been on file.

Taxpayers who relied on the amortization provision and proceeded with the acquisition and construction of emergency facilities now find that they cannot be sure of their amortization deductions. Those contemplating additional facilities are in grave doubt as to how to proceed. Largely on this account virtually all facilities now being contracted for are being built at Government expense.

In view of this impossible situation, we urge that the recommendations of the Advisory Commission officials, made last year, and then concurred in by the War and Navy Departments, be adopted at this time. Subsection (l), relating to a matter of procurement policy, has no proper place in a tax statute, and should be repealed. As indicated by the foregoing officials, the exclusion of reimbursement, or the protection of the Government where reimbursement exists, can be fully controlled by the procurement officers by means of their power over the terms of contracts. The wisdom of the testimony of those officials has been established by a year of administration which has produced only hopeless confusion. The elimination of the subsection will relieve taxpayers of an unintended, unnecessary, and impossible burden. It will also relieve contracting officers of the duty of minute examination of thousands of contracts, when their time is fully required on urgent procurement problems connected with the defense program.

In addition to this fundamental change in the provision, other important and related amendments are necessary. We urge the following:

(1) *Depreciation over actual life.*—The language of section 23 (l) should be clarified in such a manner as to remove all doubt that facilities for which no amortization has been claimed may be depreciated over the emergency period, or a shorter period, if the taxpayer can demonstrate that this is in fact the period of their useful life. Amortization was not intended to be an exclusive method of depreciating emergency facilities. It did not change, or replace, the intent of the law, which has always been that the cost of property should be written off over its useful life.

(2) *Earlier basic date.*—As it now stands, section 124 does not apply to any expenditures made before June 10, 1940. This basic date should be reexamined. The only reason for excluding facilities completed before that time was that this was the first date upon which taxpayers were officially apprised that they might expect amortization. The reason is not sound. It arbitrarily excludes contractors who built essential facilities for the national defense without waiting for express assurances of amortization. A more reasonable and logical base date would be the beginning of the war, or approximately September 1, 1939. If the present base date is retained, however, discretion should be given to the service departments to certify facilities meeting all tests except the date of completion. Such discretion is conferred in the administration of the Canadian law.

TABLE I.—*Business indexes*

	Industrial[1] production index	Factory[2] pay rolls index	Corporate[3] net income	Federal[4] income taxes	National[5] income
1926	96	104	9,673	1,230	76.5
1927	95	102	8,982	1,131	75.8
1928	99	102	10,618	1,184	79.6
1929	110	109	11,654	1,193	82.7
1930	91	89	6,429	712	69.1
1931	75	67	3,683	399	54.2
1932	58	46	2,153	280	40.1
1933	69	49	2,986	423	42.5
1934	75	63	4,275	596	50.6
1935	87	71	5,165	735	55.8
1936	103	82	6,761	1,191	65.2
1937	113	98	6,914	1,276	71.9
1938	88	78	4,680	860	64.0
1939	108	91	[6] 6,900	[6] 1,100	69.3
1940	122	105	[6] 8,300	[6] 2,400	73.9
1941[6]	155	150	[7] 13,000	[7] 5,500	[7] 90.0
January	140	121			
February	141	127			
March	143	131			
April	140	135			
May	150	144			
June	157	152			
July	[8] 162				

[1] Federal Reserve Board index. 1935-39 average=100.
[2] Bureau of Labor Statistics index. 1923-25 average=100.
[3] Corporations reporting net income only. In millions of dollars. Does not include intercorporate dividends or income from tax-exempt securities.
[4] Statistics of income. In millions of dollars.
[5] Department of Commerce, national income produced. Billions of dollars.
[6] Estimated.
[7] Preliminary.
[8] Estimate.

TABLE II.—*Federal receipts and expenditures, 1931–42*

Fiscal year	Total net receipts	Total expenditures	Gross deficits
1931	$3,189,638,632	$4,091,597,712	$901,959,080
1932	2,005,725,437	4,947,776,888	2,942,051,451
1933	2,079,696,742	4,325,149,722	2,245,452,980
1934	3,115,554,050	6,370,947,347	3,255,393,297
1935	3,800,467,202	7,583,433,562	3,782,966,360
1936	4,115,956,615	9,068,885,572	4,952,928,957
1937	5,028,840,237	8,281,379,956	3,252,539,719
1938	5,854,661,227	7,304,287,108	1,449,625,881
1939	5,164,823,626	8,765,338,031	3,600,514,405
1940	5,387,124,670	9,127,373,806	3,740,249,136
1941[1]	7,607,211,852	12,774,890,324	5,167,678,472
1942[2]	9,402,000,000	22,269,000,000	12,867,000,000
Total	56,751,700,290	104,910,060,028	48,158,359,738

[1] Actual, Daily Treasury Statement, June 30, 1941.
[2] Estimated, Treasury Department press release, June 1, 1941.

Source: Annual Report of the Secretary of the Treasury, 1940, p. 646.

TABLE III.—*Federal debt, 1931–42*

[Millions of dollars]

June 30	Gross Federal debt	Per capita	June 30	Gross Federal debt	Per capita
1931	$16,801	$135.37	1937	36,427	281.82
1932	19,487	155.93	1938	37,167	285.43
1933	22,539	179.21	1939	40,445	308.34
1934	27,053	213.65	1940	42,971	326.43
1935	28,701	225.07	1941	[1] 48,961	376.63
1936	33,545	261.20	1942	[2] 61,728	474.83

[1] Actual, Daily Treasury Statement, June 30, 1941.
[2] Estimated on the basis of Treasury Department press release, June 1, 1941.

Source: Annual Report of the Secretary of the Treasury, 1940, p. 743.

TABLE IV.—*Defense expenditures by months*

[In millions of dollars]

1940:		1941—Continued.	
July	177	February	592
August	200	March	745
September	219	April	761
October	287	May	837
November	376	June	808
December	473		
1941:		Total, 1941 fiscal year	6,047
January	572	1941: July	940

TABLE V.—*Appropriations, contract authorizations, and recommendations for national defense, fiscal years 1941 and 1942*

[As of July 19, 1941]

	Army	Navy	Other agencies	Total
Fiscal year 1941:				
Appropriations enacted	$8,480,613,877	$3,548,748,345	$1,137,671,908	$13,167,034,130
Contract authorizations enacted	5,006,589,651	946,098,112	274,000,000	6,226,687,763
Subtotal	13,487,203,528	4,494,846,457	1,411,671,908	19,393,721,893
Deduct cash included to liquidate 1941 contract authorizations	203,626,456	28,560,000	75,000,000	307,186,456
Net total, 1941	13,283,577,072	4,466,286,457	1,336,671,908	19,086,535,437
Fiscal year 1942:				
Appropriations enacted	10,391,321,624	4,099,052,122	774,723,250	15,265,096,996
Contract authorizations enacted	183,145,695	41,448,894	107,000,000	331,594,589
Recommendations pending before Congress:				
Appropriations	4,770,065,588	1,625,207,668	699,900,000	7,095,173,256
Contract authorizations			1,000,000,000	1,000,000,000
Subtotal	15,344,532,907	5,765,708,684	2,581,623,250	23,691,864,841
Deduct cash included to liquidate 1941 contract authorizations	3,357,353,076	670,790,612	120,653,000	4,148,796,688
Net total, 1942	11,987,179,831	5,094,918,072	2,460,970,250	19,543,068,153
Net total, 1941 and 1942	25,270,756,903	9,561,204,529	3,797,642,158	38,629,603,590
Defense Aid Appropriation Act, 1941				7,000,000,000
Appropriations required beyond 1942 to complete construction of the expanded Navy				[1] 7,297,000,000
Total				52,926,603,590

[1] Represents estimate of the Navy Department.

Source: Congressional Record, July 24, p. 6440.

SUPPLEMENTAL MEMORANDUM

(Detailed discussion of modifications of the Internal Revenue Code proposed by Messrs. Ellsworth C. Alvord and Roy C. Osgood, representing the Committee on Federal Finance, Chamber of Commerce of the United States, before the Committee on Finance, United States Senate, August 15, 1941.)

FOREWORD

A number of proposals for modifications of the Revenue Code are set out in the attached communication to the Senate Finance Committee.

The communication, however, does not embrace all the changes in revenue law which are urged by the National Chamber's Committee on Federal Finance, but deals primarily with technical or administrative questions.

Other proposals for such amendments to the code are still in process of consideration by the Chamber Committee. The committee expects to have opportunity to present its recommendations in relation thereto in subsequent memoranda.

Not all of the proposals in the communication are urged for inclusion in the pending revenue bill, although, it is believed they should have early consideration of the Congress. The testimony of the Chamber's representatives before the Senate Finance Committee on August 15, 1941, is the principal guide to the recommendations urged for immediate adoption.

This testimony, particularly the presentation by Chairman Ellsworth C. Alvord of the Chamber's Committee, and the statement by Mr. Roy C. Osgood, give special emphasis to such of the proposals in the attached communication as the Chamber Committee believes should have immediate attention.

The testimony, in addition, deals with phases of the pending revenue bill, not discussed in this communication, with which the Chamber's Committee is in agreement as well as those provisions with which it differs.

SUMMARY

Preliminary statement.

A. Income, estate, and gift taxes

I. Consolidated returns should be permitted for corporate normal tax and surtax purposes.
II. Taxation of intercorporate dividends should be eliminated.
III. The declared value capital stock and excess-profits taxes should be repealed; if present revenue requirements preclude repeal, there should be provision for annual redeclaration of value.
IV. The basis of depreciable assets should not be reduced on account of depreciation in prior years not used to offset taxable income.
V. Taxpayers should be given the right to a 3 months' extension for filing income returns, subject to the filing of tentative returns and the payment of tentative tax.
VI. The statute should be amended so as to provide definite and certain rules to govern the tax consequences of mortgage and lien foreclosures.
VII. Worthless stock and bad debt losses should not be treated as capital losses, and the statutory requirements relating to the deduction of bad debts should be liberalized.
VIII. Agreements extending the statutory period for the assessment of deficiencies should similarly extend the period for claiming refunds.
IX. The arbitrary treatment of gains on the redemption of preferred stock should be corrected.
X. The principle of exemption of dividends from the normal tax on individuals should again be recognized.
XI. Recoveries of bad debts should be treated as income only to the extent that the deduction of such bad debts in prior years has been used to offset taxable income.
XII. Ordinary and necessary expenses incurred in the production and collection of income and in the management, protection, and conservation of property devoted to the production of income should be deductible.
XIII. The income tax basis of property transferred at death should be correlated with its valuation for estate tax purposes.
XIV. The $1,000 annual gift tax exclusion should be made applicable to gifts in trust.
XV. Securities of nonresident aliens should be made exempt from Federal estate and gift taxes.
XVI. Provision should be made for adequate tax-free funds for payment of Federal estate taxes.
XVII. Sections 42 and 43 should be repealed or modified so as to cure the inequitable results flowing from the decision in *Helvering* v. *Enright*, (61 S. Ct. 777).
XVIII. The doctrine of congressional adoption or ratification of administrative regulations by subsequent reenactment of the statute should be abrogated or sharply limited by legislation.
XIX. Legislative regulations should be promulgated only after public hearings held upon due notice.
XX. The application of the personal holding company surtax to the capital gains of nonresident foreign corporations should be clarified.

B. The excess-profits tax

I. Taxpayer's cost should be substituted for tax basis as the general rule in computing invested capital (with proper provisions for relief in exceptional situations).
II. Determinations of invested capital under the World War excess-profits tax laws should be permitted to be used as the starting point in computing invested capital for present purposes.
III. Advances made by governments to American contractors should be treated as borrowed capital.
IV. The burdensome requirements of computations of invested capital based upon daily averages and ratios should be modified.

V. Various discriminations made by the existing law against the use of the credit based upon base period earnings should be removed.
VI. Excess profits should be measured over a longer period.
VII. The excess-profits rate schedules should be based on percentages in lieu of dollar amounts.
VIII. Section 734, relating to adjustments on account of inconsistencies, should be revised and restricted.
IX. Section 718 (c) (2), relating to the effect on equity capital of dividends within the initial 60 days of the taxable year, should be repealed.
X. Sections relating to adjustments of basis in computing invested capital should be revised.
XI. Additional special relief provisions and better yardsticks for measuring normal profits should be enacted.
XII. Supplements A and B should be revised.

C. Amortization

I. There should be some revision of the base date, the present June 10, 1940, deadline being highly arbitrary and discriminatory.
II. Emergency Plant Facility (E. P. F.) contracts should be treated as sale contracts for tax purposes.
III. Section 124 (i), relating to certificates of nonreimbursement and Government protection, should be repealed or substantially revised so as to correct the impossible situation which has developed in the administration of the section.

MEMORANDUM

To the Chairman and Members of the Committee on Finance, United States Senate:

The Committee on Federal Finance of the Chamber of Commerce of the United States respectfully submits for your consideration the following recommendations for modification of various provisions of the Internal Revenue Code, including subchapter E containing the provisions relating to the excess profits and amortization of defense facilities enacted by the Second Revenue Act of 1940, as amended.

The various proposals submitted for your consideration are based upon one or more of the following principles:

(1) The statutory net income which is the base of the personal and corporation income taxes should be fairly defined so as to correspond as nearly as practicable with net income as determined by generally accepted principles of accounting. With the rates of tax, individual and corporate, rising to unprecedentedly high levels because of the fiscal demands of the defense program, the need for greater fairness in defining the tax base is imperative if gross hardship and discrimination between taxpayers are to be kept to a minimum.

(2) Unnecessary sources of costly and wasteful litigation should be removed by clarifying amendments of the statute at points where the statute is obscure. Needless controversy and litigation are destructive of the confidence between taxpayers and their Government which is so essential to the efficient administration of tax laws based upon the principle of self-assessment.

(3) The estate- and gift-tax laws should be amended at points where they operate in a discriminatory manner or become so oppressive as to imperil the sources of future revenues through destruction of the tax base.

(4) Unfortunate consequences of judicial decisions interpreting existing law should be promptly corrected by the Congress.

(5) The processes of administration of the revenue laws should be subjected to frequent scrutiny and improved, wherever possible, by amendment of administrative provisions of the law.

(6) Extensive revision and rectification of the excess-profits tax law should be made to prevent gross inequities and severe hardships which are injurious to the national economy.

A. Income, estate, and gift taxes

I. *Consolidated returns.*—It is recommended that the privilege to file consolidated returns for normal and surtax purposes should be restored to corporations generally.

It will be recalled that this privilege was allowed under all the revenue acts from the 1918 act to and including the Revenue Act of 1932. Indeed, after the enactment of the profits tax of 1917, a committee, consisting of members of the Committee on Ways and Means and the Committee on Finance, and of leading tax experts, who were engaged in the preparation of regulations under that act, after a very careful and nonpartisan consideration of the problem, decided that the filing of such returns should be permitted. The Treasury thereupon authorized the filing of consolidated returns by corporations which,

by reason of common ownership, were affiliated. While such groups are composed technically of several corporate entities, the reality was recognized that they are as a practical matter one corporation. Congress promptly ratified the judgment of this committee by writing these regulations into the 1918 act.

The reasons justifying this action, which are still applicable, can hardly be better stated than by quoting a statement made by Senator Simmons, then chairman of the Finance Committee, in his report upon the 1918 revenue bill:

"So far as its immediate effect is concerned consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasion which cannot be successfully blocked in any other way. * * * As a general rule, therefore, improper arrangements which increase the tax will be discontinued, while those which reduce the tax will be retained.

"Moreover, a law which contains no requirement for consolidation puts an almost irresistible premium on a segregation or a separate incorporation of activities which would normally be carried on as branches of one concern. Increasing evidence has come to light demonstrating that the possibilities of evading taxation in these and other ways are becoming familiar to the taxpayers of the country. While the committee is convinced that the consolidated return tends to conserve, not reduce, the revenue, the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government." (Report, Senate Finance Committee, p. 8-9, 65th Cong., 3d sess., S. Rept. 617.)

We believe that the present Treasury officials, along with all prior officials of the Treasury responsible for the administration of the revenue laws, agree that consolidated returns are both necessary and proper to the fair application of corporate-income taxes. The Under Secretary of the Treasury stated a few years ago that "businessmen and their professional advisers, the lawyers, and accountants have long recognized that the one way to secure a correct statement of income from affiliated corporations is to require a consolidated return. * * * Such a consolidated statement is simply a recognition of the actual fact that the separate corporations, though technically distinct legal entities, are for all practical business purposes, branches or departments of one enterprise."

The necessity of retaining the consolidated return in the case of railroad corporations was recognized even in 1934. (See sec. 141 of the 1934 act.) Section 141 (d), defining affiliated group was broadened somewhat by subsequent amendments, viz, street, suburban, and electric railways, members of an affiliated group, were included by the Revenue Act of 1936, and street or suburban trackless trolley systems of transportation, or street or suburban bus systems of transportation operated as a part of a street or suburban electric railway or trackless trolley system were brought in by the Revenue Act of 1938. Section 225 of the 1939 act added section 152 to the Internal Revenue Code and thereby extended the privileges of section 141 to so-called pan-American trade corporations. Finally, the Congress recognized the imperative need of allowing consolidated returns for excess-profits tax purposes with limited exceptions (see sec. 730 of the code) and in the March 1941 amendments adopted an amendment permitting insurance companies subject to taxation under section 204 of the code to join with ordinary corporations in filing consolidated returns. In all these cases the exercise of the privilege is conditioned upon consent of the members of the affiliated group to be governed by legislative regulations promulgated by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

This steady expansion of the scope of consolidated returns since their virtual abolition in the 1934 act evinces a growing recognition of the sound principle that corporate enterprises which are essentially unitary ought to be taxed as a unit, even though for legal or business reasons it is found necessary or convenient to carry on different branches of the business through technically separate corporations. When, as under existing law, intercorporate transactions within the group are not disregarded, serious distortion of income is bound to occur. Under the present high rates of tax on corporate income and the much higher rates in prospect, such distortion becomes a very serious problem and operates as a substantial clog upon free business enterprise. The device of conditioning the filing of consolidated returns upon consent to and compliance with legislative regulations provides an effective safeguard against abuses of the privilege.

We respectfully urge that this vitally important issue be reconsidered upon its merits. We believe that such reconsideration can lead to but one conclusion, viz,

that consolidated returns for corporate normal and surtax purposes should be restored.

II. *Taxation of intercorporate dividends.*—We recommend the complete exemption of intercorporate dividends from corporate normal tax.

Dividends on the stock of domestic corporations are already excluded from income for excess-profits tax purposes (sec. 711 (a) (1) (F) and 711 (a) (2) (A) of the code) and dividends on stock of foreign corporations are also excluded with respect to corporations whose excess-profits credit is computed under section 714 (invested capital credit) (sec. 711 (a) (2) (A) of the code).

Intercorporate dividends in full are included in net income for purposes of corporate surtaxes measured by undistributed net income, such as the taxes imposed by code section 102 on corporations formed or availed of to evade surtaxes on their shareholders and by section 500 of the code on personal holding companies. Such dividends are included in the tax base for the purpose of these surtaxes for reasons which do not exist in the case of the corporate normal tax or the declared-value excess-profits tax. The discussion which follows is therefore directed only to these latter taxes.

Beginning with the Revenue Act of 1917 through and including the Revenue Act of 1934, Congress adhered consistently to the sound policy of excluding dividends received by a corporation from other domestic corporations (with minor exceptions not here material) from the corporate income tax. The policy of this exclusion was to prevent obvious multiple taxation of the same earnings. Such exclusion was not provided by the Revenue Acts of 1913 and 1916, but the problem was not then serious because of the lowness of the tax rate.

The first departure from this long-established policy came in the Revenue Act of 1935. Section 102 of that act amended section 23 (p) of the Revenue Act of 1934 so as to limit the deduction on account of intercorporate dividends to 90 percent of the amount thereof. This amendment never came into actual operation, being supplanted by section 26 (b) of the Revenue Act of 1936, which changed the deduction of intercorporate dividends into a credit against net income and limited the credit to 85 percent of the amount so received. Under the rate schedule contained in that act, the net effect was to tax such intercorporate dividends included in net income at a normal-tax rate running from a minimum of 1.2 percent to a maximum of 2.25 percent.

In the Revenue Act of 1938 the burden of this tax upon intercorporate dividends was measurably increased in two respects. Section 26 (b) was amended so as to limit the credit to an amount not in excess of 85 percent of the adjusted net income. The effect of this change was to subject such dividends to some tax in any case in which the corporation had an adjusted net income or, in other words, a proportionate part of the corporate deductions on account of expenses, losses, interest, depreciation, and the like was in effect allocated against dividend income. In addition, the effective burden of the tax was increased by the upward adjustment of the rate schedule. This burden has been measurably enhanced by the higher rate schedules which have since been enacted. Thus, in the case of corporations whose net incomes are sufficiently large to take them out of the so-called notch or alternative tax provide in section 13 and 14 of the code, the effective rate of corporate normal tax on intercorporate dividends is now 3.6 percent (24 percent of 15 percent). The proposed increase to 30 percent in the normal tax rate on such corporations would enhance the effective burden to 4.5 percent, exactly double the maximum burden under the Revenue Act of 1936.

The application of the normal tax to these intercorporate dividends has not been seriously defended or justified on the basis of purely fiscal considerations. It has not been in fact a major revenue producer. The restoration of the privilege of filing consolidated returns would reduce this yield substantially, since intercorporate dividends are eliminated as intercorporate transactions where a consolidated return is filed.

The President, in recommending an intercorporate dividend tax in 1935, sought to justify a small tax as a measure "to prevent the evasion of the graduated tax by means of a multiplicity of corporations." While this recommendation was ultimately followed, the report of the Committee on Ways and Means (p. 7) expressed the view that such a tax was unnecessary to prevent evasion in view of the moderate graduation in rates provided in the bill. It is even clearer that the tax cannot be defended as a device to prevent evasion under the statute as now drawn, where the graduated rates apply only to corporations having net incomes of $25,000 or less. No argument is necessary to demonstrate how improbable it is that a great corporation would endeavor to split up into an indefinite number of

small corporate units, each having a net income of less than $25,000, in order to get the benefit of the present restricted graduation of rates. The diseconomy and inefficiency of such a form of organization, even if possible, would far outweigh its tax advantages.

The original stated purpose of the tax on intercorporate dividends no longer obtains. The reasons, if any, for its retention can only be nonfiscal in character. It is probable that the real purpose of the tax is to coerce the simplification of complicated corporate structures by the imposition of tax pressure. Even if it were sound policy to use taxation for such nonfiscal ends, which we do not believe, the intercorporate dividend tax is a singularly inefficient and nonselective device to accomplish this purpose. It penalizes a corporation which conservatively invests some portion of its reserves in sound corporate stocks without any view to control, along with a holding company at the apex of a pyramided corporate structure. It operates upon holding companies and parent corporations which are necessary or legitimate even in the light of the standards reflected in such legislation as the Public Utilities Holding Company Act. It imposes unwarranted burdens upon corporations which find it necessary or desirable for legitimate business reasons, including insulation from liability in hazardous new enterprises, to create subsidiary corporations. In order to reach a possibly guilty minority, it penalizes a majority.

Even if the tax has possessed some degree of utility in bringing about desirable simplifications of corporate structure it is no longer needed for such purpose. Such simplification has already taken place in large measure, and will no doubt continue to do so, where it is desirable, as the result of other measures, such as the Holding Company Act, and the tax-free liquidation of subsidiaries made possible by section 112 (b) (6) of the code. It is high time that this tax, unimportant as a revenue producer and a deterrent to investment in new enterprise, should be eliminated from our tax structure.

III. *The declared value capital-stock tax and excess-profits tax; if present revenue requirements preclude repeal there should be provision for annual redeclarations of value.*—We recommend that this tax imposed by section 1200 of the code, and its companion tax, the so-called declared value excess-profits tax imposed by section 600, be repealed.

The Congress is already familiar with the many weighty arguments against these taxes, originally imposed as emergency measures in 1933 in the tax provisions of the National Recovery Act. Your committee has already shown its awareness of the basically unsound character of these taxes and the serious hardships and inequities frequently resulting from their application. While these hardships have been considerably ameliorated by amendments in 1938 providing for triennial redeclaration of value, and in the 1939 amendment allowing an increase only in declared value in nondeclaration years, the basic weaknesses in these taxes still remain. The capital-stock tax is not a true capital-stock tax for declared values have no relation to the true fair market value of the capital stock. The declared-value excess-profits tax is not a true excess-profits tax, since it is not measured by any yardstick recognized as proper for measuring excess profits. The combined operation of the two taxes penalizes very heavily the inability of a corporate taxpayer accurately to foresee the trend and amount of its future earnings. In many cases net income may be unexpectedly increased by unforeseen windfalls, the result of which may be to mulct the corporation unfairly by a heavy tax, even though the return by any fair standards may be relatively low. The proliferation of corporate taxes represented by these taxes increases the already excessive and costly burdens on corporations with respect to the filing of returns, and adds to the sources of wasteful litigation.

Finally, it seems paradoxical to say the least, that corporate taxpayers should be subjected simultaneously to two excess-profits taxes having quite different and independent bases.

We respectfully urge that these taxes be eliminated from the Federal tax system at the earliest possible date and that the revenues lost by their repeal be replaced, if necessary, by taxes having a less discriminatory and arbitrary incidence. If their elimination is not possible at this time, we believe it is vital that an annual declaration of value be allowed.

IV. *Excessive depreciation not beneficially allowed.*—We recommend that the statute be appropriately amended so as to provide beyond any question of doubt that excessive depreciation not beneficially allowed, i. e., not used to offset taxable income in earlier years, shall not be applied to reduce the basis of depreciable property.

We also urge that the policies applied in the determination of depreciation deductions should be liberalized so as to accord more nearly with business and accounting practics.

Clarification of the existing statute at this time is also needed by reason of doubt as to the proper interpretation of its terms. This doubt is causing litigation and hampering the expeditious settlement of cases before the Bureau.

Prior to the Revenue Act of 1932, the statute provided for adjustment of basis on account of depreciation by the amount of depreciation allowable. In the 1934 act, section 113 (b) (1) (B) was amended to its present form, viz, to provide for adjustment of the basis to the extent of depreciation allowed but not less than the amount allowable. The report of the Committee on Ways and Means on the 1934 act, at page 22, explained that the Treasury frequently encountered cases where a taxpayer who had taken and had been allowed depreciation deductions at a certain rate consistently over a period of years, later claimed, often after the statute of limitations had run, that the allowances so made to him in prior years were excessive and that his basis should therefore be adjusted by an amount less than the total of the amounts so allowed, i. e., that the basis could be adjusted only for the lesser amounts which were allowable. The report then went on to say that the Treasury ought not to be penalized for having approved the taxpayer's deductions. The report concluded by stating that, while the committee did not "regard the existing law as countenancing such inequitable results, it believes that the new bill should specifically preclude any such possibility."

The Bureau made its first published ruling interpreting the effect of the 1934 amendment in 1935 in I. T. 2944 XIV–2 C. B. 50. It was there held that the statute, as amended, required the basis of depreciable assets to be adjusted to accord with the amount "allowed" or the amount "allowable," whichever is the greater, irrespective of any statute of limitations applicable to the year of deduction, and that the depreciation claimed in the return for a given year which has been accepted by the Bureau is the amount "allowed" for that year. Whether or not the deduction offset income otherwise taxable is immaterial under the principle upon which this ruling is based.

This interpretation of the statute was successfully challenged by a taxpayer in the case of *Pittsburgh Brewing Co.* v. *Commissioner*, 107 F. (2d) 155, decided by the circuit court of appeals for the third circuit in 1939. A unanimous court there held that depreciation is not "allowed" within the meaning of section 112 (b) (1) (B) of the 1932 act, the text of which has not been modified in the subsequent acts nor in the code, unless it is actually taken as a deduction against taxable income. To illustrate, under this interpretation of the statute, if a taxpayer had a net income of $5,000 for the taxable year before claiming $20,000 deduction on account of depreciation, the basis of its depreciable assets should be reduced by $5,000, not $20,000. In other words, "allowed" is interpreted, in effect, to mean "beneficially allowed."

The interpretation enunciated by this decision is sound. Nevertheless, one circuit court of appeals decision cannot be regarded as settling the law on this question, particularly since the Government did not seek review of the decision by the Supreme Court on certiorari. The published ruling of the Commissioner cited above has not been either modified or revoked by any later published ruling, although it is possible that some effect is being given to the decision of the third circuit in the settlement of cases. In any event, the question involved is of great importance to such a large group of taxpayers that we believe any doubt as to the statute's meaning should be promptly removed by a clarifying amendment.

It is apparent that the above decision is consistent with the underlying rationale of the depreciation deduction. Congress has recognized the indisputable fact that depreciation is a part of the cost of carrying on business and is a part of the cost of production of goods and services. To the extent that depreciation is denied upon assets worn out or consumed in production, in computing taxable income from such production, the income tax is perverted, in effect, into a tax on capital. The reduction of the basis of depreciable assets on account of allowable depreciation which cannot be used to offset taxable income in loss years denies to taxpayers the recovery of their capital investment. To go still further and penalize a taxpayer by reducing the basis where in past years he has, with no resulting tax benefit, mistakenly claimed an amount of depreciation as a deduction which exceeds the amount legally allowable, cannot be defended either on grounds of equity or sound legislative policy.

While the situation is helped to some extent by the restoration of the operating loss carry-over (sec. 23 (s) and sec. 122 of the code, added by sec. 211 of the 1939 act), the remedy will be inadequate in many cases because of the 2-year restriction

upon the period of the carry-over. It is our conviction that the only adequate remedy is to amend section 113 (b) (1) (B) of the code in such manner that the adjustment of basis of depreciable assets cannot in any case exceed the amount of depreciation beneficially allowed as a deduction, i. e., used to offset taxable income in prior years. If it be objected that such an amendment will operate to increase the burdens of the Bureau in the audit of returns, the answer is that administrative convenience must sometimes yield to the demands of simple justice. Also, it is believed that this increase in administrative burden can be easily exaggerated. The growing complexity of the law and recent developments, such as the operating net loss carry-over and the excess-profits tax, already compel reasonably thorough audits of all but the smallest corporation returns. It is in corporate returns that the depreciation problem is most important.

While reasonable or liberal administration of the depreciation provisions is primarily an administrative problem and responsibility, Congress can make an important contribution by encouraging the adoption of wise administrative policies. The shift in administrative policy by the Bureau, reflected in T. D. 4422, XIII–1 C. B. 58, was the direct result of pressure in the form of proposals in Congress to make arbitrary horizontal decreases in depreciation rates by legislative mandate. This change to a more rigid and inelastic policy has been productive of widespread controversy and dissatisfaction among taxpayers. Moreover, it is quite certain that its result will be a net loss in tax revenue over a period of years. With the tendency of tax rates rather constantly upward, it is elementary that taxpayers who consistently overstate their depreciation deductions in earlier years are likely to end up by "paying through the nose" in higher taxes in subsequent years. So long as taxpayers keep within the limits of reasonable judgment and are required to adhere consistently to the rates once selected, the Government has little reason to fear. An arbitrary policy of consistent trimming of depreciation rates is not only destructive of taxpayer good will and promotive of sterile litigation but, under conditions now obtaining and likely to continue for many years to come, is not even in the interest of maximum revenue yield.

V. *Extension of time for filing income returns.*—It is recommended that sections 51 and 52 of the code be amended so as to give to taxpayers an absolute right to an extension of time within which to file their returns for a period of not to exceed 3 months, conditioned upon their filing tentative returns on or before the statutory due date and the payment of interest upon any deficiency in the first installment.

The adoption of this recommendation would greatly serve the convenience of thousands of taxpayers without working any injury or serious inconvenience to the Government. The requirement that a tentative return be filed, accompanied by payment of at least one-fourth the tentative tax, with interest upon any deficiency in the first installment, affords adequate assurance that only taxpayers who really need the additional time will avail themselves of the extension privilege. Many of these will file their returns well before the end of the 3-month period in order to save interest. The budget estimates of revenue will not be materially affected since almost the same amount of tax would have to be paid before the end of the fiscal year, on June 30, as under existing law. There may be a slight difference with respect to taxpayers having fiscal years ending January 31 or the last day of February. To the extent the privilege, if given, is availed of, the Treasury would stand to make a net gain on account of interest paid, since such interest would greatly exceed the cost of any short-term borrowing which might be necessary.

The allowance by statute of this extension of the period for filing should improve the administration of the income tax in several important respects. It should relieve the collectors of the burden of passing upon thousands of individual requests for extensions. It should enable taxpayers and their tax accountants materially to improve the accuracy of income-tax returns and thereby to reduce the number of cases of deficiencies and the amounts involved. This is particularly true with respect to the March 15 date, when the majority of returns have to be filed. Many taxpayers, particularly corporations, are unable to close their books and obtain figures essential in the preparation of returns, until well after the close of the calendar year. The volume of work involved in the preparation of the voluminous schedules required in many cases by the regulations is enormous. This burden has been greatly increased by the excess-profits tax, with the innumerable complex and difficult computations which it requires, even in the case of many small corporations. Tax accountants and advisers are often so swamped by the demands made upon them during this short period that it is humanly impossible for them to give as careful analysis to problems arising in the preparation of their clients' returns as they ought to

do. The result is often inaccurate returns, understating or overstating net income, and waste of administrative energy in determining deficiencies and overassessments which might otherwise have been avoided.

Only one or two plausible objections to the best of our knowledge, have been offered to proposals for such an extension. One is that the delay in filing of final returns by a large number of taxpayers will interfere with the work of Treasury statisticians in furnishing Congress promptly with data on revenue collections needed in determining the necessity for modification of the tax laws. It is not believed that this objection is sufficiently serious to outweigh the considerations in favor of the proposal. The understatement of taxes in tentative returns is not likely to be so great as to create a serious margin of error in the estimates based on March filings. Nor do we believe that the adoption of the above amendment would interfere seriously with the Bureau's routine procedure in the handling and audit of returns, in view of the large number of taxpayers with fiscal years who file their returns during months other than March. The balance of convenience is strongly in favor of this amendment.

VI. *Income-tax consequencies of mortgage foreclosures should be specifically defined by the statute.*—Perhaps in respect of no other common situation is the income-tax law in a more bewildering state of confusion and uncertainty than in the field of mortgage foreclosures.

A simple illustration will suffice to show a few of the points at which doubt and uncertainty exist. Suppose that John Smith owns a farm in Kansas for which he paid $25,000. In a prior year he mortgaged his farm to secure a loan of $15,000. In the year 1940, Smith was in default with respect to both principal and 1 year's interest and foreclosure proceedings were brought by the mortgagee. At the foreclosure sale in October of 1940, the mortgagee bid in the property for $16,200, which included the mortgage debt, $750 interest, $250 unpaid taxes, and $200 costs of the foreclosure suit. The mortgagee thereby got title to the property for the amount of his investment. The fair market value of the farm at the time of the sale was $14,000. It is assumed that under Kansas law, Smith may redeem the property within a period of 1 year from the date of the foreclosure sale.

The following tax questions, among others, immediately arise. First as to the mortgagor:

(1) Does the mortgagor, John Smith, sustain a deductible loss when he loses his farm on foreclosure?

(2) If so, is it an ordinary loss deductible in full or is it a capital loss subject to the limitations imposed by section 117 of the code? Is the answer to this question affected by the presence or absence of personal liability of the mortgagor for the mortgage debt?

(3) In what year may he lawfully claim the deduction, the year of the foreclosure or the year in which the statutory period of redemption expires, or some other year?

(4) What difference, if any, would it make from the point of view of the tax consequences if John Smith, in order to avert the expenses and delay of judicial foreclosure, conveyed the farm to the mortgagee in consideration of the latter's canceling the mortgage debt, including accrued interest?

(5) What would be the tax consequences if Smith abandoned the property?

On the side of the mortgagee, even more baffling questions arise:

(1) What is the tax effect of the mortgagee's bidding in the property on foreclosure at a price which includes the accrued interest?

(2) Is the answer to this question affected by the fact that the fair market value of the property on the foreclosure date is less than the principal of the debt?

(3) If the price at which the mortgagee bids in the property is less than the basis of the obligations of the debtor applied in satisfaction of the bid, can the excess of the basis over the bid price be taken as a bad debt deduction and, if so, in what year?

(4) If the fair market value of the property on the date of foreclosure is in excess of or less than the basis of the obligations of the debtor applied by the mortgagee in satisfaction of his bid, does the mortgagee realize a recognized gain or loss to the extent of the difference? If so, is such gain or loss classified as ordinary or as a capital gain or loss?

(5) What is the mortgagee's basis of the property acquired on foreclosure?

Despite the fact that such transactions are common and of frequent occurrence, one looks in vain to the statute for a definite answer to all these questions.

Administrators and courts have been compelled to grope for answers thereto with no legislative directions or signposts to guide them. However, the selection of the best rule from among two or more possible alternatives may depend upon considerations of policy which are peculiarly appropriate for legislative determination. Confusion and conflict in judicial decision are rife. Only two of the above questions have recently been authoritatively determined by Supreme Court decisions. One of these decisions creates doubt as to the validity of a Treasury regulation of long standing; both have undesirable practical consequences which may require correction by legislative rules.

In the case of *Helvering* v. *Hammel* (85 L. Ed. Adv. Op. 295), decided at the present term, the Supreme Court held that the loss sustained by a mortgagor upon foreclosure is a capital loss, subject to the limitations imposed by section 117 of the Revenue Act of 1934. This decision overturned several decisions of the Board of Tax Appeals and of circuit courts of appeal, and (as so frequently in judge-made law) completely overlooks the legislative policy upon which the capital loss limitations are based. The decision in *Betty Rogers* v. *Commissioner* ((C. C. A. 9th) 103 F. (2d) 790), in which the court reached a similar result where the mortgagor faced with a possible foreclosure, conveyed the property to the mortgagee in full satisfaction of the mortgage debt seems a fortiori correct, in the light of the *Hammel case*.

We believe that the results in this case are of very questionable desirability from the point of view of policy. We recommend that the statute be amended so as specifically to provide that mortgagor's losses, whether upon foreclosure sale or voluntary transfer to the mortgagee to obviate foreclosure, shall be deductible in full as ordinary losses.

Recent decisions have held that a mortgagor may establish an ordinary loss by abandoning the mortgaged property at least in cases in which it has become so great a liability that he is willing so to do without first obtaining a release extinguishing his personal liability. (*Polin* v. *Commissioner*, C. C. A. 3, 1940, 114 F. (2d) 174; *Park Chamberlain*, 41 B. T. A. 10, on appeal C. C. A. 7th.) But the fact of foreclosure is highly persuasive evidence that the mortgagor's equity in the property has already become worthless. Why should the technical event of sale operate to determine the character of the loss for tax purposes? The rule of the *Hammel case*, by assimilating losses on mortgage foreclosures to losses sustained on truly voluntary sales and exchanges of capital assets, will work a hardship on thousands of mortgagors whose transactions were not motivated by tax considerations. It may have repercussions prejudicial to the public interest in the field of mortgage loans by causing lenders to insist upon a wider margin of security. To that extent, the decision may act as a clog upon the new housing construction which is so vital to economic recovery.

We recommend that the statute also be amended to state a definite rule for determining the year in which the loss of a mortgagor upon foreclosure shall be deemed to be sustained.

Originally the Treasury took the position in a series of rulings that the event which determined the date of the loss was the foreclosure sale. Hence, the loss could be taken in the year of the sale. This was a sensible and realistic rule. The percentage of cases of redemption from foreclosure within the statutory period is almost negligible, and should not govern the normal case. However, the Board of Tax Appeals, adopting a narrowly legalistic position, held that the loss was not sustained for tax purposes until the year in which the period of redemption expired. (*J. C. Hawkins*, 34 B. T. A. 918, aff'd 91 F. (2d) 354 (C. C. A. 5th, 1937.)) The Bureau accepted this unrealistic rule and published a ruling revoking its earlier rulings. (G. C. M. 19367, 1937-2 C. B. p. 115.) In view of the activities of legislatures in the last decade in extending periods of redemption by moratory laws, the effect of this rigid and unfair rule in many cases is to defer indefinitely the year in which such losses may be taken as deductions. In the meantime, neither taxpayers nor the Government can be certain that the rule of the *Hawkins case* will survive should the problem later reach the Supreme Court for final determination. In the event of an ultimate reversal, confusion and injustice will result. A possible conflict with the *Hawkins case* has only very recently developed (see *Commissioner* v. *Peterman* (C. C. A. 9, 1941) P. H. Ct. Dec. No. 62,592), and the Supreme Court may possibly be called upon to resolve the conflict during the October 1941 term.

We recommend that the statute be amended, in line with the earlier Treasury position, so as to provide that a mortgagor shall be allowed to deduct his loss in the year of the foreclosure sale, unless he shall establish, by proof of abandon-

ment or otherwise, that his equity became worthless in an earlier year, in which case the deduction shall be allowed in such year.

No difficulty need be apprehended in the occasional case where the mortgagor redeems the property in a subsequent year, as a proper adjustment would be made in the return for that year under existing principles.

The position of the mortgagee after foreclosure is, if possible, even more obscure than that of the mortgagor under existing law. The long-standing administrative rule, found in section 19.23(k)-3 of Regulation 103, states that, where a mortgagee bids in property at a foreclosure sale, he realizes gain or loss in the amount of the difference between the fair market value of the property at the date of the sale and the basis of the obligations of the debtor applied in satisfaction of his bid; also that he may deduct as a bad debt, if and when ascertained to be worthless and charged off, the balance of the basis of such obligations which is not satisfied by his bid. The bid price is treated merely as prima facie evidence of the value of the property. The peculiar result follows, under these regulations, that a mortgagee may realize a taxable gain upon the acquisition of the mortgaged property and in the same year claim a bad-debt deduction for the unsatisfied portion of the mortgaged debt, where it is ascertained in that year that a deficiency judgment for such portion would be worthless and the requisite charge-off is made.

Suppose, however, that the mortgagee's bid price equals the amount of the mortgage debt, plus accrued interest, costs, etc., but that the basis of the debtor's obligations applied in satisfaction of the bid exceeds the fair market value of the property. It is apparent here that there is no basis for claiming a bad-debt deduction, since the debtor's obligations have been satisfied in full by the bid price. In this situation the Supreme Court has held in *Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S. 216 (1937), that the mortgagee is required to report the amount of accrued interest included in the bid price as interest received, that the bid price conclusively establishes the value of the property for the purposes of the transaction, and that the actual fair market value of the property at the time of acquisition on foreclosure is immaterial. By parity of reasoning, the mortgagor is presumably entitled to a deduction of the accrued interest thus satisfied by way of credit against the bid price. It is reasonable inference from the Court's opinion in the case that the mortgagee occupies the legal position of a purchaser; that he takes as his basis the price bid at the sale; that he is entitled to a bad-debt deduction only if and to the extent that the basis of the debt is in excess of the bid price and is ascertained to be worthless and charged off; and that the mortgagee realizes gain only if and to the extent that his basis of the portion of the debt represented by the bid is less than the face amount thereof. So interpreted, the Supreme Court's decision raises grave questions as to the validity of the existing Treasury Regulations.

That such uncertainty exists is well shown by the decision in *Hadley Falls Trust Co.* v. *United States*, 22 F. Supp. 346 (1938), affirmed in part and reversed in part in 110 F. (2d) 887 (C. C. A. 1st, 1940). Cf. *Grigsby* v. *Commissioner*, 87 F. (2d) 96 (C. C. A. 7th, 1937). In this case the Commissioner refused to follow his regulations and denied the mortgagee deduction of a loss representing the excess of the amount bid by him on foreclosure over the actual fair market value of the property. The Circuit Court of Appeals, while expressing grave doubt as to the validity of the regulations, reversed and allowed the loss on the slippery ground (always fictitious and invariably wrong) that the regulations had acquired the force of law by virtue of the repeated reenactment of the statute without material change.

Should these regulations ultimately be ruled invalid, and the rule be established that the mortgagee's bid becomes the basis of the property in his hands, confusion worse confounded will result and many gross inequities may arise when the mortgagee subsequently resells the property, in some cases to the taxpayer and in others to the Government. Where the subsequent sale price exceeds the bid, the mortgagee may be taxed on the excess even though he may have been earlier taxed under the regulation on that portion of it coresponding to the excess of the fair market value of the property on foreclosure over the bid price. In the converse situation, the mortgagee may be able to claim a loss in the year of sale, although he had earlier been allowed to deduct as a loss the excess of the bid price over the fair market value of the property on the date of the foreclosure.

These and other illustrations which might be given show the imperative necessity of legislative action to remove the confusion and uncertainty now exist-

ing in this large group of everyday business and financial transactions. It is appreciated that the choice between alternative rules will in some situations involve difficult questions of policy. Also, it may be that the same rules ought not be applied to foreclosure of corporate bond issues, secured by blanket mortgages and bond indentures, as to ordinary private mortgages and deeds of trust. But the situation demands solution. It is one where it is perhaps as important to have a definite and certain rule as to select the right rule from several alternatives. No rule is likely to work perfectly in all cases, but lenders and borrowers in the mortgage field can adapt themselves to a particular statutory rule which is reasonably definite and certain.

We recommend as the rule with respect to mortgagees which will involve the least administrative difficulty that which recognizes the fact that a mortgagee who himself bids in the property on foreclosure is engaged essentially in a salvage operation which should not be regarded as a closed transaction for tax purposes. We therefore urge the insertion in section 112 of an appropriate provision providing for nonrecognition of gain or loss to a mortgagee who acquires the mortgaged property, whether by foreclosure or voluntary conveyance, in total or partial satisfaction of his debt.

In the event that the mortgagee, subsequent to such acquisition, receives money or other property in reduction of the unsatisfied portion of the debt, the statute should provide for the application of such money and the value of such other property to reduce the basis of the property acquired on foreclosure, etc., any excess over such basis to be taxed as capital gain. In cases in which the acquiring mortgagee has sold the property in the interim, the rule should be that the full amount of property or other money so received shall be treated as capital gain. A correlative basis provision should be written into section 113, providing that the basis of property so acquired by a mortgagee shall be the same as the basis of the debt immediately prior to such acquisition, with any adjustments appropriate to the nature of the transaction.

We also recommend that section 22 (b) of the code be amended so as to exclude from gross income interest accrued on a debt secured by mortgage or lien on real property, or on leaseholds or other interests in real property, which is paid solely by means of being applied or credited in satisfaction of a bid by the mortgage creditor at a sale, or by a conveyance of the property to such creditor. Correlatively, section 23 (b) should be amended to deny a deduction of interest excluded from gross income under the proposed amendment to section 22.

The effect of these latter amendments would be to abrogate the rule of the *Midland Mutual case*, except in respect of value. The interest of the mortgagor is promoted if mortgagees bid on the property on foreclosure for the full amount of the debtor's obligations for he is freed from a deficiency judgment. The mortgagee most certainly would prefer an established rule.

VII. *Worthless corporate obligations and stocks should be excluded from capital losses.*—Prior to the Revenue Act of 1938, a long series of revenue acts had treated losses sustained on account of stocks becoming worthless as ordinary losses deductible in full in the proper year. (Sec. 23 (e) (2) of the Revenue Act of 1936 and corresponding provisions of prior acts.) Likewise, corporate obligations were treated as bad debts and, if ascertained to be worthless and charged off within the taxable year, were deductible in full to the extent of their bases. They were also subject to the deduction allowed in the case of debts on account of partial worthlessness. (Sec. 23 (k) of the Revenue Act of 1936 and corresponding provisions of prior acts.)

Congress deviated sharply from this policy by a series of amendments in the Revenue Act of 1938, now found in section 23 (g) (2) and (3) of the code, relating to worthless stocks, and section 23 (k) (2) and (3), relating to corporate obligations ascertained to be worthless. The deduction allowed on account of partially worthless debts was made wholly inapplicable to these corporate obligations, which include bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

The net effect of these amendments was to include these losses in the category of capital losses, subject to the limitations imposed by section 117. The losses are to be treated as though realized by sale or exchange of capital assets on the last day of the taxable year during which the stock became worthless, or the obligation was ascertained to be worthless and charged off. If the loss so considered is a long-term capital loss, as most losses of this type are, only a portion of it is taken into account under section 117 (b) and such portion only can be

offset against ordinary income, subject to the further limitations of section 117 (c) (2), the so-called ceiling provision. If it falls into the category of short-term capital losses, it can be applied only to offset short-term capital gains of the taxable year under section 117 (d) and, to the extent of any short-term capital net loss not in excess of the net income for such year, it can be used, under the 1-year carry-over provision of section 117 (e), to offset short-term capital gains of the succeeding taxable year.

We recommend that these amendments of 1938 be repealed and that the statute be restored for future years to its form prior to the 1938 act.

We believe that the reasons which were assigned to justify the restrictions on the deduction of capital losses from ordinary income in the Revenue Act of 1934 and succeeding acts do not apply to worthless stock and bad-debt losses because of their involuntary character. Our recommendation, however, is based both upon the proper concept of capital loss, and upon considerations of sound legislative policy. We feel that provisions in the tax laws which unnecessarily clog the free flow of capital into new enterprises are against the public interest. We think it is plain that such is the tendency of these amendments and that the harm they may do far outweighs the insignificant amount of revenue loss, which should not be controlling in any event. When equity capital or borrowed capital is sought in order to finance new enterprise, prospective investors are keenly aware of the inevitable hazard of partial or total loss of their investment should the enterprise prove to be a failure or only partially successful. They know also that, if the venture proves to be very successful, they will be required to pay over a large portion of their gains and profits to the Government in taxes. Any arbitrary limitations on the deduction of investors' losses due to their capital investment in such enterprises becoming worthless, by increasing the hazard, makes it just that much harder to finance new enterprises. It is our conviction that such limitations therefore defeat their own purpose in the end and clog the sources of the very revenues it is their professed purpose to protect.

In the same general connection we urge that careful consideration be given to some liberalization of the requirement that worthless debts must be charged off within the year of ascertainment of worthlessness in order to be deductible. While the Board of Tax Appeals and the courts have in general interpreted the statutory requirements much less rigidly than the Commissioner, nevertheless the charge-off requirement is a trap for the ill-advised or unwary taxpayer, and results in a denial of many meritorious deductions. Likewise, many taxpayers lose the benefit of the worthless stock deduction either because of over-optimism, lack of information, or the inherent difficulty of locating accurately in the stream of time the point at which a security loses its last increment of value.

It is recognized that the solution of these problems is not easy, but it is important that it should be sought. The administration of these provisions, perhaps more than any others in the statute, has been productive of sterile controversy and lack of confidence upon the part of taxpayers in the fairness of internal revenue officials. We submit three specific suggestions.

(1) Section 3801 of the code should be amended so as to apply its principles to cases of inconsistent disallowance of deductions by the Bureau in 2 or more years.

(2) The requirement of charge-off within the taxable year should be modified from a rigid requirement to a prima facie rule, i. e., that it shall be presumed, in the absence of a preponderance of evidence by the taxpayer to the contrary, that the debt was not ascertained to be worthless unless it was charged off within the taxable year, or before the due date for filing of the return.

(3) Because of the difficulty of localizing worthlessness at a point in time, the statute might be amended so as to provide that a deduction should not be disallowed if claimed in a return for the correct taxable year or for either of the two following taxable years, but that, in the event the deduction was so claimed in a year subsequent to the correct year, it should not have the effect of reducing the tax payable in the subsequent year by more than the reduction in tax it would have effected if claimed in the correct year. It would also eliminate much unnecessary controversy if the statute were amended to provide certain objective criteria, such as that the deduction should not be questioned if taken (*a*) for a taxable year in which a corporation is adjudicated bankrupt, or (*b*) in the year of corporate dissolution.

The above limitation would remove any incentive to deliberate postponement of the taking of the deduction beyond the correct year for tax reasons. The amendment would afford some protection to taxpayers making honest and reasonable errors of judgment. It would also discourage the tendency on the part of

administrative officials to rule in all doubtful cases that the deduction was claimed in the wrong year.

VIII. *Agreements extending the statute of limitations for assessment of deficiencies should similarly extend period for refunds.*—We recommend that section 322 (b) of the code, relating to the limitation on refunds and credits, be amended so as to provide that, where an agreement is executed by the taxpayer and the Commissioner, under the authority conferred by section 275 (c), (which extends the period otherwise provided by law within which assessment of tax may be made), such an agreement shall have the effect, notwithstanding any other provision of law, of extending the period within which a valid claim for refund or credit may be filed to the last day of the period, as so extended, for assessment of the tax. The period within which a determination of overpayment may be sought by the filing or amendment of a petition before the Board of Tax Appeals should be similarly extended where an agreement has been entered into under section 275 (b).

Under the existing law, section 322 (b) of the code, no allowance by way of refund or credit may be made unless a claim for refund or credit has been filed by the taxpayer within 3 years from the time he filed his return or 2 years from the time the tax, with respect to which refund or credit is sought, was paid, whichever of such periods expires the later. The Supreme Court has held that the Commissioner is without power to extend the period so fixed by law within which a claim for refund or credit may legally be made (*Finn* v. *U. S.* 123 U. S. 227 (1887); *Tucker* v. *Alexander* 275 U. S. 228 (1927). It is not the purpose or effect of the proposed amendment to vest in the Commissioner any general power, by agreement or otherwise, to waive or modify a statute of limitations in favor of the Government. It is much more limited. It would merely tend to preserve equality of operation in the statutes of limitation on deficiencies and refunds. Congress has accepted this policy as fair and equitable. However, in the classes of cases covered by the above amendment, the policy has not been realized.

A simple case will illustrate that this is so. Suppose a taxpayer filed a return on March 15, 1938, covering the calendar year 1937 and showed a tax due of $100,000 which he paid in full by a check attached to the return. In February 1941 the taxpayer, at the request of the Commissioner, executed an agreement under section 275 (b) extending for 1 year, i. e., to March 15, 1942, the period within which an assessment might be made. He did this because additional time was desired by the Commissioner for consideration of his case. Otherwise, the Commissioner would send out a 90-day letter before March 15, 1941, in order to protect against the statute. Under the existing law the Commissioner would be free to take full advantage of intervening court decisions and to assert a larger deficiency at any time up to March 15, 1942. During this time the taxpayer may be quite in the dark as to what the Commissioner will ultimately do. Even if, in excess of caution, he files a claim for refund before that date, it may not avail him to gain the advantage of some later court decisions, unless the decision is within the scope of a ground stated in his claim, since the law is now well settled that a claim for refund cannot be amended after the end of the stautory period for filing claims, so as to state a new substantive claim (*U. S.* v. *Andrews*, 302 U. S 517 (1938)).

The adoption of the proposed amendment would restore the full equality of operation of the statutes of limitation which the Congress intended they should have and which they do have, unless and until an agreement extending the period for assessment under section 275 (b) is made. Such agreements or waivers play an important and constructive part in the administration of the revenue laws by promoting administrative settlement of cases. The amendment would relieve taxpayers of the necessity of filing blanket claims for refund while the Bureau still has their cases under consideration, as a measure of self-protection. It would encourage the execution of these agreements by relieving the taxpayers of the necessity of placing the Government in a position of advantage by so doing.

We also recommend that section 322 (d) of the code be amended so as to place the taxpayer and the Commissioner of Internal Revenue on a basis of equality in cases pending before the Board of Tax Appeals.

Suppose, under the existing law, that the Commissioner has mailed a notice of deficiency prior to the running of the statutory period and the taxpayer has filed a petition with the Board, within the 90-day period prescribed by law, contesting the deficiency or alleging an overpayment and claiming a refund. The law permits the Commissioner subsequently to amend his answer to the petition so as to

claim an increased deficiency, although the statutory period for assessing a deficiency has otherwise run. The mailing of the deficiency letter stops the running of the statute against the Government. But the filing of a petition has no similar effect with respect to a claim for refund. Contrary to the true intent of Congress, the taxpayer cannot amend his petition so as to claim an overpayment or increase a claim of overpayment if the statutory period for filing a claim for refund has expired (*Commissioner* v. *Rieck* (C. C. A. 3), 105 F. (2d) 294, rehearing denied June 16, 1939; *Georgie W. Rathbone*, 39 B. T. A. 56). Fairness demands equality of treatment. This result can be secured by a simple amendment to section 322 (d) which will allow the taxpayer, who has duly filed a petition within the applicable period of limitation, to amend the claim on petition at any time before the hearing or rehearing before the Board.

IX. *Treatment of gain on redemption of preferred stock as short-term capital gain should be revised.*—We recommend an amendment to section 115 (c) and 117 (f) of the code which will make gain to shareholders realized on the redemption of preferred stock fully subject to section 117.

The effect of the adoption of this recommendation would be to treat such gains in the same manner as gains realized on the sale or exchange of such stock. Whether the gain is taxed to an individual shareholder as a short-term or a long-term capital gain will depend on how long he has held his stock prior to the redemption. This is the rule which already applies to losses sustained on such redemptions in the case of bonds.

Under the existing law the definition of partial liquidation in code section 115 (i) brings any cancelation or redemption of a part of the stock of a going corporation within the limitations of section 115 (c), unless it represents one of a series of distributions in complete liquidation as therein defined. The result is that a holder of preferred stock which is called for redemption, often contrary to his own desire, finds himself penalized by the provisions of section 115 (c) if he continues to hold his stock to the date of redemption and realizes a gain at that time. The fact that he has no thought or motive of tax avoidance is immaterial. Section 115 (c) imposes an arbitrary requirement that gain realized on a distribution in partial liquidation shall, despite the provisions of section 117, be considered as a short-term capital gain. As such, 100 percent of such gain must be taken into account, no matter how long the stock has been held. This arbitrary rule creates an incentive to its avoidance by sale of the stock, wherever possible, prior to the redemption date for a price equal to or slightly under the redemption price.

This provision was first introduced into the law in the 1934 act. The report of the Senate Finance Committee on this act (p. 37) specifically pointed out that the new limitation was aimed at cases in which shareholders might seek to avoid surtaxes levied at full rates, if accumulated earnings and profits were distributed as ordinary dividends, through distributions thereof in the form of liquidating dividends. The cure, however, went much further than was necessary to correct the evil. It was found to work such hardships upon stockholders of corporations desiring to liquidate for business reasons that the 1936 act and subsequent acts gave relief by taking complete liquidations consummated within specified periods of time out from under the rule.

We believe that redemptions of preferred stock do not fall within the purpose of the 1934 limitation and should be treated, like redemptions of bonds under section 117 (f), as sales or exchanges. The statute provides other ample safeguards against the use of such redemptions as a device for distributing earnings and profits free from high surtaxes. Section 115 (g), relating to cases where redemption of stock is made in such a way as to have the effect of a taxable dividend, will still be applicable to cases where it is apparent a primary purpose of the redemption is tax avoidance. Section 115 (c) prevents that portion of a distribution in partial liquidation which is properly chargeable to capital account from being considered a distribution of earnings and profits. A simple case will suffice to illustrate the normal situation on a redemption of preferred stock. Corporation A issues 1,000 shares of preferred stock to 1935 for $100 a share. For business reasons it calls this issue for redemption in 1941 at $105 a share, the price fixed in the share certificates. Only the excess of the redemption over the issuance price, or $5,000, could be treated as a distribution of earnings and profits. The balance would be charged against capital account.

It it quite unlikely that a corporation would endeavor to use a redemption of preferred stock for the purpose of surtax escape by the stockholders, particularly with the threat of section 115 (g) hanging over it. Our proposal would not

apply to partial liquidation of common stock, the case where the danger at which section 115 (c) is really directed, is most likely to be present.

A uniform rule should apply both to bonds and preferred stocks.

X. *The principle of exemption of dividends from individual normal tax should again be recognized.*—We recommend that an exemption of dividends from the normal personal income tax, which obtained in some form from the beginning of the present income tax in 1913 until the enactment of the Revenue Act of 1936, be restored.

We believe that such an exemption should be allowed as a measure of simple justice and for reasons of sound policy. The existing tax structure works patent and discriminatory double taxation of corporate earnings distributed in dividends, which no responsible authority has, to the best of our knowledge, had the temerity to defend.

This unfortunate form of double taxation of corporate earnings crept into the law in 1936. The House bill of that year would have abolished all Federal corporate taxes except for a heavy graduated tax on that portion of the corporate net income which was not distributed in dividends. Under that proposal, which eliminated any flat tax on corporate income, it was quite logical to subject dividends received by shareholders to both normal and surtax, as in the case of interest on corporate bonds, since dividends and interest alike would have been taken out of the corporate tax base. However, in the bill which was finally enacted into law, a substantial normal tax on corporations was restored. But the exemption of dividends from normal tax was not restored then or since.

With the corporate normal tax rate schedules presently to go to double the maximum rate of the 1936 act, and with heavy excess-profits taxes superimposed, the burden of this double taxation of corporate income has become very serious from the shareholder's point of view. Corporate equities become steadily less attractive to investors. An artificial and unwise incentive to finance corporate capital needs by borrowing is created. The discrimination against the corporate form of enterprise, in relation to other forms such as the partnership, is unfairly increased.

We appreciate that the restoration of the exemption of dividends from normal individual tax can only partially remove the discrimination, so long as there is a large disparity between the corporate normal and individual normal tax rates. As long as such disparity is unavoidable, such discrimination will of necessity continue. We believe, however, that this fact is not a good reason why the discrimination should not be ameliorated by restoring this exemption from the normal tax. This result can be readily accomplished by adding a new subdivision to section 25 (a) of the code, providing a credit in the amount of dividends received from a corporation subject to tax under chapter 1 of the code.

XI. *Recoveries on bad debts.*—We recommend that section 22 (b) of the Internal Revenue Code, as amended by the Revenue Act of 1939, be further amended so as to provide that amounts recovered during the taxable year on account of a debt, for which a bad debt deduction or deductions have been allowed in a prior year or years, shall be included in gross income only to the extent that such prior deduction or deductions have been applied to offset taxable income.

This amendment, if adopted, would be applicable to corporate as well as to individual taxpayers. However, there is no special difficulty in the case of corporate taxpayers. While the writing off of the bad debt in an earlier year or years may have operated to reduce the accumulated earnings and profits, the amount recovered in a subsequent year would undoubtedly operate to increase earnings and profits, even though the statute excluded it from gross income under the circumstances indicated above.

The effect of the amendment may be indicated by a simple illustration: Suppose that T, a taxpayer, in 1936 determined that a debt of $25,000 owed to him had become absolutely uncollectible and worthless and charged it off during the year. He claimed a bad debt deduction in this amount in his income return for that year and such deduction was allowed by the Bureau on audit of the return. T's net income before taking this deduction was only $10,000, so he paid no tax. In 1941, the debtor pays T $25,000, the full amount of his debt. Under our suggested amendment, T would be required to include only $10,000 of this amount as gross income in his return for 1941.

The principle of the proposed amendment accords with the Bureau's former interpretation of the existing law. (See G. C. M. 18525, 1937–1 C. B. 80, and

G. C. M. 20854, 1939-1 C. B. 102.) These two rulings were based upon what we believe to be the correct theory, and certainly reached the right result as a matter of good sense and sound policy. They regarded amounts received or recovered in payment of debts as constituting tax-free reimbursement of capital, unless the taxpayer had in effect already recovered his capital tax-free by securing a deduction on account of the bad debt and using such deduction to offset taxable income in a prior year.

More recently, however, the Bureau has completely reversed its position. On July 8, 1940, G. C. M. 22163, 1940-No. 28, I. R. B., page 4, was published, revoking these prior rulings and holding that all payments received upon debts previously charged off and claimed as deductions constitute taxable income in the year of recovery whether or not such deductions in fact operated to offset taxable income and so conferred a tax benefit. Limited relief against hardships resulting from the retroactive application of this ruling was granted by a special ruling of the Department on December 11, 1940.

There are no Supreme Court decisions on the precise issue and decisions by the Board of Tax Appeals are in apparent conflict. (Cf. *National Bank of Commerce of Seattle* v. *Commissioner*, 40 B. T. A. 72 (1939), and *Lake View Trust & Savings Bank* v. *Commissioner*, 27 B. T. A. 290 (1932)). There are indications that the Bureau promulgated its latest ruling with some reluctance, feeling that certain Supreme Court decisions involving other factual situations were controlling in principle. See *Burnet* v. *Sanford & Brooks Co.* (282 U. S. 359 (1931)), holding the proceeds of a judgment to be income in year of recovery, though representing reimbursement of a business loss sustained in a prior year, when the tax return filed showed a large net loss, and *U. S.* v. *Ludey*, (274 U. S. 295 (1927)), where the Court held that, in determining the cost basis of certain oil properties, adjustment had to be made for properly allowable deductions for depreciation and depletion in prior years, whether actually claimed or not, inasmuch as the thing sold is not physically the same as when it was purchased. The *Ludey case* was followed in *Hardwick Realty Co.* v. *Commissioner* (29 F. (2d) 498 (C. C. A.-2, 1928)), where it specifically appeared that the taxpayer derived no tax benefit from the prior deductions.

The *Sanford & Brooks case* was definitely an income case, the difficulty being that the computation of income on a strict annual basis precluded any consideration of the fact that there had been no net profit if all the years involved were considered. But the recent ruling ignores the fact that the payment of a debt is not income per se and that the only way it can become income is by virtue of the fact that it has been charged off and deducted so as to offset taxable income in a prior year.

Whatever the proper interpretation of the existing law may be, the issue is not settled by the recent ruling. An amendment is needed to settle the doubt and resolve the confusion. Such an amendment might well be made retroactive, in view of the recency of the change in the Bureau's position. Under this recent ruling, the question whether subsequent recoveries of bad debts constitute income apparently turns upon the more or less adventitious fact whether the taxpayer has claimed and has been allowed a deduction on his income-tax return for a prior year. Such a result is certain to offend the good sense of the common man.

We believe the sensible and just solution is for Congress to write into the law the rule formerly followed by the Bureau. It is fair to the taxpayer and affords adequate protection to the interests of the revenue.

XII. *Deductions of expenses should be liberalized.*—We recommend an amendment to section 23 (a) of the code to fill a hiatus in the existing law, as it has been interpreted by recent Supreme Court decisions, and relieve hardships inflicted upon a large number of taxpayers. The effect of the amendment is to allow the deduction of ordinary and necessary expenses incurred in the production and collection of income, and in the management, protection, and conservation of property devoted to the production of income in situations which do not involve the "carrying on of a trade or business," as that phrase has been interpreted by the courts.

Since the first income-tax law enacted under the sixteenth amendment, Congress has adhered to the policy of using net income, not gross income, as the basis of the income tax. Only net income can represent even roughly ability to pay. The only significant deviations from this principle have been in the taxation of income from United States sources of nonresident aliens (sec. 211 (a) of the code) and nonresident foreign corporations (sec. 231 (a) of the code), and in various limitations imposed on deductions.

Deduction has always been permitted of the ordinary and necessary expenses incurred in carrying on a trade or business on the one hand; deduction of personal and family expenses has always been denied on the other. It is extremely doubtful that the Congress realized, when the groundwork of the personal income tax was laid, that this dichotomy did not fully cover the classification of expenses, and that there was a third category of expenses falling between trade or business expenses and personal or family expenses. This category includes expenses incurred in the production or acquisition of income, where such production or acquisition does not constitute the carrying on of a trade or business. Yet, such expenses are not personal or family expenses under the common understanding of that term. The denial of a deduction for such expenses transforms a net-income tax into a gross-income tax with respect to these types of income. It is not believed Congress ever intended any such result. Too frequently, the courts are rewriting our tax laws, and the protection of legislative procedure is lost.

For many years the hardships latent in this imperfect classification of expenses in the statute were minimized by a series of administrative rulings. These rulings, in the interests of equity and good sense, resolved doubts in the taxpayer's favor in many situations by permitting individuals to deduct ordinary and necessary expenses incurred in the production of income. (See I. T. 2751, XIII-1 C. B 43 (1934), I. T. 2579, X-2, C. B. 129, and many earlier rulings, such as O. D. 877, 4 C. B. 123.) Such expenses typically included costs of bookkeeping, stenographic work, office and safety vault rent, auditing fees, fees paid to investment counsel and attorneys, and the like, in connection with the management and conservation of income-producing property and investments. The validity of these rulings was clouded with doubt by the decision of the Supreme Court in the case of *Van Wart* v. *Commissioner* (295 U. S. 112 (1935), where the Court held that an attorney's fee paid by a guardian for conducting litigation to secure income for his ward was not deductible under section 241 (a) of the Revenue Act of 1924 (sec. 23 (a) of the code is the corresponding section of the present law), because it was not an expense incurred in carrying on a trade or business. The rulings received their death blow on February 3, 1941, when the Supreme Court held in *Higgins* v. *Commissioner* (61 S. Ct. 475), that such expenses incurred by a so-called passive investor, who devoted a major portion of his time to managing security investments and maintained two offices for such purposes, were not entitled to be deducted. In this case the Commissioner allowed to be deducted the portion of such expenses allocated to the management of real estate, and this issue was not passed upon by the Court.

The Bureau thereupon revoked its earlier rulings. (See I. T. 3452, 1941-8 I. R. B., page 4.) For the present, at least, a distinction which seems difficult to justify is drawn between expenses incurred in the management of real estate and of other income-producing investments. (The case of *Heiner* v. *Tindle* (276 U. S. 582 (1928)), gives some support by inference to the propriety of the real-estate deductions.) More recently, on April 28, 1941, the Supreme Court has applied the Higgins doctrine in holding nondeductible similar expenses incurred by trustees in the management and conservation of the securities investments of trusts. Affirming *City Bank Farmers Trust Co.*, v. *Commissioner* (112 F. (2d) 467 (C. C. A.-2, 1940)), and reversing *U. S* v. *Pyne et al.* (35 F. Supp. 81 (Ct. Cls, 1940)) It is therefore apparent that only legislation can solve the problem.

The possible need for such legislation was recognized in 1938 when a subcommittee of the Ways and Means Committee made the following recommendation which was endorsed by the Treasury Department:

"*Expenses incurred in connection with the collection or production of income.*—Your subcommittee believes that a taxpayer should be granted a reasonable deduction for the direct expenses he has incurred in connection with his income. Under the present law, section 23 (a) of the Revenue Act of 1936, some expenses attributable to the collection or production of taxable income are not permitted as deductions because the statute limits deductible expenses to those incurred in carrying on a trade or business. Thus a taxpayer cannot deduct fees and expenses paid in litigation for moneys which are includible in gross income but which are not received in connection with the trade or business. In order that net income be more equitably ascertained, your subcommittee recommends (recommendation No. 33) that section 23 of the Revenue Act of 1936 be amended so as expressly to include as deductible items all expenses not at present deductible, which are immediately and directly incurred in the collec-

tion or production of income, limited to 50 percent of the amount collected or produced."

Pursuant to the foregoing, which was set forth on page 46 of the Report, Recommendation No. 33 itself, which was set forth on page 76, read as follows:

"*Recommendation No. 33.*—It is recommended that a deduction be permitted under section 23 of the Revenue Act of 1936 for expenses not attributable to the taxpayer's trade or business, but immediately and directly incurred in the collection or production of amounts included in gross income, limited to 50 percent of the amount collected or produced."

The particular recommendation was not written into the law in 1938, partly because the necessity for it was not then so acute. The Bureau was still following the sound policy then reflected in its rulings. It is also understood that it was desired to delay action until inquiries could be made as to how similar provisions in State income-tax laws, such as New York, were operating, and because of technical drafting difficulties, attributable largely to the form of limitation on the deductions which was then recommended. It is our understanding that these States have found no difficulty in administering their provisions.

It is believed that the dangers of abuse of such an amendment are greatly exaggerated. If the amendment is carefully drawn and accompanied by appropriate explanatory statements in the committee reports, there is small danger that the courts will give it a broader application than Congress intended. It will not break down the well-established concepts of what constitute nondeductible personal and family expenses or nondeductible capital expenditures. It will do little more than to ratify the earlier Bureau practices. For that reason, it is recommended that whatever amendment be adopted be applied retroactively.

The heavy increases in income-tax rates recently made or now projected greatly increase the gravity of this problem. Taxpayers are willing to pay heavy taxes to help meet the great demands of the present time upon the National Treasury, provided the burden is distributed on an equitable basis. This can only be done by a fair definition of the net income which is taxed. They feel it is unfair discrimination to allow a limited deduction for gambling losses (code, sec. 23 (h)), and to deny any deduction for expenses incurred in producing or collecting income, or in conserving income or income-producing property. The Treasury benefits from such income in increased taxes and also benefits by measures taken by careful investors to conserve and protect it. It is unfair to tax more than the portion which remains to the taxpayer after such expenses have been paid.

It will be noted that this problem is limited to individuals, including fiduciaries. All the ordinary and necessary expenses of corporate taxpayers are deductible.

XIII. *Correlation of income-tax basis of property with valuation for estate-tax purposes.*—We recommend an appropriate amendment to section 113 (a) (5) of the code which will definitely establish as the basis, for income-tax purposes, of property transmitted at death the valuation of such property which was used in the computation of the Federal estate tax.

There is a serious lack of correlation between the estate tax and the income tax at this point under the existing law. While the valuation of property used for estate-tax purposes is prima facie evidence of its value at the date of death, it may be challenged by either the Commissioner or the heir, devisee, or legatee in a subsequent income-tax proceeding. This fact creates an incentive to change of position and litigation which should be removed. Section 3801 of the code does not operate to discourage such inconsistency since it does not apply where the estate tax is involved in one year and the income tax in the other.

Moreover, code section 811 (j) allows the executor or administrator to elect between valuation at the date of death or 1 year thereafter for estate-tax purposes, with a proviso that, if value at the later date is elected, then as to assets in the gross estate distributed or sold during the year, value at the date of distribution or the sale price shall be used. Yet section 113 (a) (5) of the code has never been amended so as to correlate with section 811 (j). It continues to define, as the basis of property transmitted at death, its value at the date of death. The result, in cases where the benefits of section 811 (j) are elected, is that the income-tax basis will usually, as a matter of law, be higher than the valuation used in computing the value of the taxable estate. This unfair discrimination should be corrected.

The proper remedy is to amend section 113 (a) (5) of the code so as to provide that the basis of property transmitted at death shall be the value at which it was included in the gross estate of the decedent (under sec. 811 of the code), in the determination of the estate tax. Where the property formed a part of an

estate too small to require the filing of an estate-tax return, the income-tax basis will continue to be its value at the date of death.

XIV. *Annual gift-tax exclusion should apply to gifts in trust.*—We recommend appropriate amendments to section 1003 of the Internal Revenue Code to accomplish the following results:

(1) Restore to gifts in trust of other than future interests the benefit of the annual exclusion from the tax base of the first $4,000 given to any particular donee during the gift-tax year.

(2) Treat as gifts of present interests (in proportion to the beneficiaries' interests), entitled to the benefits of such exclusion, gifts in trust for the benefit of one or more minors, whether the income is to be distributed or accumulated, if both principal and income are payable only to or for the benefit of such minors or their estates.

Prior to the Revenue Act of 1938, gifts in trust enjoyed the benefits of the annual exclusion of $5,000 to the same extent as gifts made in other ways. The only exception was gifts of future interests, whether by trust or otherwise. Section 505 of the Revenue Act of that year reduced the annual exclusion to $4,000 for gift tax years beginning on or after January 1, 1939, and denied its benefit altogether to gifts in trust.

The effects of the 1938 amendment will appear from a simple illustration. D has two children, one of them a minor, 12 years of age, and the other an adult. He makes a gift of $14,000 outright to the adult child in 1940. Of this amount only $10,000 is subject to tax. Desiring to treat his children equally, but knowing his other child is a minor and without legal capacity to manage his own affairs, he sets aside $14,000 irrevocably in trust for the benefit of such child. The entire amount of the gift is subject to tax, even if the trust provides that the income from the trust be distributed currently to the child, or applied for his benefit. As a practical matter, however, it is difficult and usually unwise to make such gifts to minor children outright. Hence, such trusts other than those established to provide for maintenance and support, commonly provide that the income be accumulated for the child until he reaches his majority.

Is this discrimination necessary? The report of the Senate Finance Committee (p. 32) justified this discrimination on the ground that it was a practical measure to protect the revenue by minimizing the abuses growing out of such decisions as *Wells* v. *Commissioner* (88 F. (2d) 339 (1937)), where it was held that the trust entity was the donee in the case of a gift in trust. This decision severely restricted the scope of the exception of future interests from the benefit of the annual exclusion and encouraged the creation of mutiple trusts for the same beneficiary in order to obtain a $4,000 exclusion for each trust.

This reason for the 1938 amendment has vanished by virtue of the recent decision of the Supreme Court in *Helvering* v. *Hutchings* (March 3, 1941) (61 S. Ct. 653), which held that the donee of a gift in trust is not the trust entity but the beneficiary, thereby overruling the *Wells case* in principle. On the same day the Court ruled in *United States* v. *Pelzer* (61 S. Ct. 659), that where a trust provides for accumulation of income during the minority of a beneficiary and the beneficiary's right to receive the accumulated income and corpus is contingent upon his surviving until he reaches his majority or other specified age, the interest given to the minor is a future interest and the annual exclusion does not apply. This decision is squarely contrary to the *Wells case*. The situation in which there is no contingency, and the minor or his estate are absolutely entitled to receive the accumulated income at a future date, was not directly ruled upon, but the reasoning of the court suggests that the rule of the *Pelzer case* would still apply.

We believe that the reason justifying the exception of future interests, viz, the uncertainty as to the identity and number of the donees of the remainder interests, does not apply to a case in which there is a present gift of the entire interest, with only the actual enjoyment of the income postponed during the minority of the beneficiary.

XV. *Exemption of securities of nonresident aliens from estate and gift taxes should be provided.*—Under the existing law, nonresident aliens are subject to estate and gift taxes only with respect to property situated within the United States. However, the Internal Revenue Code provides in respect of both taxes (sec. 862 (a), sec. 1030 (b)) that stock of a domestic corporation shall be considered property situated within the United States, no matter where the stock certificates are physically located. In accordance with this theory, it is suggested that the statute should specifically enact the rule stated in the present regulations (regs. 80, Art. 50, and regs. 79, Art. 18) that stock of a foreign corporation shall

be deemed to be property without the United States, regardless of the physical location of the certificates.

No similar inconsistency exists in the case of bonds, which are usually taxed in the place where the bonds are physically located.

We recommend that stock, bonds, and other securities of foreign corporations owned by nonresident aliens be specifically exempted from estate and gift taxes. This recommendation is based solely upon practical considerations. There are many good reasons for encouraging nonresident aliens to keep their securities, whether foreign or domestic, in American custodian accounts. Employment and income is provided to numerous persons handling such accounts. The presence of these accounts facilitates the collection of other taxes due from the owners thereof. The transactions consummated by the custodians in American markets yield revenue in the form of stamp taxes and otherwise.

The existing law defeats its own purpose, viz, maximum revenue, by creating a tax incentive to foreigners to keep their foreign securities outside the United States, thereby defeating the policy of the changes in the income-tax law made in 1936 (see code, sec. 231 (a)) which exempted nonresident aliens from tax on their capital gains realized by transfers on American securities exchanges. Also, since most persons prefer to keep all their securities in a single account, the result is that many accounts of such aliens are kept in Canada or elsewhere, which might otherwise be maintained in the United States. For these reasons it is confidently believed that the adoption of the foregoing recommendation would, in the net, benefit the revenue. Also, it is believed that the estate and gift-tax revenue derived from such nonresident alien securities is so small as to be negligible.

For these reasons we recommend that paragraph (b) of section 863 of the Internal Revenue Code be amended by changing the period at the end thereof to a semicolon and adding the word "and", and that a new subsection be added reading as follows:

"(c) *Foreign securities.*—Stock in, and securities of, a foreign corporation or a foreign government or political subdivision thereof, owned and held by a nonresident not a citizen of the United States, without regard to the physical location of the certificates or other physical evidences representing such stock or securities at the time of the decedent's death."

The adoption of this recommendation should be accompanied by the addition to section 1030 of the Internal Revenue Code of a new subsection (c) with a text identical with that of the foregoing proposed section 863 (c).

XVI. *Provision should be made for adequate tax-free funds for payment of Federal estate taxes.*—It is strongly recommended that appropriate provisions be written into the Federal estate tax statute which will permit the owners of estates to build up reserves or funds for the payment of estate taxes at death, the amount of which shall be exemped from estate taxes to the extent they are applied to the payment of such taxes.

We believe that such provisions are urgently needed under the existing law and that they are absolutely imperative if the radical revision in the rate schedule and reduction in exemptions recommended to your committee by the Treasury Department should be enacted into law, in whole or in part. High progressive estate tax rates have already created acute problems for executors and administrators in finding funds to pay these taxes without disastrous forced liquidation of assets at sacrificial prices. This problem is especially acute where all or a major part of the estate consists of the ownership of a going business or of real estate or other nonliquid assets. The artificial pressure for liquidity created by the present law is a serious obstacle to the movement of enterprise capital into new business ventures which the general welfare demands.

Collection of estate taxes will be speeded up. Losses, due to sacrificial liquidation of estates which are costly to income-tax revenues, will be greatly reduced. The depressing influences on market values generally of such liquidations will be minimized. Most important of all, businessmen will be able better to plan their affairs and will be encouraged to embark upon new enterprises when the pressure to maintain a high degree of liquidity in their assets is materially reduced. The estate tax, of all taxes, should be constructed from the point of view of its long-run effects.

There are several possible alternative methods which may be provided whereby the shock of high estate-tax rates upon other types of assets may be cushioned and the Government assured of prompt payment of its tax. The only cushion now provided is the possibility of extensions of time in which to pay estate

taxes up to 10 years. However, such extensions carry an interest burden of 4 percent, which is in excess of the current average earning power of investments. The combined impact of heavy estate-tax rates and increasing income-tax rates upon the incomes of estates makes it impossible to meet estate taxes out of income of estates within any reasonable period. The tax problem is further increased in some cases where State death taxes exceed the amount of the Federal credit.

We do not suggest any specific method as the best or only possible one, but submit for your consideration two general methods for providing essential relief. It is believed that some combination of these two methods, which may be denominated (1) "self-insurance," and (2) "purchased insurance," may provide the most practical solution.

(1) *Self-insurance.*—This plan involves setting up a trust specifically for estate-tax purposes. If deemed desirable, the statute might limit the types of assets which could be placed or kept in such a trust, such as, for example, Government bonds, securities listed on the New York or other recognized exchanges, and the like. It is suggested, however, that no such special limitations be imposed in order to avoid discrimination between investments, since the trust instrument would ordinarily contain provisions as to liquidity.

In the interests of simplicity and prevention of possible income-tax avoidance, such trusts should be permitted to be revocable, except that after the settlor's death the assets would be specifically earmarked for estate-tax payments, and no prior distributions could be made till such tax liabilities were liquidated. The trust instrument could provide for the disposition of earnings prior to the settlor's death, either by way of accumulations or distribution to him. In either event, the trust income would be taxable to the settlor. The instrument might also require as a guaranty of liquidity that the trust be liquidated within a relatively short time after the due date of the estate tax.

Whatever portion of the trust assets are required to pay estate taxes should be made exempt from such taxes, and any excess should be subject to tax. Some special provision may be necessary, in the event of such an excess, to prevent introducing algebraic complication into the computation of the tax, but there are several ways in which resort to algebra can be obviated by proper draftsmanship. There should be no tax on the privilege of creating such trusts.

The principle of not taxing such portion of the estate as is required to pay the tax accords with the result now reached under the gift tax, where the tax is paid by the donor out of the estate remaining to him after a gift. The tax so paid is not taxed as a part of the gift and operates to reduce the estate passing at death and subject to estate tax.

2. *Purchased insurance.*—Past proposals in this field have usually taken the form of exempting from estate tax the proceeds of life insurance, definitely earmarked in some way for the purpose, to the extent such proceeds are required to pay estate-tax liabilities, with any excess added to the corpus and subject to tax. Here, also, some special provision may be necessary to obviate the use of algebraic formulas when such an excess is present.

It is recognized that its simplicity is a major advantage of this plan. On the other hand, a limitation of relief to this plan alone may be deemed objectionable because it may discriminate between taxpayers, since all taxpayers are not insurable.

For these reasons it is believed that some form of both plans should be recognized by the statute, leaving the taxpayer to select the form best adapted to his own circumstances.

XVII. *Section 42 of the code should be repealed or modified.*—We recommend that section 42 of the Internal Revenue Code, as interpreted and applied by the Supreme Court in the recent case of *Helvering* v. *Enright* (61 S. Ct. 777 (1941)), be repealed or modified.

Section 42 of the code provides in part as follows:

"In the case of the death of a taxpayer there shall be included in net income for the taxable period in which falls the date of his death the amounts accrued up to the date of his death, if not otherwise properly includible in respect of such period or a prior period."

There is a correlative provision in section 43 relating to the accrual of deductions and credits. The combined effect of these two sections is to compel the net income of a deceased taxpayer to be computed on an accrual basis, irrespective of the fact that in all prior years the deceased taxpayer had been on a cash basis. This provision was first introduced in the Revenue Act of 1934

and grew out of a decision that income accrued before the taxpayer's death, but actually collected or received thereafter, was not income to the estate, but a part of the corpus (*Nichols* v. *U. S.*, 64 Ct. Cls. 241; cert. den., 277 U. S. 584). The report of the Ways and Means Committee on the 1934 act (H. Rept. 704, p. 24) stated that such an amendment was necessary, since, if such income is not taxable to the estate, it escapes taxation altogether unless the law taxes it to the decedent. There is no quarrel with the position that such income should not escape taxation altogether.

However, the form of remedy employed in the 1934 amendment in correcting an inequity to the revenue has created several new and even more serious injustices to deceased taxpayers and their estates. The truth of this statement is vividly exemplified by the cases of *Helvering* v. *Enright*, supra, and *Pfaff* v. *Commissioner* (85 L. Ed., Adv. Op. 693) decided the same day. In the *Enright case*, section 42 of the code was held to require the inclusion in the closing return of the decedent who was a member of a partnership which also reported its income on a cash basis, not only the decedent's interest in the firm's uncollected accounts valued at about $2,650, but also his interest in unfinished work of the firm at its appraised value for estate and inheritance tax purposes, viz, about $40,850.

Simple analysis will show the many inequities lurking in such a result.

(1) A large and disproportionate amount of income, which may be collectible only over a period of several years, if at all, is subjected to a heavy surtax as an addition to the decedent's normal income in the year of his death.

(2) This income so accrued is thus taxed entirely in the decedent's "top brackets" in the year of his death, although it would normally have been taxed at lower rates over several taxable years, had the decedent lived.

(3) The additional income tax required to be paid by the estate as the result of the inclusion of such accruals would, in many cases, exceed the cash income available for payment thereof.

(4) The items accrued under the doctrine of the *Enright case* will often include large amounts which are not accruable under the ordinary understanding of that term, since in many cases the amount of the fees to be charged by professional partnerships for work in process are not determined until the work is completed.

(5) The decision will require the accrual of substantial amounts of professional fees which will never be collected, since the excess of fees on the books over the fees collected in such cases is notoriously large. Decedents' estates will therefore be mulcted of income taxes on "dead horses" in many cases.

(6) In summary, an income tax law which is based upon the principle that incomes shall be taxed in accordance with ability to pay; i. e., $10,000 taxpayers at one rate, $30,000 ones at a higher rate, and $50,000 ones at a still higher rate, in fact may work out in many cases under section 42 as follows: In the year in which a $10,000 taxpayer dies, the rate of tax to which he will be subjected may be that of the $30,000 one; or the rate payable by the $30,000 man may become that of the $50,000 man, etc.

We do not believe that the Congress contemplated such paradoxical results when it enacted section 42 in the 1934 act. The section works a practical approximation to fairness in ordinary cases where the amounts involved, such as wages and salaries, interest, rents, and the like, are small and the amounts accrued are for the most part amounts which the taxpayer would have actually received in ordinary course, had he lived until the end of his taxable period. But it works serious injustice as applied to many decedents, such as doctors, lawyers, dentists, insurance agents, advertising agents, and the like, whose compensation is subject to delay in determination and payment, and to substantial shrinkage in actual realization by collection. This injustice is gravely accentuated by the broad concept of accrual applied to section 42 by the Supreme Court in the *Enright case*.

The extremes to which the doctrine of the *Enright case* may be carried are shown in a very recent decision of the circuit court of appeals for the fourth circuit in the case of *Helvering* v. *McGlue* (April 10, 1941), P. H. C. D. No. 62, 607, revg. 41 B. T. A. 1186. In this case the court held that section 42 compelled the inclusion in the decedent's gross income reported in the closing return of estimated executor's fees, neither allowed by the probate court nor received by the decedent prior to his death. The court stated that "Had respondent been alive, and had he kept his books on the 'accrual basis' (as that term has been interpreted in many court decisions) we should feel obliged to uphold the Board's

findings that the executor's fees could not have accrued prior to the allowance and approval of these fees by the probate court." Nevertheless, the court felt bound by the *Enright* decision, and held the estimated fees accruable under section 42, since it was the rationale of that decision that it was the intent of Congress by that provision to reach all income earned during the life of the decedent that might otherwise escape income tax. The court said that there was no contingency or uncertainty qualifying the decedent's right to at least a quantum meruit recovery, although there was no finding as to the value of the services on this basis. Furthermore, until the executor's final accounting had been approved by the probate court, appraisal of the value of his rights, even in quantum meruit, would be a matter of guesswork, in view of the possibility of offsets and surcharges arising out of his administration of the estate.

The *Enright doctrine* has very recently been carried to similar extremes in a case involving section 43, relating to deductions. In the case of the estate of *Lewis Cass Ledyard*, 44 B. T. A. No. 162, a substantial amount was held deductible on account of a liability, which was involved in a lawsuit pending at the time of the decedent's death, and which was not settled until more than a year. Such a deduction would not have been allowed on ordinary principles of accrual. The implications of this decision are clearly very adverse to the interests of the revenue.

We recommend the repeal of sections 42 and 43 as the simplest method of rectifying these inequities.

XVIII. *The doctrine of congressional adoption or ratification of administrative regulations by subsequent reenactment of the statute should be abrogated or sharply limited by legislation.*—The past few years have witnessed the judicial evolution and sporadic, though increasing, application (or misapplication) of an ill-defined doctrine that congressional reenactment of a statute, without changes of substance, after the statute has been interpreted in departmental regulations, has the effect of legislative approval or adoption of such regulations. Leading cases for the doctrine are *Brewster* v. *Gage*, 280 U. S. 327; *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110. The result of the application of the doctrine may be tantamount to an incorporation of the regulation into the statute.

The doctrine has been invoked in many cases without regard to whether the regulation in question is a legislative regulation, promulgated under specific authority and direction of Congress to spell out detailed rules necessary to effectuate the general principles of a statute, or is an interpretative regulation setting forth merely an administrative construction. It has been most frequently applied in cases arising under the internal-revenue laws. The Supreme Court has itself vacillated so frequently in its formulations and applications of the rule that it has produced serious uncertainty among taxpayers and confusion among the lower Federal tribunals. The natural tendency in the inferior courts has been to apply the doctrine mechanically, frequently with inequitable or even absurd results. The uncertainty and confusion has been aggravated by several vaguely defined limitations upon the scope of the doctrine itself. The doctrine has met with widespread criticism, mainly adverse, by close students of the problem.[1]

The application of the principle tends to favor the Government, since most Treasury regulations incline to resolve doubts in a manner beneficial to the revenue. Yet there are striking exceptions, among them the recent case of *Helvering* v. *R. J. Reynolds Tobacco Co.*, *supra*, where the court held that Treasury regulations which had survived several reenactments of the statute had been adopted by Congress. These regulations had laid down the unqualified rule that a corporation realized no income from dealing in its own stock. This position had been sharply modified by the Treasury in its regulations under the Revenue Act of 1934, at which time the earlier regulations were also retroactively amended. The court held that the Treasury was bound by the prior regulations, at least so far as it was sought to amend them retroactively.

The uncertainty created by the apparently rigid and far-reaching formulation of the doctrine in the *Reynolds case* was slight compared to the confusion engendered by the decision at the same term in *Helvering* v. *Wilshire Oil Co.* (308

[1] See, especially, Paul, Use and Abuse of Tax Regulations in Statutory Construction, 49 Yale L. J. 660 (1940); Alvord, Treasury Regulations and the Wilshire Oil Case, 40 Col. L. Rev. 252 (1940); Surrey, The Scope and Effect of Treasury Regulations Under the Income, Estate, and Gift Taxes, 88 U. of Pa. L. Rev. 556 (1940); Brown, Regulations, Reenactment, and the Revenue Acts, 54 Harv. L. Rev. 377 (1941); Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398 (1941); Feller, Addendum to the Regulations Problem, 54 Harv. L. Rev. 1311 (1941); Griswold, Postcriptum, 54 Harv. L. Rev. 1323 (1941).

U. S. 90). There the court, by a resort to very technical grounds, distinguished the *Reynolds case* and refused to be bound by a prior regulation where it deemed that doing so would produce a bad result. The *Wilshire case* seems also to indicate that the doctrine does not prevent the administrative authority from modifying regulations presumably adopted by congressional reenactment of the statute, if the amended regulations are limited to prospective operation. This leads to the paradoxical and absurd result that conflicting regulations interpreting identical statutory language may both have the force of law, one before and the other after a particular date, by virtue of the same doctrine of congressional approval.

The uncertainty and confusion created by the foregoing decisions seriously impede the proper administration of the revenue laws. More serious, however, is the threat which the doctrine carries to the integrity of the legislative process itself. It assumes that, when Congress legislates by reenactment of revenue laws, with amendments to only a few sections, it thereby gives its approval to prior regulations interpreting the many sections in which no changes are made. It even assumes familiarity on the part of Congress with the content of such regulations. These assumptions are unrealistic and are based upon ignorance of the legislative process. In occasional instances only, are particular regulations brought to the specific attention of Congress or its Ways and Means and Finance Committees. Only in such cases is there any reason for regarding a failure to amend the section interpreted by the regulation complained of as amounting to legislative approval of such regulation in fact.

Congress lacks the time required for careful analysis of the vast volume of regulations promulgated by the Treasury Department under the tax laws. It is, therefore, invidious policy to attach to the bare reenactment of the statute consequences which should flow only from an express or clearly implied ratification in fact of such regulations by Congress. In the absence of such a ratification, the regulations should carry no additional weight in the courts by virtue of reenactment of the statute.

We believe the situation has become so urgent that it can be satisfactorily solved only by legislation. We therefore recommend that each revenue act contain a specific provision declaring that the reenactment of any portion of the statute shall not be deemed to imply legislative sanction of prior regulations relating thereto, unless (1) Congress specifically declares that it shall have such effect, or (2) a committee report upon the bill providing for such reenactment states that the committee has considered the regulation in question and has found it to contain the proper interpretation of the reenacted statute.

XIX. *Legislative regulations should be promulgated only after public hearings held upon due notice.*—In a limited number of situations under the internal revenue laws, Congress has found it desirable to vest in the Commissioner, with the approval of the Secretary, specific authority to promulgate regulations which may be found necessary to carry out the provisions of a statute. These regulations are very different in their effect and in the functions they perform than the more common type of interpretative regulations, which merely serve to inform the public as to the official interpretation of certain provisions of the statute. They are in reality legislation supplementing the basic statute itself, made under a delegation of power by Congress, within the framework of the general principles and standards contained in the statute. Assuming that the delegation of power itself satisfies constitutional limitations, the regulations, when promulgated, have the force and effect of legislation and can be attacked only if they violate some substantive constitutional guaranty, or contravene the limitations of the statute under which they are promulgated. Hence, it is a matter of relative infrequency for such a regulation to be held invalid.

A good illustration of this type of regulations is found in the case of consolidated returns of railroad corporations, provided by section 141 of the Internal Revenue Code, and consolidated returns of corporations generally for excess-profits-tax purposes, provided by section 730 of the code. In both cases the subject matter is too complicated and technical to permit the spelling out of highly detailed rules in the statute itself. Congress solved this difficulty by conditioning the privilege of filing such returns on consent by the taxpayer to the provisions of regulations promulgated prior to the making of such return, the filing of a return to constitute such consent. The statute itself contains only very general standards to govern such regulations. Regulations of this type, unless held invalid by court decision, are unusually stable and are seldom amended, save when the enactment of another statute permits changes to be made in a new regulation promulgated thereunder, effective only for the future.

We have no quarrel with congressional employment of this device. Indeed, in situations such as the above, its use is a matter of necessity. There may even be increasing occasion for its use in the future. But we think, by reason of the peculiar character of such regulations, that careful control of the procedure followed in their promulgation is necessary in the public interest, as a safeguard against hasty, ill-informed, or arbitrary administrative action in framing them. Congress itself follows the policy of allowing public hearings before framing and enacting important legislation affecting private rights and interests. We believe a similar procedure is necessary here.

In line with the report and recommendations of the President's Committee on Administrative Law and Procedure, we recommend the enactment of legislation requiring the holding of public hearings by the Treasury Department prior to the promulgation of any legislative regulations. Adequate notice of the date and place of such hearings should be given in the Federal Register. In order that such hearings may be of maximum utility, the basis of the hearings should be supplied by the publication in the Federal Register, along with the notice, of a draft of the regulations as tentatively proposed to be issued by the Department. Anyone interested in the subject matter should have the right to appear orally or by brief, or both, to submit criticisms and suggest additions, deletions, and other amendments to the regulations as proposed. Similar requirements should apply to any amendments to such regulations the Department may desire later to make. The validity of any such regulations or amendments thereto should be conditioned upon prior compliance with these requirements.

XX. *The application of the personal holding company surtax to the capital gains of nonresident foreign corporations should be clarified.*—Beginning with the Revenue Act of 1936, Congress deliberately relieved from tax the capital gains of nonresident alien individuals and nonresident foreign corporations not engaged in trade or business or having an office or place of business in the United States. (Secs. 211 (a) and 231 (a), Revenue Act of 1936.) Congress further specifically declared that the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian did not constitute the carrying on of a trade or business (sec. 211 (b)). In lieu of the income taxes formerly imposed, Congress levied a flat-rate tax, ordinarily withheld at the source, on dividends, interest, wages, rents, and other specified types of income, not including capital gains.

In the Revenue Act of 1937, Congress changed the method of taxation of nonresident alien individuals by making them subject to graduated surtaxes where their United States incomes from the specified sources aggregated more than $21,600 for the taxable year. Again, Congress made it clear that their capital gains were excluded from the tax base (sec. 211 (c)).

Despite this clear expression of legislative policy, the Treasury Department has ruled in its regulations that the personal holding company surtax applies to the capital gains of nonresident foreign corporations. (Regs. 94, art. 351–1; Regs. 101, art. 401–1; Regs. 103, sec. 19.500–1.) This is true even if all the stock of the corporation is owned by nonresident alien individuals.

This paradoxical position was adopted in face of the well-known fact that this surtax was aimed at incorporated pocketbooks commonly used by individuals to hold their investments and effectuate their transactions in order to reduce their individual surtaxes. But what possible tax incentive could there be since 1936 for nonresident alien individuals, who were themselves exempt from all taxes on capital gains, to use their corporations to effectuate their capital-gain transactions in the United States? Obviously none. Congress, having exempted nonresident alien individuals and nonresident foreign corporations from any normal or basic tax on their capital gains, cannot reasonably be supposed to have intended to apply this surtax to such gains.

In order to effectuate the clear intent and policy of the statute, we recommend a clarifying amendment which will specifically exclude from taxable income for the purposes of the tax imposed by section 351 of the 1936 act and the corresponding provision of later acts the capital gains and losses of a nonresident foreign corporation, all of whose stock is owned by nonresident alien individuals.

B. The excess-profits tax

I. *The present basis for determination of invested capital should be revised so as to employ cost to the taxpayer in lieu of cost basis as the general rule, with proper provisions for relief in exceptional situations.*—It is respectfully submitted that several important changes in the methods prescribed for the

determination of invested capital are essential in the interests of sound policy and fair and equitable results.

(*a*) The first change which we recommend is that section 718 (a) (2) of the Internal Revenue Code be amended so as to provide for the use of taxpayer's cost instead of tax basis in the computation of invested capital where property is paid in for stock.

Section 718 (a) (2) now reads as follows:

"(2) *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss on sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis, it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113 (b) (2)."

This use of "tax basis" represents a major departure from the old excess-profits tax laws. See section 207 (a) of the Revenue Act of 1917, and section 326 (a) (2) of the Revenue Acts of 1918 and 1921. The basic rule under those acts was that invested capital was increased by "the actual cash value of tangible property paid in, other than cash, for stock or shares." Arbitrary limitations were applied to intangibles paid in. This departure creates a whole host of new complications in the computation of invested capital and will result in serious and indefensible discrimination between corporations similarly situated in many cases, as will be demonstrated hereinafter.

It will be noted that the above provision prescribes as the "tax basis" to be employed the unadjusted basis for determining loss upon a sale or exchange in accordance with the basis provisions of the present law. The report of the Ways and Means Committee on the bill (p. 24) gave as the reason for using unadjusted basis, rather than adjusted basis, that:

"The use of the unadjusted basis is dictated by the fact that adjustments of basis, notably for depreciation, are reflected in earnings and profits * * *."

This is at best only partially true, since such adjustments will often have been made to a basis different from that at which the property is required to be taken into invested capital. In the case of depreciation, this very discrepancy is present, since under section 114 (a) of the code depreciation must be taken on the basis for computing gain, not loss, on the sale or exchange. This difference becomes important wherever March 1, 1913, value is involved. Wherever such disparity of bases exists, the reflection of adjustments to basis in the earnings and profits account will be distorted. This distortion is less than if adjusted tax basis were used, and constitutes one of the lesser objectives to the employment of "tax basis" in section 718 (a) (2).

It is our position, however, that the decision to use "tax basis" at all as a measure of invested capital was not well taken and should be reconsidered. There is no necessary relation, economic or otherwise, between basis for ordinary corporate tax purposes and the concept of invested capital. The chief function of invested capital is to provide a yardstick in determining what part of the profits of a business enterprise are "excess profits" which may properly be subjected to a high-rate graduated tax. If the term "excess profits" means anything at all in this context, it must mean a return in excess of a fair return on the property which the taxpayer is employing in its business and which is thereby exposed to all the risks and hazards of the enterprise. This reality was recognized in the older laws when the cash value of the property paid in was used as a measure of invested capital, although the arbitrary limitations imposed on intangible property paid in were unfortunate and it is well that such distinction has not been adopted in the present law.

The essential problem is, "What capital has been invested in an enterprise by the taxpayer which is subjected to tax." How much capital was invested by some other entity or person in the acquisition of assets subsequently acquired by the taxpayer and employed in its business is of no relevance in determining a fair profit to the taxpayer itself.

A simple case will serve to illustrate this distinction and also to show the results reached under the existing law. Suppose that X corporation, the taxpayer, in 1936 issued one-half its authorized stock of 10,000 shares in consideration of the transfer to it by another corporation or by a group of individuals of certain assets which X employs in its business. At or about the same time X issues the balance of its stock to others for cash, the subscription price being $50

per share or more. Had X sold all its stock for cash at $50 per share, there could be no doubt the cash received would constitute its invested capital. However, under the existing law, if the transactions in which X obtained property for stock were of such nature that, under the basis provisions of the present law, found in section 113 of the code, a carry-over or "substituted" basis will apply to the property so acquired, and the adjusted basis of such assets to the transferors was only $25 per share of the stock issued, then the invested capital of X under the existing law will be only $125,000 ($25×5,000)+$250,000 ($50×5,000) or $375,000, although X has by hypothesis issued stock of a value of $500,000, stock which might have been sold for that amount, in order to acquire the assets employed in its business.

The foregoing illustration will serve to bring out several of the vices inherent in employing tax basis as a yardstick of invested capital. Let it be assumed, as may often be the case, that another corporation, Y, perhaps an actual competitor of X, has a capital structure identical with that of X. The only difference between the two corporations in that Y issued its stock for cash, which it used to purchase the assets needed in its business. The two corporations are both well managed, do about the same volume of business, and enjoy about the same net income. Yet under the existing law, Y will have an invested capital (exclusive of any accumulated earnings and profits) of $500,000, while X has an invested capital of only $375,000. Y's excess profits credit will be correspondingly larger than X's, and X may have to pay a substantial excess-profits tax, while Y, having the same net income, pays little or no tax. Moreover, in the case of X, the 50 percent of shareholders who paid cash for their stock are penalized by the excess-profits tax on the corporation, since the corporate profits available for dividends are thereby reduced, because X is compelled by section 113 of the code to use its transferror's basis for normal tax purposes with respect to the assets acquired through the issuance of stock. Only very weighty considerations can justify such manifest discrimination in a tax law.

It is believed that there are no such considerations. It may be contended that these paradoxical results are justified because in the case in which assets were exchanged for stock gain or loss was not recognized to the transferors; therefore, the law should not permit the stepping up of invested capital with respect to the interest so transferred. There are several cogent answers to this argument.

First: Whatever substance it may seem to have, it is fairly applicable only to such nontaxable transactions consummated after the effective date of excess-profits-tax law. There may be reasons why, with such a law on the books, Congress might deem it wise policy to condition any increase in invested capital by means of a reorganization upon the recognition of gain to the transferors in the transaction, at least where there is no substantial change in ownership or control. But such considerations of policy could not apply to such transactions consummated in prior years when the parties never dreamed of the possibility of an excess-profits tax, and when the only tax benefit derived from nonrecognition of gain was the postponement of normal taxes. This benefit bore no relation to taxes on excess profits. But to penalize transferee corporations and their present stockholders years later by heavy excess-profits tax computed upon a base which is arbitrarily reduced cannot be justified either as a matter of policy or equity.

Second: The argument proves too much. It confuses the investment of the corporation issuing the stock with the investment of the owners of the stock in their shares. A simple illustration will help to illuminate the point. Suppose that corporation S issued its stock originally to A, B, and C for $50 in cash per share. The corporation has prospered and its assets have appreciated in value so that its stock is now worth $100 a share. A, B, and C sell their stock at that figure to M, N, and O, gain being recognized to A, B, and C, of course, on the transfers. Such transactions have no effect upon S's invested capital. It remains the amount of cash received, plus any accumulated earnings and profits. If the increase in the value of its shares is due entirely, as it might be, to unrealized appreciation in the value of its assets rather than to accumulated earnings, the corporate invested capital would be only one-half of the investment of its new shareholders in their equities. In the converse situation, there is no reason why the corporate invested capital should be limited by the investment of those who transferred assets to it for its stock, where for any reason the value of the stock when issued exceeds the transferors' investment.

Third: The provisions of the existing law are not even consistent, in that they do not in fact require a corporation issuing stock for assets to use tax basis in all cases where no gain was recognized to the transferors in the transaction by

which the property was acquired. The reason for this is that section 113 of the code, the present law which is made applicable, does not prescribe the transferor's basis as the basis of the transferee in every case in which no gain or loss was recognized to the transferor under the law applicable to the year in which the transfer was made. A striking case of this sort is one of a reorganization where the tax basis is governed by section 113 (a) (7) (a) of the code, that is, a transfer by a corporation in connection with a reorganization in a taxable year beginning prior to January 1, 1936, where immediately after the transfer an interest or control of less than 50 percent remained in the same persons or any of them. Similarly, many reorganizations were treated as tax-free in prior years under interpretations of the law which have since been disturbed or overthrown by the judicial introduction of nonstatutory overriding doctrines such as the "germaine to business" requirement of *Gregory* v. *Helvering* (293 U. S. 465 (1935)), the "continuity of interest" requirement of *Helvering* v. *Minnesota Tea Co.* (296 U. S. 378 (1935)), and *LeTulle* v. *Schofield* (308 U. S. 415 (1940)), and the "party to the reorganization" requirement of *Helvering* v. *Bashford* (302 U. S. 454 (1938)), and *Groman* v. *Commissioner* (302 U. S. 82 (1937)). In many of these cases, taxpayers are free to use cost rather than transferor's basis in computing invested capital, subject only to the adjustments prescribed by sections 3801 or 734 of the code. These sections do not apply to the cases governed by section 113 (a) (7) (a) of the code, referred to above.

It is probable, however, that section 718 (a) (2), in its use of "tax basis," will be defended chiefly upon the ground of administrative convenience or simplicity. It will be said that the use of taxpayer's cost would involve many difficult problems of valuation of the stock issued in consideration therefor. There are several sufficient answers to this argument. In the first place, while administrative convenience is entitled to due weight, it does not justify inflicting serious hardship and discrimination. In the second place, the apprehended difficulties of valuation may be easily exaggerated. The Bureau of Internal Revenue is in a far better position to administer problems of valuation without undue controversy or litigation than it was under the earlier excess-profits tax laws. In many cases stock-exchange sales and over-the-counter transactions will afford ready evidence of values of the stocks involved. Vast stores of information, in the form of balance sheets and profit-and-loss statements of thousands of corporations, appraisals of corporate securities for estate- and gift-tax purposes and the like, accumulated over a long period of years, are now available in Bureau files. The Securities and Exchange Commission and other Federal agencies possess great amounts of relevant and trustworthy data with respect to corporate valuations. All these resources, if intelligently used, would minimize the seriousness of the valuation problem.

Finally, in appraising the merit of the administrative argument based on valuation, the formidable difficulties inherent in the "tax basis" rule of the present law should not be ignored. The use of the basis for determining loss rather than gain, in order to eliminate March 1, 1913, value as a substitute for cost in the case of property acquired prior to that date, will require that records be traced back in all cases to the original acquisition of property by the taxpayer in order to determine its cost. Moreover, where the taxpayer acquired the property in a transaction resulting in a substituted basis under section 113, it will then be essential to trace the records back to the acquisition of the property by the taxpayer's predecessor to determine such predecessor's original cost. In many cases, the necessary records will be missing or will be incomplete and unsatisfactory.

It is obvious that the administration of these requirements will present an unknown number and variety of knotty issues of law and fact and very formidable difficulties of proof.

Furthermore, the requirement of the third sentence of section 718 (a) (2) that, where property has been disposed of prior to the taxable year, the basis shall be determined as if such property were still "held" has the effect of applying the present basis provisions of section 113 of the code to all transactions, even though the property may have been acquired and disposed of at a time when the basis provisions were different from those of the present law, and the resulting gain or loss may have been computed in accordance with the earlier provision. This is particularly significant in view of the reduction of the control requirement in a "control reorganization" from 80 to 50 percent by section 113 (a) (7) of the Revenue Act of 1932, which reduction was applied retroactively to acquisitions of property occurring prior to 1932. It is apparent that the effect of these requirements incidental to the use of the "tax basis" rule will be to require a reexamination of a vast number of transactions consummated in prior years.

This necessity goes far to rebut the claim of administrative convenience advanced to support the adoption of the "tax basis" rule.

Finally, the existing law involves all the difficulties of valuation in the very class of cases in which they are likely to be most acute, viz, cases where property was acquired by taxpayers for stock prior to January 1, 1918, or, in some cases, prior to January 1, 1921.

A careful analysis and weighing of all relevant factors leads to the conclusion that the use of taxpayer's cost to measure invested capital, where assets, other than cash, are paid in for stock, will present less difficulties of administration than the existing "tax basis" rule. Certainly, it will be more easily understood by taxpayers than the bewildering complexities of law and fact which the determination of "tax basis" often involves.

We recognize that there are situations, especially those involving reorganizations and readjustments under court decree, in which a rigid adherence to the general rule of taxpayer's cost would lead to serious hardships. We believe that the proper remedy for such situations lies in the enactment of appropriate special relief provisions, rather than the infliction of the present unsound rule of tax basis upon the majority of growing enterprises whose future prosperity is of such great moment to the economic welfare of the Nation.

II. *Use of determination of invested capital under World War excess-profits tax as the starting point for present purposes should be allowed.*—It is recommended that the excess-profits tax law be amended so as to permit a taxpayer which computes an excess-profits tax credit under section 714 (invested capital) to use, as its "starting point," its invested capital as finally determined under the 1918 act, pursuant to rules and regulations promulgated by the Commissioner with the approval of the Secretary.

There are many thousands of corporate taxpayers throughout the Nation who filed returns for excess-profits tax purposes under the World War excess-profits tax law. In virtually all of these cases, determinations of invested capital were made for purposes of the 1918 act, either by judicial decision which has become final or by administrative determinations which have become final in effect because of the statutes of limitation.

It would be highly convenient if the statute permitted such corporations to use these determinations as the starting point in making their computations of their current invested capital. It would save many of them enormous burdens of tracing old records of themselves or of predecessors to determine original cost. No grounds for serious objection to this proposal are apparent, particularly if section 718 (a) (2) is amended so as to substitute taxpayer's cost or the fair value of assets paid in as the measure of invested capital in cases where property is acquired for stock or paid in as surplus or as a contribution to capital. The permission to do this should, of course, be granted subject to compliance with Treasury regulations which would prescribe the necessary adjustments and the manner of making them in order to conform to the structure of the present law.

It is believed the adoption of this recommendation would greatly facilitate the application and administration of the excess-profits tax law, both from the point of view of the Government and the taxpayer. Special provisions might be needed in the law or regulations to extend the privilege to an acquiring corporation to use such final determinations of invested capital of one or more qualified component corporations in computing its own invested capital.

III. *Advances by governments to American contractors should be treated as borrowed capital.*—Section 719 (a) (2) of the present law made provision for the inclusion in borrowed capital, under certain conditions, of amounts received as advance payments under contracts entered into with a foreign government before the date of enactment of the law or 30 days thereafter, for furnishing articles, materials, or supplies of such foreign government.

We recommend that this section be amended so as to strike out the limitation date and so as to make its provisions applicable also to such contracts entered into with the United States Government. No good reason has been suggested why the provision should be limited to contracts with foreign governments. The policy underlying it seems equally applicable to contracts with our own Government.

The only apparent reason for the time limitation, which restricts the application of the provision to contracts entered into with foreign governments prior to November 8, 1940, is that it may have been assumed that the period allowed would be sufficient to enable contractors to arrange their future dealings with foreign governments so that any advance payments would be given the form of loans which would constitute borrowed capital under section 719 (a) (1). This assumption, if made, was erroneous. Such changes in established forms and prac-

tices of foreign governments could be made, if at all, only after protracted negotiations. Such negotiations interfere with expeditious delivery of essential war materials to them. Since it is not believed the time limit is necessary to prevent abuses under this section, it is recommended that it should be removed.

It is also recommended, in the interest of simplification and ease of administration, that section 719 (a) (2) be further amended so as to permit the inclusion in borrowed capital of that part of the advance payment which has not been applied to the purchase price of articles furnished under the contract at the beginning of the given day. It is extremely difficult, because of unknown factors and uncertainties which are often present, to determine in many cases how much of the advance would be repayable to the foreign government, if the contract were to be canceled on any given date, as the existing provision requires.

IV. *Modification of the requirement of computations based upon daily averages and ratios should be made.*—It is recommended that the various provisions of the statute which require computations of invested capital by the use of daily averages (secs. 715 and 716), computation of net capital changes in computing the excess-profits credit based on income (sec. 713 (g)), and the determination of the ratio between admissible and inadmissible assets (sec. 720) be amended so as to vest the Commissioner with general power by regulations to waive such rigid requirements where in his judgment the circumstances do not demand the use of daily averages or ratios and, in lieu thereof, to permit the use of ratios on a monthly, annual, or other appropriate basis.

The adoption of this recommendation would restore section 715, in essentials, to the form it had in the Senate bill in 1940. The Senate provision was unfortunately reduced to an absurdity in conference, where it was changed to limit the Commissioner's power to relax the requirement of dairy computation only if he finds that it will not change the results by more than $1,000. This leads to the anomalous result that the taxpayer must first make the daily computations in order to ascertain whether or not it must make them.

The apparent purpose of the requirement of dairy computations is to reflect a highly exact weighted average for changes in invested capital occurring during the taxable year. While reasonable accuracy is desirable, it is believed that the rigid requirements of the present law impose upon taxpayers burdens of computation, which are disproportionate to the protection of the revenue afforded thereby. No such precision was found necessary in the earlier excess-profits tax laws where monthly averages were commonly employed. The Commissioner by regulation can provide ample safeguards to cover cases where relatively substantial changes in invested capital occur by reason of large new stock issues, heavy borrowings, or large capital distributions.

Under section 720, relating to admissible and inadmissible assets, a rigid adherence to the requirement of daily computations would have created insuperable difficulties making the law unworkable, since it would have necessitated daily adjustments to basis for depreciation and depletion, and daily valuation of inventories and of other assets on hand. No accounting method heretofore devised was capable of meeting such demands. Fortunately, the rigidity of these requirements was somewhat relaxed by the excess-profits tax regulations. (See Regulations 109, sec. 30.720–1.) While section 720 (b) perhaps gives some statutory support to the regulations, their validity should not be left open to any doubt.

We believe the proper solution, one which will facilitate the administration of the law and measurably relieve the burden of preparing the returns, is to grant power to dispense by regulation with daily averages and ratios to the extent the Commissioner deems it advisable to do so.

V. *Discriminations against the earnings basis should be removed.*—The enactment of a heavy graduated tax on excess profits in 1940 was justified largely on the ground of prevention of profiteering and the creation of a new crop of millionaires out of profits attributable to the defense program. (House of Representatives, 76th Cong., 3d sess., Rept. No. 2491, p. 3; Rept. No. 2894, pp. 1, 2. House of Representatives, 77th Cong., 1st sess., Rept. No. 146, p. 1.) There has been little apparent disposition anywhere to quarrel with these objectives. In accordance with this policy, the Congress in the Excess Profits Tax Act of 1940 wisely provided that either the average income method or the invested capital method might be used in computing the excess-profits credit. Congress thereby recognized and applied the principle that an excess-profits tax should as its name implies, apply only to excess profits. Normal profits

should not be subjected to such a tax, but should make their chief contribution to the fiscal needs of the Government through the normal tax. This principle was again recognized in the amendments enacted in March 1941 which introduced several needed refinements into the measurement of normal profits.

While much progress along sound lines has been made, it is believed that a number of additional changes are needed to eliminate inequities and to prevent the heavy burden of excess-profits tax from falling upon normal profits. Otherwise, the resources of many corporations, which are necessary to the maintenance of a healthy financial structure and to the provision of reserves, which will be essential to carry them through the period of painful readjustment after the present crisis is over, will be depleted.

The present law is still marred by several discriminations against the average earnings method of computing the excess profits credit. These discriminations should be removed. One of these discriminations is the limitation of the excess profits credit under section 713 to 95 percent of the average base period excess profits net income. It is respectfully recommended that this percentage should be increased to 100 percent.

Proposals that the percentage be further reduced are unwise and economically unsound and should be rejected. Their effect is to transform the tax upon excess profits into a high rate graduated tax on normal profits, in violation of the policy deliberately enunciated by the Congress as recently as March of this year. The consequences of such a change to thousands of corporations and to the economy as a whole are certain to be serious.

It is recommended that corporations using the income method be permitted to use their experience in any 3 of the 4 years of the base period in computing their average base period excess-profits net income.

Under the existing law (sec. 714 (e)), a taxpayer must aggregate the excess-profits net income for its taxable years 1936, 1937, 1938, and 1939. The aggregate of any loss year is subtracted from the aggregate of the plus year, except that the largest loss year is treated as zero. The resulting figure is then divided by the total number of months for all the taxable years, usually but not always 48, in the base period and multiplied by 12 in order to obtain the average base period excess-profits net income. This can in no event be less than zero.

The chief defect of this formula, as a yardstick for determining normal profits, is that the years 1936–39, which constitutes the base period, were not a period of normal earnings for most American corporations. Many companies suffered depressed conditions during a major part of the period. For many others, who made reasonably good earnings in 1936 or 1937, or both, 1938 was a bad year and resulted either in losses or severe decline in profits. Many of these companies enjoyed only a partial recovery in 1939. Consequently, an average of earnings in the 4 years of this period is not a fair measure of normal profits, even though the largest of the deficit years is treated as zero. Such year is still included in the number of years used in computing the average.

While section 713 (f), the so-called normal-growth provision, added to the law by the March amendments, is an excellent modification, its utility is limited in many cases because the year 1938, a bad year for a majority of corporations, falls in the latter half of the base period.

It is believed that average base period net income, as a yardstick of normal profits, will be greatly improved by a further amendment which will permit taxpayers to select any 3 of the 4 years in the base period in computing the average, the aggregate net incomes for such period to be divided by three.

A possible alternative amendment is also suggested which would permit a taxpayer to exclude any 1 year in the base period, where the excess-profits net income for such year is less than 65 percent (roughly two-thirds) of the average exceess profits net income for the other 3 years of such period. Attention is called, in this connection, to the fact that the British act allows a choice of any 2 of 3 years; also that the Canadian Excess Profits Tax Act is being amended this year so as to give a taxpayer the right, in computing its standard profits for the standard or base period (1936–40) to drop 1 year if the profits for such year were less than 50 percent of the average profits of the other 3 years (or in the case of taxpayers who have been in business only 3 years during the standard period, if the results of 1 year were less than the average of the profits of the other 3 years). While it is believed that this Canadian amendment is sound in its purpose, it is thought that 50 percent is too low, and that the percentage should be at least 65 percent.

VI. *Excess profits should be measured over a longer period.*—The profits of a great majority of enterprises are subject to wide variations from year to year. In certain types of business, particularly the so-called durable-goods industries, these fluctuations are often extreme in character. One or two years of large profits may be followed by several years of heavy losses. Many other enterprises deem themselves fortunate to have as many as 2 years of substantial profits in any 5-year period.

Congress has recognized the unsoundness and inequity of taxing business profits, even under a normal tax, solely on an annual basis. In the Revenue Act of 1939 it restored to the law a 2-year carry-over of net operating losses. See section 23 (s) and section 122 of the Internal Revenue Code. To the extent of their application, these provisions give some relief from hardships which would be intolerable if any excess-profits tax at very high rates were imposed strictly upon an annual basis.

The relief provided by a 2-year carry-over, however, is clearly inadequate for the purposes of a heavy excess-profits tax. Heavy loss years may be followed by 2 or more years when earnings are meager. If, thereafter, there are 1 or more years of large profits, a corporation may be mulcted of a large part of such profits by the tax, although a part of such profits is badly needed to repair the damage to its fiscal structure caused by the prior loss years. A carry-over of operating net losses for a minimum period of 5 years is necessary, at least for the purposes of the excess-profits tax, adequately to prevent hardships of this character. Such hardships are very injurious to the national economy.

The 1941 amendment to section 710 (b) (3) and 710 (c) which extended to all corporations subject to excess-profits tax the privilege of carrying forward for 2 years unused excess-profits credits should also be broadened in order adequately to accomplish its purpose. This sound provision evidences a partial recognition by Congress that it is sound policy to regard the emergency period as a whole in measuring excess profits which are to be taxed. Here also, however, the effectuation of such policy is in substantial measure defeated by the shortness of the period within which the carry-over may operate. It is submitted that the period of the carry-over should be extended to at least 5 years, and that section 710 should also be amended to allow unused excess-profits credits to be carried back for a reasonable period, perhaps 2 years, so as to reduce excess-profits tax liabilities for such years. An appropriate provision should, of course, be inserted to prevent the beneficial use of the same unused excess-profits credit under both the carry-over and carry-back provisions.

Since it is probable that many corporations will suffer heavy losses during the period of readjustment following the present crisis and the termination of extraordinary expenditures for national defense, it is believed it would be wise policy to provide that corporations suffering such losses during the first 2 years after the termination of the emergency, such termination to be evidenced in such manner as the Congress may see fit to provide, shall be permitted to apply such losses against earnings during the emergency period, so as to reduce prior excess-profits taxes. There is legislative precedent for such a measure in the 1918 act, which permitted inventory losses in 1919 to be offset against 1918 income. Unless some such protective measure is provided, the resources of many corporations will be so depleted that they cannot weather the strain of such subsequent losses. Widespread bankruptcy and increase in unemployment will result.

It is therefore recommended that the law be amended in the following respects:

1. To extend the period of carry-over of net operating losses to 5 years for purposes of both the normal tax and the excess-profits tax.

2. To extend the period of carry-over of unused excess-profits tax credits to 5 years.

3. To permit unused excess-profits tax credits to be carried back for a period of 2 years.

4. To allow operating net losses to the extent thereof incurred during the first 2 years after the termination of the present emergency to be used, to the extent thereof, to offset excess profits net income during the emergency.

VII. *The excess-profits-tax rate schedules should be revised.*—Under the present law (sec. 710 of the code) the tax brackets in the rate schedule are based exclusively upon the amounts of excess profits without regard to the ratio of excess profits to the normal profits. This leads to the paradox that corporations A and B, which have the same amount of excess profits, will pay the same tax, although the earnings of A may be 50 percent of its invested capital or several times its base period earnings while the earnings of B, because of its greater

corporate size, may be only 9 or 10 percent of its invested capital or 5 or 10 percent in excess of its base period earnings. A schedule of rates so constructed destroys the character of the tax as a true excess profits tax and makes it a tax upon mere size. As such, it discriminates seriously against stockholders, large and small, of big corporations.

The excess-profits-tax laws of 1917, 1918, and 1921 were based upon the equitable principle that excess-profits-tax rates should be based primarily upon the ratio between the excess profits and the exempt profits, rather than upon the dollar amount of the excess profits. The brackets were so adjusted as to subject a reasonable amount of excess profits to taxation at the lower rates. The soundness of this principle was also recognized in the report of the Ways and Means Subcommittee under date of August 8, 1940.

The departure from this principle in the rate schedules as now constituted is responsible for many of the complexities of the existing law, such as the provisions in supplement B, relating to the highest bracket amount in supplement B. The statute could be considerably simplified by a return to the principle of the earlier acts.

It is recognized, however, that the Congress may deem it unwise to impose excess-profits tax at the higher rates on small income corporations. If so, such a result can be easily avoided by substituting for the present schedule a schedule, such as was contained in section 710 of the Senate bill in 1940, containing alternative excess-profits-tax rates based on dollar amounts of excess profits or the ratio to excess profits to the excess-profits credit. It should be noted also that the inequity of the present rate schedule becomes greater the higher the rates of tax which are applied.

It is therefore recommended that section 710 be amended to incorporate alternative tax brackets based upon the percentage ratio of excess profits to the excess-profits credit.

VIII. *Section 734 should be revised.*—This section was added to the code by the March 1941 amendments to the Excess Profits Tax Act. Its professed purpose is to provide for an equitable adjustment, in the form of an addition to or subtraction from the excess-profits-tax liability for the taxable year, when a determination of the excess-profits-tax liability treats an item in a manner inconsistent with the treatment of such item in determining the income-tax liability of the taxpayer or its predecessor for any prior taxable year, i. e., any taxable year beginning before January 1, 1940.

It is recommended that this section be carefully revised and the scope of its application more precisely defined. Otherwise, it is certain to have a very disturbing effect and to cause serious uncertainty and confusion. As now drawn, the provision may operate to produce an adjustment on account of inconsistency in the treatment of items as far back as 1913, including the wartime excess-profits-tax years with respect to which the bar of the statute of limitations has fallen long since. The result is that the taxpayer of the Bureau may be compelled to search through all the income-tax records from 1913 to date in order to ascertain whether the computation of the excess-profits credit for the taxable year involves the treatment of any item "in a manner inconsistent with the treatment accorded such item in the determination of the income-tax liability of such taxpayer or a predecessor for a prior taxable year or years." With respect to many of these years, the tax returns or other essential records and data may be no longer available.

The section in its present form leaves the meaning of several important terms undefined or obscure. For instance, what is meant by an "item"? Section 734 lacks the detailed provisions found in section 3801 of the code in this connection. What is meant by the term "inconsistent"? During the period of more than 25 years in which income-tax laws affecting corporations have been in effect there have been numerous changes in the statute itself, not to mention the changes in its practical application due to changing judicial interpretation. Is there "inconsistency" within the meaning of the section where the treatment of a given item in the prior taxable year was correct under the statute and/or regulations then in effect, merely because the statute and/or regulations prescribe a different rule for the taxable year to which the determination relates? Or is there "inconsistency" only when the treatment of the item in the prior year is found to be erroneous under the law which was applicable in that year? It is submitted that the latter is the correct rule. In any event, the section should leave no doubt on this basic question. Otherwise, it may become a Pandora's box of confession and controversy.

In this connection, attention is called to the fact that section 115 (1) of the code (sec. 501 of the Second Revenue Act of 1940), relating to earnings and profits of corporations, was made applicable retroactively to the date of enactment of all prior revenue acts. It is probable that such retroactive application may cause determinations heretofore made for certain prior years to be incorrect. It is possible that the treatment of certain items in the computation of the excess-profits-tax credit, such as accumulated earnings and profits and the basis of stock held or formerly held, in accordance with the principles prescribed by section 115 (1) may create an inconsistency upon which section 734 would operate. This would be a paradoxical result, since the inconsistency would not be due to the taxpayer's volition but would be forced upon him by statutory changes made by Congress itself.

In order to obviate any such result, it is recommended that section 734 be amended so as to make it inapplicable in any case in which the inconsistent treatment of an item in the taxable year is caused by a change in the statute. It is also believed that the same principle should apply to cases in which the inconsistency results from a change in Treasury regulations. Why should a taxpayer be penalized where in the tax returns for both years it has complied in good faith with the current applicable regulations, because it subsequently develops that the prior regulation was based upon an erroneous interpretation of the statute by the Treasury Department?

It is also recommended that section 734 be amended so as to impose a 6-year limitation upon its operation. This would mean that the adjustment prescribed by it would be made only where the inconsistent treatment of an item occurred in a taxable year beginning after December 31, 1935. Such a provision would accord with the limitation prescribed in the application of section 3801 of the code. This provision became law in section 820 of the Revenue Act of 1938 and its operation was confined to taxable years beginning on or after January 1, 1932. Such a limitation would obviate the interminable search of old returns and records to uncover possible inconsistencies in the computation of the excess-profits credit. In the absence of such a search, it is highly probable that both the taxpayers and the Commissioner will unwittingly adopt inconsistent positions in the taxable year and will not discover the fact until after a determination is made. It will then be too late to withdraw from the inconsistent position, even where the party would otherwise desire to do so.

It is recommended that at least three other amendments to the section be made in the interest of clarity and fairness.

(1) The relation between section 734 and section 3801 of the code should be precisely defined. While it is probable such a result was not contemplated or intended, it is possible that an adjustment might be required under section 3801 in a case to which section 734 had previously been applied. It is suggested that any possibility of double adjustment could be avoided by an amendment to either section 3801 or section 734 which would make section 3801 inapplicable in any case to which section 734 applies.

(2) Section 734 should be clarified to preclude the possibility of an adjustment with respect to a particular item, in the treatment of which inconsistency exists, to more than a single taxable year, preferably the first taxable year under the excess-profits tax law in which such inconsistency appears. It is probable that this is the intent of the present law. If so, it should be made clear. To illustrate: Suppose that corporation X, in its excess-profits tax return for 1940, claims a basis for depreciation with respect to an asset higher than the basis which would be consistent with the tax treatment accorded to the acquisition of the asset in a prior taxable year. The use of the higher basis for 1940 is sustained in a subsequent determination, and an adjustment is made in the manner provided by section 734 (c) and (d). In its return for 1941, such higher basis is again used by X and such use is sustained in a subsequent determination. Another adjustment under section 734 should not be made.

In accordance with the same principle of prevention of multiple adjustments by virtue of the same inconsistency, if X had first claimed the higher basis in 1938 or 1939 and, as a result of a final determination sustaining his claim, an adjustment had been made on account thereof in the manner provided by section 3801 of the code, no adjustment should be made under section 734 because such higher basis was used by X in computing its excess-profits credit for the taxable year 1940 and subsequent years.

(3) Doubt has arisen whether interest included in determining the amount of the adjustment in the manner provided by section 734 (d) loses its character as interest for other purposes under the revenue laws. For instance, where such

interest forms a part of the amount added to the excess-profits tax for the taxable year, is the amount thereof deductible by the taxpayer under section 23 (b) of the code, whether it be on the cash or accrual basis? Similarly, is the included interest, where the adjustment constitutes a decrease, includible in the taxpayer's gross income under section 22 (a) of the code, whether it be on the cash or accrual basis?

Any doubt on this score should be resolved by an appropriate amendment, thereby preventing unnecessary controversy and litigation.

IX. *Section 718 (c) (2) should be repealed.*—Section 718 (c) (2) of the code provides that, for the purposes of section 718 (a) and (b), relating to the determination of equity invested capital and reduction in equity invested capital, distributions to shareholders in any taxable year beginning after December 31, 1940, to the extent they do not exceed the accumulated earnings and profits as of the beginning of the taxable year, if made during the first 60 days of the succeeding taxable year, shall be considered to have been made on the last day of the preceding taxable year.

It is recommended that the above provision be repealed.

This provision was taken from a similar provision in the 1918 act, section 201 (e). Its purpose is undoubtedly to discourage postponement of distributions into a succeeding year in order to minimize or postpone the reduction in the equity-invested capital of the prior year. The effect of the provision, however, may be easily avoided by taxpayers, who are inclined to adopt this rather petty form of tax avoidance, by postponing the distribution slightly more than 60 days beyond the beginning of the subsequent year.

The presence of this provision in the law, however, is a source of confusion and uncertainty because it runs contrary to the general provision of the code (sec. 115 (b)) relative to the source of distributions, viz, that "every distribution is made out of earnings and profits to the extent thereof, and from the most recenly accumulated earnings or profits." Also, there is doubt as to when a distribution is "made" within the meaning of the provision. Must a dividend be actually paid within the 60-day period in order for it to be applicable, or is the date of declaration or the record date determining?

Since the provision is so easy to avoid and the abuse at which it is directed is not serious, and in view of the uncertainty it creates, it is believed its repeal is desirable.

X. *Sections relating to basis should be revised.*—(1) Adjustments to basis for invested-capital purposes, with respect to depreciation, depletion, etc., should be such as are appropriate to the basis for loss.

It has earlier been pointed out, in connection with recommendation No. I, relating to the elimination of the "tax basis" rule from section 718 (a) (2), that the reflection of adjustments to basis in the earnings and profits account, and, therefore, in invested capital, will be distorted in any case in which March 1, 1913, value is involved. This distortion is due to the fact that the adjustments to basis with respect to depreciation and depletion are required, under section 114 (a) and (b) of the code, to be taken to the basis for determining gain, while the basis reflected in invested capital under such sections as 718 (a) (2) and 720 (b), relating to admissible and inadmissible assets, is the basis for loss. It may be noted in this connection that section 718 (a) (5), relating to increase on account of gain on tax-free liquidation, and section 718 (b) (4), relating to reduction on account of loss on tax-free liquidation, do not specify whether the adjusted basis to be employed is that for gain or for loss. However, regulations 109, section 30.718-5, prescribe adjusted basis for determining loss. The statute itself should, of course, prescribe specifically in all cases which basis is to be used.

It is recommended that all the above sections, which prescribe the use of basis for loss in connection with the computation of invested capital, be amended so as to provide that adjustments to such basis which may be required shall, for purposes of the excess-profits tax, be such as are appropriate to the basis for loss. Such an amendment will be in accord with the sound principle contained in section 115 (1) (2) of the code, which provides that "where in determining the adjusted basis used in computing such realized gain or loss the adjustment differs from the adjustment proper for determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided."

(2) It is recommended that the provisions of section 718 (a) (5) and 718 (b) (4) be limited in their operation to the case where property acquired by a parent

corporation on the liquidation of a subsidiary is thereafter sold or otherwise disposed of in a taxable transaction.

This result would accord with that provided by an exception in these sections in cases where the parent corporation has elected, under section 113 (a) (15) of the Revenue Act of 1936, as amended by section 808 of the 1938 act.

The above provisions, as now drawn, produce very unfair results in many cases by compelling an adjustment in equity-invested capital to be made in the year of the liquidation, rather than in the year when property acquired on such liquidation is sold. A simple illustration will demonstrate this fact. Suppose that X corporation owns all the stock of Y corporation, acquired at a cost of $1,000,000, which is also its adjusted basis for determining loss. Such stock is a part of X's invested capital but is treated as an inadmissible asset under section 720. If the stock were sold for that amount, there would be no change in invested capital as such, but the inadmissible asset would become an admissible asset. Suppose, however, that in 1941 X liquidates Y into itself under section 112 (b) (6) of the code. The fair market value of Y's assets, including goodwill and other intangibles, is at least $1,000,000, but the adjusted basis of such assets to Y prior to the liquidation is only $500,000. Y has no liabilities.

In the illustration put, were it not for section 718 (b) (4), the only effect of the liquidation upon X's invested capital would be to change $1,000,000, the adjusted basis of its stock in Y, from an inadmissible to an admissible asset. The effect of 718 (b) (4), however, is to compel X immediately to reduce its equity-invested capital by $500,000, the excess of its adjusted basis of the stock over the subsidiary's basis of the assets acquired by X on the liquidation. It is assumed, of course, that X's accumulated earnings and profits at the beginning of the taxable year were at least $500,000. Otherwise, the adjustment would not exceed the amount of such earnings and profits.

The only apparent reason for section 718 (b) (4) is that if X should subsequently sell all the assets acquired on the liquidation for an amount equal to its adjusted basis of the Y stock, thereby realizing a gain of $500,000 over the tax basis of the assets, earnings and profits would be increased by that amount. If no offsetting adjustment were provided by the statute, the result would be to "step up" X's invested capital by $500,000 over its actual investment in the acquisition of the Y stock. But this reason does not justify compelling the adjustment to equity capital to be made in the year of the liquidation. The hardship resulting to the parent corporation is apparent in the illustration and similar cases. Liquidations under section 112 (b) (6) are not commonly made with a view to a subsequent sale of the assets by the parent. On the contrary, they are usually for the purpose of continuance of the business of the subsidiary by the parent corporation. The hardship will be particularly severe where, as in the above case, a principal part of the value of the assets taken over consists of goodwill, trade-marks, and similar intangibles which can usually be sold only as a part of a sale of the business itself.

No unfairness to the revenue is apparent if the adjustment prescribed by section 718 (b) (4) is confined to cases of subsequent sale or other taxable disposition of property acquired on the liquidation. On the contrary, the correlative adjustment by way of increase in equity capital, provided by section 718 (a) (5), in cases where the parent's basis of the stock is less than the basis of the assets acquired, creates perhaps the most serious loophole for tax avoidance in the excess-profits-tax law. It is this provision which makes it possible for a corporation to acquire at depreciated prices the stock of another corporation with a high invested capital base and, by liquidating it into itself under section 112 (b) (6), forthwith to "step up" its own invested capital by an amount substantially in excess of its own actual investment.

The enactment of the amendment we recommend will, therefore, be in the interest of the revenue as well as equity to taxpayers.

XI. *Additional special relief provisions should be enacted.*—Congress has already manifested a desire that the excess-profits tax shall not operate inequitably or oppressively through taxing as excess profits earnings which are in reality normal profits. The fact that the Congress in 1940 insisted upon allowing the use of average-income experience during a standard period as the basic yardstick of normal profits is impressive evidence of this fact. The alternative invested-capital yardstick was in effect relegated to the status of a relief provision for those corporations which, by reason of low earnings or losses during the base period, would have been taxed unfairly if compelled to use the average-earnings formula.

Congress has also recognized, however, that neither of these yardsticks can be depended upon to afford equitable treatment to all taxpayers and that some provisions for equitable relief in meritorious cases are imperative. Much that is constructive has already been accomplished in such provisions as section 713 (f), the so-called normal growth provision, section 721, relating to abnormalities in income in the taxable period, and section 722, relating to abnormalities in income during the base period. Unfortunately, since the elimination of section 722 of the Second Revenue Act of 1940 by the March 1941 amendments, there is no provision whatever for relief in special cases involving abnormalities in invested capital. Many of these taxpayers may be able to get fair treatment by using the average-earnings method, but it is certain such will not be the case in many instances. Thus, there is a complete absence of any relief provisions for those classes of corporations which are legally compelled to compute their excess-profits credit, in whole or in part, on the basis of invested capital. They include new corporations, corporations having to construct an excess-profits net income for a part of the base period by using a percentage of invested capital, and many foreign corporations.

The fact is that no yardstick or set of yardsticks has yet been evolved which will measure excess profits or normal profits with tolerable accuracy in all cases. The variations and peculiarities of circumstances, including business and financial history, in individual cases is so great that no set of statutory formulas, however precise and elaborate they may be, will afford essential equitable relief in more than a majority of instances.

There are several reasons for this. One is the great complexity and diversity of business itself. Another is that the base period years of 1936 to 1939, inclusive, were not a period of normal earnings for business in general, much less for particular taxpayers. A third difficulty is that, in many businesses, invested capital is not the chief, or even a major, income-producing factor. Particular cases cover the whole scale from those where capital is the principal factor to those where its importance is almost negligible. The special provisions of section 725, relating to personal-service corporations, apply only to a fraction of the corporations where invested capital is relatively unimportant. Finally, there is no single normal rate of return which will suffice to attract investment of capital in all types of enterprise. The rate of return must necessarily vary considerably according to the degree of risk involved. It is believed that, in general, an 8-percent return on equity capital is about the minimum essential to secure such capital, but in many cases the hazard is so great that a higher rate is required.

All these factors combine to prove the necessity of a broad, equitable relief provision in order to prevent gross injustice in exceptional cases. The provision must be sufficiently flexible to permit the exercise of sound administrative judgment in order to adopt the relief to the peculiar facts of the individual case. It is therefore recommended that the law be amended so as to restore a general relief provision similar to section 722 of the 1940 act, which authorized the Commissioner to make such adjustments as may be necessary to adjust abnormalities affecting income or capital, his decision to be subject to review by the Board of Tax Appeals.

It is believed not only that such a general equitable provision is essential to avoid gross hardship in the case of many taxpayers but that it is necessary from the point of view of the Government itself. Without it, the expeditious administration of the law will be impossible. The Board of Tax Appeals and the courts will be flooded with cases of the most difficult kind. Taxpayers smarting under what they feel to be intolerable injustice will fight such cases to the bitter end. The collection of large sums of revenue will be seriously delayed, and the energies of the administratice staff will be diverted from other pressing tasks. The bulk of such litigation can be avoided if the commissioner has adequate power to make reasonable adjustments when he is convinced that equity and the general purposes of the law will be served thereby. The disposition of such cases will then proceed along normal channels of administrative settlement.

The situation of new corporations under the Excess Profits Tax Act is difficult in the extreme. To date, virtually nothing has been done to alleviate the shock of so heavy a tax upon new business enterprises. The "normal growth" provision is very helpful to corporations experiencing growth in the base period but affords no remedy for normal growth after 1940. A fortiori, it gives no relief whatever to new corporate enterprises which came into existence after the end of the base period. No argument should be necessary to show the stagnating effect upon the national economy, through the throttling of new enterprise, which this tax will have if it remains in effect for any considerable period of time. New enterprises

producing new goods and services of a kind which will not compete with the defense program, are needed right now as one safeguard against serious inflation.

The Canadian Government has recognized the seriousness of this problem in its Excess Profits Tax Act. The Canadian law has established a board of referees to which cases of inequitable hardship may be referred for consideration and appropriate adjustment by means of constructing a fair standard profit for a particular taxpayer in the light of all the relevant facts. This board is subject to reasonable limitations upon the exercise of its discretion, the chief of which is that the standard profit so constructed shall not be less than 5 nor more than 10 percent of its invested capital. Under a pending amendment, these limitations are relaxed with respect to taxpayers where capital is not an important income-producing factor.

The categories of cases in which this board may act, however, are broad. They include cases in which the standard profit computed under the general provisions is unfair either (1) because the industry to which the taxpayer belongs was in a depressed condition during the standard (base) period, or (2) because the taxpayer's business was in a depressed condition due to factors peculiar to itself, and (3) cases of new enterprises, a new enterprise being defined as one which commenced business on or after January 1, 1938. A further special provision, based on volume of production, is applied only to gold mines and oil and gas wells. The findings and orders of the board of referees are final and conclusive, unless disapproved by the Minister of National Revenue.

It is believed that equitable provisions at least as broad as these are necessary to prevent our own law from causing havoc and gross hardship in many cases. We, therefore, recommend a relief provision broad enough to apply to new corporations and to cases, such as those involving abnormalities in capital, which are not covered by more specific provisions of the existing law. If it is necessary to set up special machinery, comparable to Canada's board of referees, to assist the Commissioner in administering such a provision, we believe the general welfare requires that this be done.

We recommend that careful consideration be given to inclusion in the statute of additional yardsticks for measuring normal or fair profits.

(*a*) The so-called Stiles formula, which was presented to your committee during the present hearings, in which the excess-profits credit is determined by applying to the pay roll of the taxable year subject to social-security tax a percentage representing the ratio of profits (net income less normal corporation tax) to such pay roll during the base period. This formula has certain definite advantages which entitle it to serious consideration. Among these are: (1) It recognizes the fact that labor is as important or more important in producing income than invested capital in many enterprises; (2) it gives growing enterprises an opportunity and incentive to keep on growing as long as net profits do not increase more rapidly than labor's share in the fruits thereof; (3) it is simple to apply and relieves the taxpayers using this method of the costly burdens of computation of the excess-profits credit which the preparation of returns under the existing law involves; (4) by the use of Social Security pay roll, a taxpayer cannot inflate its excess-profits credit through payment of large salaries to officers and a restricted group of higher paid employees; (5) abuse of the use of the method can be limited by excluding cases where the net profits after taxes during the base period exceeded the social-security pay roll; (6) the adoption of the formula would not deprive a taxpayer of the right to use the average income or invested capital methods in case one or the other reaches a more equitable result.

We therefore recommend an amendment incorporating the principles of the above plan as an alternative method of computing the excess-profits credit.

(*b*) We recommend that your committee give careful consideration to the employment, as an alternative yardstick for measuring excess profits, during the taxable year of a ratio based upon the relation between net income after payment of corporate income taxes, other perhaps than the tax imposed by section 102 of the code, and gross sales or gross income from the manufacture and/or sale of goods and services during the base period. This formula has several of the advantages of the formula which employs social-security pay roll. It is based upon the principle that there is no excess profit fairly attributable to the defense program or to price inflation which may result from defense spending where a taxpayer's margin of profit on the sale of goods and services does not increase over such margin during the base period.

(c) We recommend that careful consideration be given by your committee to an amendment to provide specific relief to many enterprises of which the following case is fairly typical.

A corporation is organized during the base period or thereafter to develop a patent or to perfect and exploit some new nondefense product or service. It does not commence to earn sizable profits until 1940 or a subsequent year. By virtue of the nature of its business, its invested capital may be relatively small. Hence, its excess-profits credit, whether computed under section 713 or 714, is small and gives it little relief. As the other relief provisions of the existing law have little or no application to such a taxpayer, it will be compelled to pay as high as 55 or 56 percent of its net income in corporation normal and excess-profits taxes in 1940 or in subsequent years. It is difficult to believe that Congress intended that such a corporation should be mulcted in tax of so high a fraction of its profits attributable to manufacture of a new product rather than to an increase in business attributable to defense contracts.

It is suggested that a practicable remedy for cases of this type would be a provision which would allow such a taxpayer to use as a base period its first 4 taxable years under the excess-profits tax law, and to compute for use in subsequent years an average base period net income based upon its experience during such years, employing for this purpose the growth formula contained in section 713 (f), and excluding income, if any, directly attributable to defense contracts. It is suggested that, during the years in such period, the corporation's excess profits tax be computed according to the provisions of existing law, with a proviso that the total of tax payable, including corporation income and excess-profits taxes, shall in no event exceed 35 (40) percent of its net income. Net income, if any, attributable to defense contracts, however, should be excluded from the operation of this proviso and taxed at full rates.

We recommend that section 722 of the code be amended in such manner as to relieve a taxpayer, who has filed an application for relief in the manner provided by section 722 (e), of the burden of full payment of the excess-profits tax as computed without the benefit of the relief provision. Under the existing law, full payment of the tax so computed must be made, pending action by the Commissioner on the application for relief. If relief is subsequently granted, the excess in payment is refunded or credited.

The difficulty with this procedure is that there will be delay, amounting in some cases to several years, before there is a final determination of the relief, if any, to which a taxpayer is entitled. In the meantime taxpayers may be forced to pay and deprived of the use in its business of substantial sums which may be badly needed for various purposes. The receipt of a refund or tax credit some time later, even though interest is allowed, will often be an inadequate remedy. This problem was met in part in the 1918 act by a provision which placed a ceiling on the tax which had to be paid immediately of 50 percent of the net income. Under that act there was a maximum war-profits rate of 80 percent, and the war-profits and excess-profits tax was first to be computed and then deducted before computing a 12-percent income tax.

This 50-percent limitation was, therefore, the virtual equivalent of allowing a tentative credit of 37½ percent of the amount of the net income before applying the 80-percent tax, as shown by the following:

Net income	100.0
Credit	37.5
Subject to tax	62.5
Tax at 80 percent	50.0

The Canadian act goes still further, with the adoption of an official recommendation recently proposed. This recommendation reverses the prior procedure whereby relief is obtained from the board of referees after a return is filed and full tax under the ordinary rules has been paid. Instead, the taxpayer is permitted to compute his own tax, after taking into account the relief adjustments to which the taxpayer deems itself to be entitled. If the Minister of Revenue deems the return as filed to understate the tax, he refers the return to the board. If the board decides the tax paid to be too low, a deficiency is assessed on the basis of its findings.

In lieu of such a provision, which may be regarded by your committee as too liberal under our conditions, we recommend for your consideration as a tentative tax limitation to be inserted in the present law the following:

"In any case in which a bona fide claim for relief has been filed under section 722, the amount of tax originally payable by the taxpayer shall be the amount computed on the return regardless of any undetermined claim under section 722, except that in no case shall the original tax payment exceed the amount of a provisional tax computed with the allowance of an excess-profits credit (a) equal to one-third of the amount of the excess-profits net income, or (b) equal to the excess-profits credit claimed under section 722, whichever is the lesser amount."

Computations indicate that, unless more than 50 percent of the relief claimed is ultimately disallowed, the tax will not materially exceed the provisional tax paid. Since interest will have to be paid on any deficiency, the Government will be well compensated for any delay in payment. Provision might be made, if Congress deemed it desirable, that the limitation should not be applicable in any case in which the Commissioner should determine that collection of the tax would be placed in jeopardy thereby.

XII. *Supplements A and B should be revised.*—These supplements are by far the most complicated portion of the Excess Profits Tax Act. In their present form they represent an unsuccessful attempt to prescribe detailed rules to govern the effect of mergers, consolidations, liquidations, split-ups, and other tax-free exchanges upon the excess-profits-tax credit and the tax brackets. The draftsmen did not have time in 1940 to analyze the problems, think the policies through, correlate the two supplements, and perfect the language. Some of the most serious defects result from the fact that the supplements, particularly supplement A, were not thoroughly revised to keep abreast of the important shifts in underlying policy which occurred when the House bill was revised in the Senate and in conference. The consequence is that the supplements in their present form are unsound in policy and replete with loopholes, ambiguities, and inequities.

The situation with respect to supplement A was considerably improved by the March amendment to section 742 which permits a taxpayer acquiring corporation to elect to come under that supplement or under section 713. It is believed, however, that the best interests of both taxpayers and the Treasury require that these supplements be completely revised as soon as possible.

Since the considerable time needed for an adequate revision by your committee and the draftsmen may not be available at this time, we recommend the repeal of these supplements and the substitution of general statements of principle and policy, with the promulgation of detailed rules to effectuate the same left to departmental regulations. We further recommend that, in the event this course should be followed, the amended statute continue the provision making section 713 applicable unless a taxpayer acquiring corporation elects to come under supplement A, and that an appropriate saving clause be inserted to protect any reorganizations consummated prior to such repeal from the loss of any advantages to which the resulting corporations may be entitled under the existing law.

In the event that it is decided to retain detailed specific provisions in the statute, it is recommended that the following amendments be made, in the interest of sound policy and in order to minimize inequity and uncertainty.

(a) *Supplement A.*—(1) Subsections (a) (1) and (2) of section 742 should be carefully revised to eliminate the incongruous results which may arise where the taxable years of the taxpayer and one or more of its qualified component corporations are not the same. Under section 742 (a) (2) as now drawn, where the taxpayer is on a calendar-year and qualified components are on a fiscal-year basis during the base period, then the income of the latter could be included in the taxpayer's base period net income for 3 taxable years, while under a strict construction, none of such income could be included. There is no justification for such results, and they were probably unintended.

(2) Section 742 (a) (2) should also be amended to eliminate the limitation which permits the inclusion of the base period net income of a component corporation only if it is a qualified component. Since the act permits a taxpayer to use the credit based on income where it was in existence for only a part of the base period, there is no reason in policy for excluding such a component. Rather, its actual income should be includable and, in addition, either a base-period income should be constructed for the part of the period in which it was not in existence or its actual income should be averaged over that part of the base period in which it did exist.

(3) The very severe limitations contained in subsections (f) (1), (2), and (3) should be reexamined and, we believe, removed. There is no reason of policy in the act as now drawn for excluding, as does section 742 (f) (1), the base period net income, whether actual or constructed, of a taxpayer which was in

existence for only a part of the base period, with respect to the period prior to the date it became an acquiring corporation. Nor is there any more reason for subsection (f) (2) which excludes the income of a component corporation, which was actually in existence during only a part of the base period, prior to the time it becomes qualified itself under section 740 (f) by acquiring a qualified component corporation.

Subsection (f) (3) is unfair in that, in cases in which a qualified component was actually in existence at the beginning of the taxpayer's base period, such component's excess profits net income for the period prior to such date is excluded, though a corresponding inclusion of an additional period at the end of the base period, in order to make up 4 complete taxable years, is not allowed.

(4) Section 742 (f) (4) contains a reasonable limitation, but is defective, as now drawn, in that it does not apply to cases governed by section 742 (d) (1) and (2) (A). This appears clearly to be due to an inadvertent oversight in draftsmanship.

(5) A serious defect from the revenue point of view from the complete silence of supplement A as to the effect on a component corporation's separate income credit where its base period net income is included in the acquiring corporation's base-period income, but the component corporation remains in existence.

For example, section 740 (a) (1) (A) does not require the liquidation of a component corporation. After the transaction making it a qualified component, it may continue to exist and may sell stock of its acquiring corporation and realize income therefrom subject to excess-profits tax. It is apparently free to use the credit provided by section 713 measured by its own base period net income, even though its acquiring corporation also uses the income credit. This or similar transactions may be repeated several times, with like duplication in the use of the same base-period income in computing the excess-profits credit under section 713.

(6) The principle of the normal growth provision of section 713 (f) should be applied to taxpayers computing an average base period net income under supplement A. There is no reason why a taxpayer should lose the benefit of this excellent provision merely because it includes the income of one or more qualified component corporations in its base period income. Such acquisitions are a normal incident in growing enterprises.

(*b*) *Supplement B.*—(1) Section 751 (b) should be amended to eliminate unfair results which may arise under it. Suppose a transferee issues stock and bonds for property acquired. Under the section as now drawn, it may increase its equity invested capital only by that portion of the basis of the property which may be allocated to the stock. The bonds are wholly excluded from borrowed capital. The result is that where the transferor liquidates, as is often the case after such exchanges, invested capital equal to the portion of the basis allocable to the bonds is lost. This inequity should be removed by a limitation on section 751 (b) which would prevent its application in cases where the transfer of the property is followed by the liquidation of the transferor.

(2) The provisions of supplement B, particularly those relating to highest bracket amount (sec. 752 of the code) are very complicated and difficult to understand, but more nearly approximate fairness in result than supplement A. They should be simplified as much as possible, and section 752 can be eliminated if the brackets in the rate schedule are revised so as to be based upon percentage relations between excess profits and the excess-profits credit, in lieu of the present dollar amounts.

However, there is one serious flaw in subsections (b) (4) and (c) (4) of section 752 which should be corrected by appropriate amendment. The method therein prescribed, as applied to section 112 (b) (5) transactions involving several transferors, where 90 percent control does not become vested in any one of the transferors, produces a reasonable and equitable allocation of highest bracket amount only where the transaction is limited exclusively to corporate transferors. In cases where the bulk or a large part of the property transferred comes from persons other than corporations, the corporate transferors are unfairly mulcted of a disproportionate part of their highest bracket amounts to the benefit of such other persons.

It is believed that a fair solution of this problem would be to reduce the reduction of the highest bracket amount of the corporate transferors, as computed under the subsections (b) (4) and (c) (4) of section 752 as now drawn, by a percentage representing the ratio between the amount of property transferred by noncorporate transferors and the total amount of property transferred in the transaction.

C. *Amortization*

We recommend that several amendments be made to section 124 of the code, relating to the amortization deduction. These amendments are believed to be necessary if the principal purpose of this provision is to be realized. That purpose was to facilitate the carrying out of the defense program by encouraging private capital to finance, so far as possible, the great expansion of plant, machinery, and other facilities, which its successful execution requires. In the light of experience to date, this purpose has not been achieved to any material extent. The result is a tremendous additional draft on Government funds for financing facilities, the amount of private financing to date having been relatively very small. It is believed this reluctance on the part of private capital is due in substantial measure to the requirements of section 124 (1), which are proving to be impossible of expeditious administration. These obstacles in the way of the defense program should be promptly removed, as they can be without depriving the Government of any essential protection.

There are also two or three major sources of injustice in the section as now drawn which should be promptly corrected.

I. *There should be some revision of the base date.*—As it is now drawn, the privilege of amortization under section 124 is limited to emergency facilities. Section 124 (e) by definition limits the scope of this term to include only "any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which was acquired after such date, and with respect to which a certificate under subsection (f) has been made." The certificate so referred to is the certificate of necessity.

It will be noted that the privilege is limited to facilities construction of which has been completed or which have been acquired subsequent to June 10, 1940. This statutory language appears to deny the privilege only in cases where the completion of construction or the acquisition occurs prior to the base date. It has not been so interpreted, however, as the Treasury regulations limit the amortization allowance where construction of a facility was commenced prior to the base date to that fraction of its basis corresponding to the part of such construction attributable to the period after such date. Thus, if 50 percent of the construction was complete on June 10, only 50 percent of the basis of the plant or other facility can be amortized. Ordinary depreciation only is allowable as to the remainder. If the facility were constructed on land acquired for the purpose prior to June 10, no part of the cost of the land could be amortized, and ordinary depreciation would be denied since land is not subject to the depreciation allowance provided by section 23 (1) of the code.

The June 10 date operates very unjustly. It came into the law, apparently, as an afterthought. When it was announced from the White House on July 10, 1940, that the principle of a 5-year amortization allowance on necessary defense facilities had been approved by the President, the Secretary of the Treasury, and the chairmen of the Ways and Means and Finance Committees, there was no suggestion of any such limitation. The House bill fixed, as the decisive date, July 10, 1940. The only possible reason for such a date was that the above announcement, which said nothing about a deadline date, issued on that day. The Finance Committee changed the date to January 1, 1940, on the ground that plant expansion for defense purposes had begun at least that early and that it ought to be covered. The June 10 date was selected in the conference as a compromise. It happens to be the date on which the revenue bill of 1940 was reported by the Committee on Ways and Means.

The adoption of such an arbitrary date produces very unfair results. Amortization is allowed in one case and denied in another, not by reason of differences in the character or necessity of a facility required for the performance of defense contracts, but solely because of its completion after or before a fixed date. Many taxpayers who cooperated with the Government by going ahead with necessary expansion of plant and facilities are penalized, while those who waited until they could see what law would be written are given discriminatory advantages. Such discrimination is not justified by the argument that the amortization deduction was allowed in order to encourage free cooperation in the defense program and that only those who withheld such cooperation until the deduction was promised by high authority or actually enacted could have relied upon such allowance. This cynical proposition simply penalizes those who, at greater risks to themselves, cooperated promptly in the defense program.

We respectfully submit that discrimination such as this is not only unfair but is contrary to sound legislative policy and creates an evil precedent for the future.

We therefore recommend an amendment to section 124 which will permit a certificate of necessity to be granted where a defense contract is in all respects, other than the date of completion or acquisition of the facility, within the terms of the regulations.

It is believed this suggested solution is preferable to a change of the statutory date. Any date which might reasonably be selected would still be somewhat arbitrary and might shut out some cases where the deduction should equitably be allowed. It should be noted that the Canadian Excess Profits Tax Act solved the difficulty in this manner. The base date in the statute is September 9, 1939, unless the War Contracts Depreciation Board and the Minister of National Revenue are satisfied that in all respects save as to date, the contract satisfied the requirements of the regulations.

II. *Emergency plant facility (E. P. F.) contracts should be treated as sale contracts for tax purposes.*—It now seems very probable that the amortization deduction of many taxpayers having emergency plant facility contracts will commence earlier than their inclusion in gross income of payments received from the Government under such contracts. The reason for this lack of coordination between deductions and payments is that the deduction is tied in with the acquisition or installation of particular portions of the facilities, such as machinery, under section 124 (a), whereas the payments under the contract may commence only when the whole plant is completed. This lack of correspondence will work great hardship in cases where a taxpayer has insufficient income from other sources to offset the amortization deduction in one or more of the periods for which it must be taken.

The only reason for allowing the contractor under an emergency plant facility contract any deduction for amortization, when the contract guarantees it direct reimbursement of the entire cost of the facilities, is to protect him from taxation upon the amounts so received by him, the Treasury having already indicated that such amounts constitute income. (See T. D. 5016, sec. 19.124–6.) The provisions of emergency plant facility contracts provide for reimbursement in 60 equal monthly installments, presumably so that they will coincide with the tax deductions. It has been pointed out, however, that this assumption of coincidence of deduction and payment will often fail to be realized. Also, section 124 (b) has provided that, if such a contract is terminated in less than 5 years, and the Government is obligated to pay the unpaid balance in a lump sum, a deduction may be taken equal to such amount, in lieu of the deduction otherwise allowed.

We therefore recommend that section 124 be amended so as to specifically provide that no amortization of facilities under an emergency plant facility contract shall be allowed, and that payments under such contracts, to the extent they do not exceed the cost of the facilities, shall be excluded from gross income. The effect of this amendment is to treat such contracts for what they in substance are, i. e., sales on deferred payments.

III. *Section 124 (i), relating to certificates of nonreimbursement and Government protection, should be repealed or modified.*—Great difficulties have been experienced, both by taxpayers and the Government, in the application and administration of this section. This is due in part to ambiguities in the drafting of the section; in part to overlapping authority between different agencies and conflicting policies in its administration; and in part to baffling difficulties inherent in the concept of reimbursement itself.

The combined effect of these factors has been virtually to paralyze the administration of this provision. Only a handful of nonreimbursement certificates out of the large number applied for have been issued. The expeditious execution of the defense program is being materially impeded by this log-jam. The time and energies of large numbers of Government and corporate officials and employees are being absorbed by the onerous requirements which the preparation, analysis, and review of applications for certificates, and frequent supplements or amendments thereto involves. Burdensome expenses are entailed. The time and labor so consumed might better be devoted, in the national interest, to the execution of the defense program itself.

Default in the issuance of certificates will have the later result of clogging the Board of Tax Appeals and the courts with a flood of refractory cases. In these cases taxpayers will have claimed amortization deductions, which the commissioner has disallowed. They will seek to prove nonreimbursement in fact, in order to support such deductions, even though nonreimbursement certificates have not

been obtained. A heavy burden will thereby be thrown upon the Treasury Department.

While much can be done by suitable amendments to improve procedure under the section and to correct some of its ambiguities, we do not believe any solution can be found which will be entirely satisfactory, short of repeal of the section itself. This is due to the uncertainty in the concept of reimbursement itself. The problem is one which by its nature should be solved by proper procurement procedure. It ought not to be imported, as it has been, into the tax laws to complicate and confound their efficient administration. We therefore recommend its repeal.

If repeal is not possible, then we favor the immediate enactment of legislation, such as that which has recently been proposed by the War and Navy Departments, which will remove some of the serious defects which are susceptible to correction. The proposed legislation would centralize jurisdiction to grant the certificates in the single agency immediately concerned, such as the War or Navy Departments, the Maritime Commission, or such other agency as the President by regulation may designate.

The issue of reimbursement should, so far as possible, be determined in the negotiations establishing the price to be paid under the contract. Amortization should be denied only to the extent reimbursement is determined to exist. Under the existing law, the presence of $1 of reimbursement may result in the denial of any amortization upon a million-dollar capital outlay. The proposed legislation, as now drawn, does not correct this defect. We believe this omission is very unfortunate.

The requirement of a certificate would be limited by the proposed legislation to contracts involving a substantial minimum, viz, $15,000. This is a very meritorious provision. The burden involved in procuring a certificate is out of all proportion to the benefits thereof unless the amount of the contract is substantial.

Under the proposal, the certificate requirement should not obtain with respect to purchases by all the Government departments. The proposed legislation wisely limits the requirement to contracts made with the United States and made on its behalf by the War or Navy Departments, the Maritime Commission, or such other department or agency as the President may designate.

One provision of the proposed legislation apparently requires the submission by the taxpayer, whenever practicable, of its estimated costs, in connection with the determination of whether there is any element of reimbursement contained in the price. We believe this provision is dangerously broad and is objectionable for several reasons. First, the statute provides no adequate safeguards against disclosure of valuable information which the cost schedules or other data submitted may contain, safeguards such an exist in connection with income-tax returns and information obtained by revenue agents in the audit thereof. Second, there is no apparent necessity for requiring such information in the case of contracts let upon the basis of competitive bids. In the case of cost-plus-fixed-fee contracts the information must already be made available. In any event, the new requirement might well be limited to contracts for new articles and perhaps negotiated contracts. Finally, compliance with the requirement may impose heavy additional burdens of expense upon the taxpayers affected.

The rigid requirement of a proprietary interest in the Government, as a condition to a certificate of Government protection in all cases, is burdensome and unnecessary. In many cases, a stand-by agreement or other contract obligation will amply secure the public interest. Power should be given to the Executive by regulation to make flexible adjustments in these and other requirements in order to adapt them to the practical realities of individual cases. Unfortunately, this problem is not covered by the proposed legislation.

We favor and recommend the enactment at this session of Congress of the proposed or any other legislation which will accomplish these and other improvements in the statute which may be necessary. The success of the defense program should always be kept in mind as the primary objective.

Respectfully submitted for the Committee on Federal Finance, Chamber of Commerce of the United States.

ELLSWORTH C. ALVORD, *Chairman.*

AUGUST 15, 1941.

(Senator Guffey requested that the following letter be incorporated in the record:)

PENNSYLVANIA STATE CHAMBER OF COMMERCE,
Harrisburg, Pa., August 25, 1941.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: Representing and speaking for business and industry in a State which is the keystone of the Nation's defense structure, contributing about 8 percent of the national-defense production and Federal internal revenues, the Pennsylvania State Chamber of Commerce is conscious of the patriotic duty to voice its views on methods of financing defense that will be currently effective without impairing the recuperative strength of the country when the present emergency has passed.

On June 5, 1941, the executive committee of the State chamber issued a statement on taxes for national defense. The basis of this statement was an intensive study made by the chamber's joint committee on taxation and Federal legislation, the members of which have a practical grasp of the economic and technical phases of national taxation. The well-considered conclusions reached by these representatives of Pennsylvania business warrant the serious consideration of your committee. Therefore, they are being fully set forth below, with added comments and certain specific recommendations for modifying existing and proposed Federal revenue laws.

TAXES FOR NATIONAL DEFENSE

We join with the President and Congress in recognizing that the national-defense program is paramount. Its demands transcend the interest of every man and every group. It must have priority over politics and pocketbooks. National unity in our defense effort cannot otherwise be achieved.

Obviously we cannot carry on either business or government as usual from now on and adequately meet our defense needs. While the task of building our defense is primarily one of greatly increased physical production, yet it must not be overlooked that a sound economic organization and financial stability are equally essential to effective military preparedness.

Problems of defense financing unparalleled

Secretary Morgenthau has estimated that expenditures for the next fiscal year will be about $19,000,000,000. He suggests that two-thirds of this amount, or $12,700,000,000, be raised by taxation and one-third by borrowing. He estimates that existing tax laws will produce $9,200,000,000 of revenue, leaving $3,500,000,000 to be raised by additional taxes. Other authorities have estimated expenditures and revenues in varying amounts.

The magnitude of estimated expenditures clearly indicates that financing the national-defense program presents a most serious and unparalleled problem. To say the least, the cost is difficult to approximate and may be limited only by the amount it is possible to spend during any fiscal period of the emergency.

Increased yields from present taxes

Sound fiscal planning requires that before any additional taxes are imposed, a most careful estimate should be made of the probable yield under existing tax laws. Further, any deficiency in revenue requirements for defense purposes should be made up insofar as possible by reducing so-called normal Government expenditures.

Recent forecasts of 1941 national income have varied from $85,000,000,000 to $90,000,000,000, as against the currently quoted estimate of $80,000,000,000. At the revenue-revision hearing of the House Committee on Ways and Means, a well-known economist conservatively estimated that national income would reach $95,000,000,000 in 1942.

Federal, State, and local taxes now require over 20 percent of the national income. Increased national income will produce increased Federal revenues under present tax laws. Therefore, estimates of revenue under present laws should be carefully determined in the light of greatly expanded business activity, before substantial changes are made in the existing tax structure.

Retrenchment in nondefense activities of Government

It is essential that any deficiency in revenue requirements under present laws should be made up as far as possible by—

1. Suspension of every activity of the Federal Government that may not be characterized as essential in the light of the present emergency. It would be neither just nor wise for Congress to enact the exceedingly heavy taxes proposed without demonstrating that the Government is willing to match the sacrifices it asks of the people by cutting down its own nonessential spending.

2. Achievement of rigid economies with respect to all remaining Government services.

Principles of taxing and borrowing

After drastic reduction in nondefense spending of the Government, so much of whatever additional revenue is required should be raised by taxation as the national economy will stand, with due regard to preserving our system of private enterprise and preventing inflation. The remainder should be borrowed. The amount to be borrowed should not be determined according to a fixed ratio. Too great a tax burden will seriously interfere with industry and retard production for defense purposes.

To finance the requirements of the defense program will necessitate the united and cooperative efforts of public officials and all the people. We deplore any attempt to enact additional revenue legislation that unfairly discriminates against, or in favor of, any class or group, or fails to distribute equitably the burden of added taxation resulting from the defense program.

Additional revenues for the emergency

To the extent that any new or additional taxes must be imposed, we offer the following specific suggestions:

1. A flat rate pay-roll tax, without exemptions; collected at the source.

2. A slightly higher flat rate tax on dividends and interest; also collected at the source.

3. Elimination of all tax-exempt securities.

4. Increase in the normal tax rate on personal incomes, but no increases in surtax rates.

5. Reasonable increase in excess-profits tax rates, with retention of both the income and invested capital credit bases as now provided by law.

6. Reasonable increase in rates on all excise taxes and broadening of the base by including other items or commodities, if necessary.

All new and additional taxes for the defense program should be imposed primarily for revenue purposes and be limited to the period of the national emergency.

Broadening of tax base essential

If additional taxes must be levied, then a broadening of the tax base is necessary. Without a broader tax base, serious doubt exists—in view of the present high tax rates and the size of the public debt—whether adequate revenue can be produced without permanently impairing our productive economy and drying up the sources of Government revenue.

Total annual income under $5,000 per consumer unit, i. e., families or self-supporting individuals, is estimated by the National Industrial Conference Board to aggregate $60,000,000,000, or 75 percent of a current $80,000,000,000 national income. Thus, consumer units with annual incomes of $5,000 or over, representing some $20,000,000,000, or 25 percent of the total national income, are bearing the brunt of existing Federal taxation.

It is both unjust and unwise to emphasize further this unbalanced condition. The defense program is for all the people. Accordingly, all should be taxed for it, in proportion to their means and in keeping with the sound fiscal policies which this critical hour demands.

Since the above views were published, the Revenue Act of 1941 (H. R. 5417) has been passed by the House of Representatives and is now under consideration by your committee. The following additional comments are submitted:

NONDEFENSE EXPENDITURES

We cannot emphasize too strongly that sound fiscal policy demands utmost economy in nondefense spending by the Federal Government. We urge the suspension, during this emergency period, of every activity of the Federal Government that is not essential in the light of the emergency and rigid economy with respect to all remaining activities. Curtailment of nondefense expenditures by the Government would be a convincing argument that the need for additional revenue is real, and would promote a greater willingness on the part of the people to accept the burden of additional heavy taxes.

After maximum reduction in nondefense expenditures, so much of whatever additional revenue is required should be raised by taxation as the national economy will stand, with due regard to preserving our system of private enterprise. The remainder should be borrowed.

BROADENING OF THE TAX BASE

It is imperative that the tax base be broadened if the additional revenue required to be raised by taxation is to be secured without drying up the source of private capital. Individuals having annual incomes of $5,000 or over, who now bear the brunt of existing taxation, are further called upon to bear the major part of the burden of the additional taxes proposed by H. R. 5417. Only a minor part of the burden will fall on those having annual incomes of less than $5,000. This latter group now receives approximately 75 percent of the national income and will receive an even greater proportion of the increase produced by defense activities.

We submit that all recipients of national income should bear a reasonable share of the burden of rearmament based on ability to pay. The suggested reduction in personal exemptions will not accomplish this purpose. Therefore, we urge the imposition of a flat-rate pay-roll tax, without exemption, on all compensation paid, to be collected at the source. This levy should be accompanied by a provision allowing credit against the individual's income tax for any such pay-roll tax withheld.

EXCESS-PROFITS TAX

Corporations are now required to comply with an excess-profits tax law which undoubtedly is the most complicated taxing statute ever enacted by Congress. It should be greatly simplified. Not only is the law difficult to apply, but it contains numerous inequities.

We further submit that only true excess profits should be taxed as such. Normal profits are in no sense excess and should not be so taxed. In passing the Second Revenue Act of 1940, Congress recognized the difficulty of determining excess profits by permitting the use of either the income or invested capital basis for establishing the excess-profits tax credit. Inequities will result from the elimination of the income basis, as recommended by the Treasury Department. We strongly urge your committee to retain in the law the present option of determining the excess-profits credit on either an income or invested-capital basis.

The following specific recommendations are made so as to tax uniformly only true excess profits:

1. Rates of tax upon excess profits should be graduated according to the ratio of excess to normal profits, as represented by the excess-profits credit, and not according to the dollar amounts of excess profits, as in the present law and proposed amendment. Discrimination against the owners of stock in large corporations as against stockholders in small corporations, will result unless this principle is recognized.

2. One hundred percent of base period income rather than 95 percent should be permitted as a credit in the case of taxpayers electing to use the average earnings basis. Otherwise, 5 percent of normal profits will be taxed under the guise of excess profits. Also 8 percent of invested capital rather than 8 percent on the first $5,000,000 and 7 percent on capital in excess of $5,000,000 should be allowed taxpayers electing to use the invested capital basis.

3. Provision for deducting the normal tax in determining excess-profits tax net income, as included in existing law, should be retained. Normal income tax should be treated as an ordinary expense in determining profits subject to an excess-profits tax. The only justification for denying this deduction is to increase the tax yield, which could be accomplished by raising the tax rates.

4. We are unalterably opposed to the special excess-profits tax of 10 percent, proposed by section 201 of H. R. 5417. The imposition of this special tax would operate to tax as excess profits, earnings below a normal return on capital.

5. The law should provide that losses incurred during the period of readjustment following the termination of the national emergency, should be allowed as deductions in reducing taxable income for income and excess-profits taxes, retroactively over the period of the national emergency.

We also suggest the following technical amendments to improve the workability of the act.

1. A corporation should be permitted to establish its invested capital on the basis of the determination made under the 1917 to 1921 acts, adjusted to December 31, 1939.

2. Section 716 of the existing law should be amended to give taxpayers the option of using a daily, monthly, or annual basis for determining average invested capital.

3. The law should expressly provide that the right to an excess-profits carry-over is in no way affected by the nonfiling of a return or the incompleteness of the data shown on a previous year's return. The carry-over provided under the 1940 act should not be recomputed.

The law should also provide that where a return is not required at the time of filing any elections available if a return had been filed can be exercised at any time until the tax liability is finally determined.

(4) Section 734 of the existing law should be revised to apply only to the years 1936 to 1939, inclusive.

(5) The amortization provisions of the existing law should be amended by eliminating section 124I.

CAPITAL-STOCK AND DECLARED-VALUE EXCESS-PROFITS TAX

The capital-stock tax and its companion measure, the declared-value excess-profits tax, should be repealed. These taxes have been a constant source of irritation to business, because they substitute guesswork for sound principles of taxation. They are measured by forecasting income for 3 years in advance. Under present conditions, only a Jeremiah could forecast income for 1941, let alone 1942 and 1943. These taxes should be repealed, but, if retained, the law should provide for a new election in determining the declared value of the capital stock each year.

The Pennsylvania State Chamber of Commerce had planned to present the foregoing views through an official spokesman appearing before your committee. However, since most of the recommendations have been ably presented orally, it is desired to conserve the committee's time by submitting this written statement to be included in the printed record of the hearings held on H. R. 5417 in lieu of a personal appearance. If the committee so desires, a representative of the chamber will gladly amplify this statement.

The careful consideration by the Finance Committee members of all the foregoing suggestions will be appreciated.

Respectfully submitted.

E. M. ELKIN, *Chairman*,
C. L. TURNER, *Vice Chairman*,
Joint Committee on Taxation and Federal Legislation.

The CHAIRMAN. John W. Hooper.

STATEMENT OF JOHN W. HOOPER, BROOKLYN, N. Y., CHAIRMAN OF THE COMMITTEE ON FEDERAL TAXATION OF THE BROOKLYN CHAMBER OF COMMERCE

Mr. HOOPER. I am John W. Hooper, comptroller, American Machine & Foundry Co., appearing on behalf of the Brooklyn Chamber of Commerce Committee on Federal Taxation of Corporations.

The Brooklyn Chamber of Commerce, in the city of New York, through its Federal taxation committee in cooperation with an advisory group from the Brooklyn Chapter of the National Associa-

tion of Cost Accountants, has closely followed the proceedings of the Committee on Ways and Means in the House of Representatives and has carefully considered insofar as time has permitted, the Revenue Act of 1941, introduced as H. R. 5417. While we differ in some respects as hereafter referred to, broadly speaking, in our opinion, the Ways and Means Committee have acted constructively in continuing the two bases—Invested capital and Prior years earnings—as methods for computing the theoretical normal earnings of corporations for excess-profits tax purposes. In order to conserve time, we are limiting our observations to the most essential points of tax legislation.

Congress should take lead in reducing expenditures for peacetime activities.—We recognize that neither the Ways and Means Committee nor the Senate Finance Committee appropriate money. Nevertheless, expenses and revenue are so closely interrelated that these committees, in performing their revenue-raising functions, can and should be a powerful factor in emphasizing to the Appropriation Committees the urgent need for retrenchment. The conviction is growing in the taxpayer's mind that we cannot carry on simultaneously an expanding defense program and unabated Government peacetime activities. In New York at least, taxpayers are shocked to learn that such tremendous long-term outlays as those for the St. Lawrence waterway and the Florida ship canal are being urged in the name of defense. Many taxpaying businesses and industries are thus being asked to finance their own eventual demise in the name of projects which cannot be completed for many years. The citizens generally will be bending their back under burdens of taxation and mounting debts, the proceeds of which are being spent in ways which threaten the existence of the institutions and the ways of life they are striving to protect. The taxpayers are looking to the Congress to maintain the distinction between a social revolution and the defense program so that we shall not be unwittingly or otherwise deprived of our birthright.

Emergency revenue legislation should have definite time limit.—Taxpayers should be given assurance of eventual relief by writing into the law a definite time limit on the emergency revenue legislation, thereby retaining in the Congress control over the essential functions of financing the Nation. The emergency nature of defense taxation must not be overlooked at any time.

Senator CONNALLY. What time limit would you put on that?

Mr. HOOPER. Just the period of the emergency.

Senator CONNALLY. You think we will be able to quit paying taxes then? Do you believe that in your lifetime we will be able to substantially reduce this $50,000,000,000 we owe without these taxes?

Mr. HOOPER. Not quit paying taxes but have the form of taxation changed to a more equitable one. This is an emergency law only, supposed to be designed for the period of the emergency.

Senator CONNALLY. We are going to have an emergency as long as we owe all this money.

Mr. HOOPER. That is true; but I don't think we will have to employ an emergency method of raising these funds.

Business control measures should be removed from tax legislation.—The taxpayers, individual and corporate, realize that they will be called upon to meet increasingly heavy tax burdens and will do so

willingly. However, in order that the faith of the taxpayer be not betrayed, any regulatory intention toward business should be considered separately from the tax legislation. In other words, the power to tax should be used for fiscal purposes only. A pertinent example of using the taxing power for control is the levying under existing law of excess-profits taxes at rates graduated according to specific dollar amounts rather than according to percentages of excess-profits credits.

Form and application of excess-profits tax should be simplified.—The tremendous cost of preparation and administration of returns of the excess-profits tax constitutes a nondefense expenditure which could be used to good advantage otherwise by both taxpayers and Government bureaus. Since the proposed changes of substance in the application of the excess-profits tax and the substantial increase in the rates are in themselves a frank admission that the primary purpose of the tax is revenue production and not the originally announced objective of recapturing excess profits, it is most advisable that simplification of the form and application of the tax in every possible way should be uppermost in the minds of the legislators now considering amendments of the act.

Special assessments board should be established.—In addition to the maximum simplification, we urge that in view of the many uncertainties which will inevitably remain, there be expressed the intention of the Congress that this law be liberally administered to avoid the interminable conflict between taxpayers and administrative bureaus which was the result of previous excess-profits tax administration. In furtherance of a liberal attitude in administration there should be included provision for a special board independent of the Treasury, with authority to carry into effect this intention and thus afford relief in cases where specific abnormality provisions do not apply.

Caution should be used in the adoption of additional forms of taxation.—In the interest of ameliorating the burdens which are being placed upon taxpayers and administrators alike, we strongly advocate that utmost care be exercised in the creation of additional forms of taxes now and urge that there be no general modification of present tax formulas at least until taxpayers generally have had opportunity to judge the effect of their application and adjust themselves to the taxes thereby imposed. Needless to say, a constantly changing and shifting burden is the hardest to carry under any circumstances.

Many such changes are included, or are being urged, and considered for inclusion, in the present bill. Those which would be most violent in effect are the following:

Alternate bases for computing excess-profits credit should be retained.—The Treasury is urging the elimination of the earnings basis as a method for computation of the excess-profits credit. There seems to be danger of forgetting that the alternative computations of the excess-profits credit are for the purpose of safeguarding the taxpayer's right under any just excess-profits tax, to limit the taxation to income which is in fact in excess of normal actual income and in excess of an established rate of return on invested capital.

Special 10-percent tax is unjust penalty which should be eliminated.—A special 10-percent tax is proposed to be assessed on those corporations where the excess-profits credit based on invested capital exceeds a credit based on their preemergency net income. This special

tax is unfair and burdensome in the case of companies using the invested-capital method in that it presumes that all earnings before income tax and surtax, in excess of its preemergency earnings up to 8 percent and 7 percent of its invested capital, are due to the emergency. Investigation will disclose that many growing companies will be unjustly penalized by this special assessment and that other companies which would ordinarily have enjoyed a return in the neighborhood of 8 percent on invested capital before normal and surtax, were it not for the depression, will also be burdened although their activities are in nowise related to the defense program of the country. We feel that any special taxation levied against income within the limits of the excess-profits credit is not only unfair but discriminatory. This type of taxation is typical of the unnecessary complexities added by the proposed legislation to an already bewildering situation.

Senator CONNALLY. You represent the American Machine & Foundry Co.?

Mr. HOOPER. No; I represent the Brooklyn Chamber of Commerce.

Senator CONNALLY. But you are an official of the American Machine & Foundry Co.?

Mr. HOOPER. Yes.

Senator CONNALLY. Your company has procured a lot of contracts as a result of this emergency you referred to?

Mr. HOOPER. We have some contracts.

Senator CONNALLY. Well, you wouldn't have those except for this emergency, would you?

Mr. HOOPER. We might not have those.

Senator CONNALLY. These materials which are being bought; they must be paid for.

Mr. HOOPER. We are paying for them plenty.

Senator CONNALLY. You are not paying for them yet; you won't unless we pass this bill.

Mr. HOOPER. Our objection is to the form of the taxation. This 10 percent I am speaking about is a most unjust tax.

Senator CONNALLY. You are earning more than you did last year and you are doing so as a result of this activity on the part of the Government.

Mr. HOOPER. No; we are not.

Senator CONNALLY. I am talking about this American Machine & Foundry Co. If you weren't, you wouldn't be down here talking to Senators to get contracts.

Mr. HOOPER. We haven't talked to any Senators to get contracts.

Senator CONNALLY. You are making a lot of money, aren't you?

Mr. HOOPER. No, sir; we are making about 4 percent.

Senator CONNALLY. That is 4 percent gross on the contract?

Mr. HOOPER. Yes; that is right, and we are working 23 hours a day to get it.

Senator CONNALLY. It might be 10 or 15 percent on your invested capital?

Mr. HOOPER. The percentages quoted are fantastic, as American's net return on defense work for the first 6 months of 1941 was 2 percent of its invested capital. And I want to say we have not been going around to Senators getting war contracts.

Senator CONNALLY. Well, you got them without it; I congratulate you.

Mr. HOOPER (continuing):

Procedure of assessing excess-profits taxes before income taxes should be reversed.—The assessment of excess-profits taxes before normal income taxes is a perversion of the relation between the two taxes and results in nullification of a substantial portion of the rates of excess-profits credits fixed in the law. Corporations which earn more than their excess-profits credit under the invested-capital method find their allowable rate of return reduced to inadequate percentages running from 4.9 percent to 5.6 percent, as pointed out in the report of the Ways and Means Committee. That is the 8-percent figure less the 30-percent normal rate. We would rather face greater direct tax rates on excess profits than have exemption decreased by the indirect method employed in the proposed legislation.

Carrying forward of unused excess-profits credit should be extended and provisions liberalized.—The excess-profits credit carry-forward provisions of the present law should be amended. At the present time the law permits carrying forward of unused-excess-profits credit for 2 subsequent years. There should be an extension of this principle so that the carrying forward will be permitted until all previously unused excess-profits credit has been used; otherwise there will be taxation of normal profits which happen to occur in a single year in the cases of corporations having wide fluctuations in earnings from year to year. There should also be provision for keeping open for adjustment the excess-profits-credit computation for all years of the emergency period and adding thereto unused-excess-profits credit for not less than 2 years after the close of the emergency period, to prevent taxation of apparent profits which were not realized, the actual net amount of which can only be ascertained after passing through the subsequent adjustment period, which includes the 4 percent which we in the American Foundry & Machine Co. figure on the books is being made.

Full amount of average base period net income should be allowed.—The full amount of the average base period net income should be allowed as an excess-profits credit, there being no logical reason for arbitrarily reducing it to 95 percent.

Provision should be made for adequate income on invested capital.—The provisions of the proposed bill for return on invested capital are inadequate. The proposed legislation allows a return of 8 percent on the first $5,000,000 of capital and 7 percent on the capital in excess of $5,000,000. After deducting the proposed normal and surtax of 30 percent, these returns are reduced to 5.6 percent and 4.9 percent, respectively, and are further reduced to the extent of the 10-percent special tax levied against earnings in excess of income in the pre-emergency period, as previously referred to. These rates of return are utterly inadequate if a corporation is to successfully interest new equity capital. Further, they do not allow for setting aside necessary reserves for contingencies. The act does provide for a 10-percent rate of return on new capital, but such rate is reduced to 7 percent when the normal tax and surtax are deducted, which rate of itself, in the light of the risks and personal income taxation, is insufficient.

Period for adjustment of inconsistencies should be limited.—Section 734 of the Excess Profits Tax Act provides for adjustment of inconsistencies, with payment of taxes and interest going back for an unlimited period of years. This leaves taxpayers in a position of uncertainty and jeopardy with respect to matters which have been properly settled and closed. It is our opinion that this adjustment period should be limited to not more than 5 years prior to 1940, and in view of the extraordinary type of legislation represented by the Second Revenue Act of 1940, as amended, and the proposed 1941 Revenue Act, collection of interest by either the Government or the taxpayer under section 734 should be waived.

And in this connection I think one of the finest expositions of the difficulties under section 734 was made the other day here by Mr. Blodgett, of Boston. (See p. 140.) One of our main troubles with it, aside from not understanding it, is the definition of the various phrases. I am not a lawyer, and I thought I read it through and got some idea of its intention, but when the experts read it through, it is just impossible.

Present capital-stock tax and declared-value excess-profits tax should be repealed.—The taxation absurdity now known as the capital-stock tax and declared-value excess-profits tax, the speculative features of which are unjustifiable under any circumstances and particularly so under present difficult and changing conditions, should be repealed. The least that can be done in common justice is to give the taxpayer opportunity each year to adjust the valuation guess upward or downward instead of compelling a 3-year prophecy under such unpredictable conditions.

The only justification for that law is the fact that it does raise money for the Treasury; that is the only justification that anyone can see. At least, what could be done would be to permit the taxpayer an opportunity to adjust his valuation guess which he is required to make upward or downward each year instead of requiring him to try to predict 3 years in advance under present conditions.

Discriminatory tax on radio broadcasting should not be enacted.—The proposed Revenue Act of 1941 levies a special tax on the net time sales of radio-broadcasting companies, per section 601 of title VI. Although the industry affected is generally outside the scope of business activities represented by the Brooklyn Chamber of Commerce, we cannot let this opportunity pass to protest the introduction of such a form of taxation. The singling out of a specific industry for special taxation of its gross income allegedly justified because it is operating under a special Government privilege is alarming to many businesses operating in whole or in part under Government franchises. Such taxation is revolutionary and destructive. A tax on gross income levied without relation to the net income of the taxpayer is not only objectionable but is in many instances confiscatory. The fact that the broadcasters may earn a high rate of return on a small invested capital does not mean that their earnings are excessive and therefore should be subject to special taxes not levied on other businesses.

Ingenious and wasteful tax devices should be eliminated in interest of economy.—At a time when national resources of manpower and materials must be conserved in the interests of defense, we urge the importance of avoiding waste and stress, the need for efficiency in matters of taxation, recommending in this connection the elimination of special

ingenious devices of taxation which may be very interesting as intellectual exercises when time is available, but which are wasteful, annoying, and tend to stimulate ill will rather than cooperation between the agents of Government and the taxpayers at a time when utmost cooperation is essential. A few examples are as follows:

Requirement in the law for computation of invested capital based on daily balances, under certain conditions—which balances are seldom available in taxpayers' records.

Requirement that dividends paid within the first 60 days of a taxable year be deducted in computing invested capital.

Capital-stock tax and its companion, declared-value excess-profits tax.

The 10-percent tax on portions of the net income under the special rule in section 201 (a) (2) of H. R. 5417.

Recomputation of excess-profits credit carry-over under proposed 1941 law instead of continuing the carry-over as originally determined by the law recognizing it.

Taxation to make up deficiency in revenue.—The apparent deficiency in revenues brought about by elimination of the provision for a joint husband-and-wife return should not be made up at this time by arbitrarily adding or increasing taxes. The amount of the deficiency is small when compared with the enormous expenditures being made during the defense period and the amount planned to be raised by the bill. Taxpayers and legislators alike need time to experience the incidence of the present taxes and determine a more scientific and rational application thereof to the purchasing power of the Nation. The present concentration on the earnings of a small sector, comprised in large part of incorporated businesses and its investors, must be relieved if they are to survive. We are of the opinion that provision for this comparatively small addition to the total deficiency may well await consideration of the next session of the Congress, particularly in view of the large savings possible in the curtailment of nondefense spending. If the Congress is confirmed in the opinion that the deficiency be provided for the 1941 revenue bill, then we recommend that it look to the broad purchasing power of the Nation to raise the money and, if necessary, to the lowering of the personal exemption for purposes only of the normal income tax on individuals, or a withholding tax such as suggested by Mr. Alvord.

And before closing, I will say I listened to Mr. Alvord's very interesting exposition of the subject and our committee would have mentioned many facts which he has made unnecessary. We therefore wish to go on record to the effect that we are 100 percent in accordance with the recommendations of the United States Chamber of Commerce. Further, I would like to record our agreement with the thought expressed here that developments on the part of industry during this period should be encouraged taxwise, so that when the emergency is over industry will be in position to come out with some new things to enhance employment. I think it is a very important thing that he mentioned.

Senator BAILEY. You would favor his recommendation of withholding at the source this 3 percent regardless of whether it was a $90-a-month stenographer or $50,000-a-year lawyer; regardless of ability to pay?

Mr. HOOPER. Yes.

Senator TAFT. Of course, with the surtax on that?

Mr. HOOPER. Yes; but I do think a little consideration should be given to those brackets which are now being so hard hit. I think the 3 percent should be given consideration in those cases.

The CHAIRMAN. Mr. Alexander King.

Mr. KING. At this time I would like to yield to my colleague, Mr. Gibson, of the Pioneer Rubber Co., Willard, Ohio.

The CHAIRMAN. Will you indicate something as to the length of your testimony?

Mr. GIBSON. About 7 minutes.

STATEMENT OF J. C. GIBSON, PIONEER RUBBER CO., WILLARD, OHIO

Mr. GIBSON. Mr. Chairman and gentlemen of the committee, I think it is about time to have 5 minutes of serious entertainment. The manufacturers of toy balloons particularly, and likewise all rubber toys will be adversely affected if a 10-percent excise duty is placed on these products. Rubber toys of all kinds, and particularly toy balloons, are in competition with products made of various other materials, and it will seriously handicap them if they are taxed, and all other toys exempted.

By far the largest number of toy balloons are sold to the retail trade—to the children of America—at 1 cent apiece. This selling price is set substantially by the producer, and through the years, merchandise has been built to fit into this price structure. The balloons themselves are sold by the factory generally in the neighborhood of 78 or 80 cents per gross. This enables the jobber who purchases them to dispose of them at approximately 95 cents a gross to the retailer, who, for servicing 144 sales, receives a gross profit of approximately 50 cents.

If a 10-percent excise tax is placed on this product, it will mean that the penny item is immediately raised to about 90 cents per gross, including tax, to the jobber which does not leave sufficient margin for him to handle toy balloons, and thereby eliminates such merchandise from the market, for without adequate jobbers' sales efforts and services, the merchandise could not be expected to move.

Another phase of the problem is, that we cannot decrease the size of balloons readily, and give the child a smaller balloon for his penny, because of the aluminum priorities. Toy balloons are made on forms that are made of aluminum. They are mounted on strips and 4 or 5 strips are then attached to a board so that it is possible to make perhaps 150 balloons at one dipping. Were there no limitations on aluminum, it would be possible to have new aluminum forms made, and the child would have to be satisfied with an item of smaller size for his penny. We have built up some pretty big sizes for a penny. In order to cut these sizes, if we must, will require new forms. You say we can melt them. True, but we can only save 10 percent, thereby requiring us to look for the 90 percent of virgin rubber.

Senator TAFT. Virgin aluminum?

Mr. GIBSON. Yes; virgin aluminum, which we cannot get.

We have just cut off a few of these knobs that I have here [indicating].

It is impractical to place an excise tax on toy ballons because they are made from latex; that is, liquid milk rubber. The latex is not readily preservable. In warm weather it will sour, in cold weather it will freeze. In view of this, it seems impractical to store it. And even if it were practical to store it in steel drums or tanks, it would be impossible to get such storage equipment in adequate quantities without taking it from defense needs.

Therefore, by placing an excise tax on toy balloons, you would simply be taxing the children, and the poorest children in America at that.

Senator CONNALLY. How is the tax levied in this bill; is it on the manufacturer?

Mr. GIBSON. If you will just give me one moment, I will give it to you; I have it here.

You would be taxing the child who buys a little rubber article, and by the use of air and sunshine, inflates it and beautifies it, so that he has a whole armful of fun for his penny. Are those children with their good influence for morale, to be penalized? Are these little children going to be totally deprived of a penny balloon while all the rest of the toy industry is exempted? Have we come to a point in this richest country in the world where the little child will have to carry the burdens that are taken from the shoulders of others?

Senator CONNALLY. Yes; but how is this tax levied; does the manufacturer pay it, in this bill?

Mr. GIBSON. Yes.

Senator CONNALLY. And you say that you are going to pass this tax to these poor little children you have been talking about; you won't exempt them but will take their heart blood?

Mr. GIBSON. I suppose we will have to, if you pass this bill.

The toy-balloon industry consists of 10 factories, 9 of which are located in the State of Ohio and 1 in Illinois. These plants furnish employment to 983 people, mostly women. If this excise tax is imposed on the manufacturers of toy balloons, and not on various competitive articles, such as various toys, candy, and so forth, the discriminating public, and particularly the discriminating child, who has no more than a penny to spend, is sure to eliminate toy balloons from his purchases—incidentallv, those are the balloons which will have to be made shorter if we cannot get the rubber—thus seriously affecting the employment of these 983 people—of these, 547 women. It will offer cold consolation for such to know that the wealthy husbands and wives have won their point and may continue to file separate income-tax returns and saving them hundreds of thousands of dollars a year, if their representatives in Congress, in an effort to make up these losses, turn to the factory workers and the children of America and make them jointly contribute in a desperate effort to raise the required revenue.

Toy-balloon manufacturers recognize the necessity of revenue in this time of emergency. They have accepted without complaint increased minimum wages, higher corporation, income, and excess-profit-tax rates. By exempting them from this excise tax, and permitting them to do a near-normal business, the Government will receive more in taxes than can be expected from a reduced volume which would result, should this tax be imposed.

Have you stopped to consider that this bill proposes exactly the same excise tax for the child's toy balloon that it does for furs, safety-deposit boxes, radio-receiving sets, air conditioners, sporting goods, luggage, electric mixers, motion-picture films, and so forth? On the other hand, section 541, of the admission-tax provision, exempts paid admissions of less than 10 cents. Is the child who buys a penny balloon to be taxed for that, and the moving-picture house exempted on 9-cent entrance fees?

It is our considerate opinion that the United States Government will receive a greater amount of revenue from income-taxes on the toy-balloon industry than they would receive by burdening the industry with this 10-percent tax, which would logically substantially reduce the volume of business, so that it would be beyond the realm of reason to expect that the tax would apply on today's normal production, for it is evident that with such a penalty, we could not rightfully expect more than half of present-day production. Factories operating on such a limited basis would have their earnings seriously affected by virtue of the excessive overhead and burdens due to operating on a low-quality, or high-cost production basis.

Can it be that the provision to tax rubber toys is an effort to conserve the use of rubber?

In 1940 the rubber industry used 648,000 tons of rubber; in 1940 the rubber-toy industry used about 2,500 tons of rubber—I am talking about the conservation of rubber—and in 1940 the toy-balloon industry used about 523 tons of rubber.

The entire toy-balloon industry consumed an average of 43½ tons a month, 4 tons per factory, employing an average of nearly 100 people each.

About half a ton of crude rubber gives employment to one person for a year in the toy-balloon industry.

You readily see that an infinitesimal amount of rubber would be saved, even if the entire toy-balloon industry were put out of business. The dangerous thing would be the effect on employment of nearly 1,000 people, in an effort to discourage the use of a fraction of a paltry 500 tons of rubber used in the manufacture of toy balloons.

Toy balloons constitute only 2.6 percent of all toys, games, and so forth. All rubber toys, including toy balloons, total only 5.9 percent of all toys, games, and so forth.

In conclusion, the question and the only question involved is whether out of over one hundred million dollars worth of toys sold in the United States annually, rubber toys are going to be penalized. The question is, can you in fairness exempt all other toys and place this burden on rubber toys only? There seems to be no logical middle ground—tax all toys or exempt all toys including toy balloons. We are not objecting to the tax so much as to the discrimination. The Revenue Act of 1932 recognized the wisdom and necessity of such a course.

Now, in closing, we are going to leave these balloons here for you to take home to your grandchildren. I want to request that you put in this paragraph here [indicating] just two words after the word "surgical," namely, "rubber toys."

The CHAIRMAN. Any questions?

(No response.)

The CHAIRMAN. All right. Thank you.

Mr. Edward A. O'Neal?

Mr. O'NEAL. I am prepared to go ahead, but I think it will take about 35 minutes, and I think you gentlemen are worn out. I therefore think it would be preferable for all concerned, if we did not start at this hour when you gentlemen are tired.

The CHAIRMAN. We would be sitting 35 minutes more.

Mr. O'NEAL. No; I didn't suspect so; I think you will all run out.

Senator TAFT. Do we meet tomorrow morning?

The CHAIRMAN. No. I think it would be best for you to be here and be heard next week. File your brief anyway, then. We will be in session anyway.

Mr. O'NEAL. I will be here, but I have a conference with the Secretary of Agriculture.

Senator JOHNSON. Are we going to have the 10-minute rule in effect next week?

The CHAIRMAN. Yes; we are.

Mr. O'NEAL. I will have to leave town—after Monday, I have an engagement.

Senator CLARK. I think we can hear him next Monday.

Mr. O'NEAL. I would like to have the opportunity to be heard on behalf of the farm people, at least the 3,000,000 in our Federation.

Senator CLARK. I think you would get better attention on Monday.

Senator TAFT. I think it will be possible to hear you.

The CHAIRMAN. All right, you will be with us again, then, next week.

Mr. Cowles. Mr. John Cowles.

STATEMENT OF JOHN COWLES, PRESIDENT, THE MINNEAPOLIS STAR JOURNAL AND TRIBUNE CO., MINNEAPOLIS, MINN.

Mr. COWLES. I would like to call your attention to provisions in the proposed tax bill which seem to put a discriminatory and inequitably heavy tax burden on those companies that are least able to carry it. I refer to companies which have a proportionately large amount of debt so that a big share of their invested capital is in the form of borrowed money and which also had small or no earnings during the base-year period of 1936 through 1939 and so must use the invested-capital instead of average-earnings method of computing excess-profits taxes.

Many persons who have not studied all the provisions of the bill assume that corporations may earn 8 percent on their total capital, or even more if their base-period average earnings were higher, before becoming liable for the excess-profits tax.

Actually, the way the bill is drawn, those companies whose capital structure includes a substantial proportion of borrowed money and who likewise because of lack of base-period earnings must rely on the invested-capital method of computing taxes must pay excess-profits taxes long before reaching the 8-percent return figure. Borrowed-money capital is, in the first place, counted at only 50 percent of its face, and in the second place one-half of the interest paid out is added to the actual net earnings and the excess-profits tax is computed on an artificially inflated earnings figure.

The way the thing works out, as I understand it, is that a corporation that has borrowed money, whether bonds, notes, or bank loans, can only

earn on such borrowed capital one-half of the difference between the interest rate paid and 8 percent, without being subject to excess-profits taxes on those earnings.

To use a specific illustration, the company I represent has about twice as much borrowed capital as equity capital. In round numbers we owe $5,000,000—largely in term notes—on which we pay 4 percent interest. As the law stands, we can only earn 2 percent above interest on that $5,000,000 without being subject to excess-profits taxes.

Moreover, if I understand the bill's terms correctly, which in this case I hope I do not, companies like the one I represent that did not have big earnings in the 1936-39 base-year period and so cannot use average earnings, are further penalized and discriminated against by having to pay an additional special 10-percent tax that is not levied against those corporations that did prosper in the base period. If my impression is accurate and we do have to pay this additional 10 percent, then under the terms of the bill we could make, after interest, only 1.6 percent on that portion of our capital that is borrowed money without being subject to heavy excess-profits taxes.

And that 1.6 percent which we would be allowed to earn is of course subject to the normal Federal income and defense tax of 30 percent, leaving us net 1.12 percent as the maximum above interest that we may earn on our borrowed capital without paying excess-profits taxes.

The point I want to emphasize is that unless a company that is in debt is allowed to make more than 1.12 percent or even 1.4 percent above interest on its borrowed capital without becoming liable for heavy excess-profits taxes it will be almost impossible for such companies ever to pay off their debts and get into strong, sound, financial condition.

If any types of companies are to be favored, not as a gift but in order to keep our whole free-enterprise system of private capitalism functioning, it should be those companies that are struggling with debts. If companies with large debts are allowed to make net, free of excess-profits taxes, only 1 percent, or 2 percent, or even 3 percent above interest on their borrowed capital, many of them will not be able to meet their debt-retirement provisions and may be forced into receivership even though, paradoxically, they are at the same time paying big so-called excess-profits taxes.

The way the bill is drawn, wealthy debt-free companies and companies that prospered greatly from 1936 through 1939 and are consequently far better able to pay large taxes than the weaker companies will actually pay excess-profits taxes at only a fraction of the rate that companies in the category of the one that I represent will pay.

While we will pay heavy excess-profits taxes after making only a 1 and a fraction percent return above interest on that portion of our invested capital structure that consists of borrowed money, other corporations may make five times as large as proportionate return with no excess-profits-tax liability. And the strongly entrenched, rich companies have no debt-retirement obligations while the companies that are in debt must meet their regular debt payments or go into receivership.

My specific suggestions for correcting the inequities are:

First, that all companies using the invested capital basis for calculating taxes be allowed to earn 8 percent on their borrowed capital as

well as their equity capital before becoming subject to excess-profits taxes. Of course, companies owing debts would have to pay their interest out of that 8 percent.

Second, that in computing a company's excess-profits taxes, the actual net income be used, instead of adding back half of the interest paid to secure an artificial and fictitiously high figure on which to base the excess-profits tax. The recipients of the interest are also paying taxes on it, so there is no justification in taxing it twice. The argument that companies not needing additional capital might borrow solely to increase their invested capital base and so reduce their taxes, could be met by a provision in the law that only borrowings made prior to, say, August 1, 1941, could be included as invested capital unless the corporation could demonstrate that the additional borrowings were required for bona fide working capital needs.

Third, that the special additional tax of 10 percent levied on those corporations using the invested capital alternative instead of the average-earnings method be eliminated. If either group is to pay a heavier tax as a premium for being allowed to choose its alternative method; such heavier tax should be levied on companies selecting the average-earnings method, because such selection indicates earnings in excess of 8 percent on their capital.

Unless changes along this general line are made many companies with heavy indebtedness face receivership. A debt-free corporation should not be allowed to make several times as high a return on its capital, without paying excess-profits taxes, as a corporation that has outstanding debt to retire.

We must not limit, moreover, the establishment of new business enterprises only to those individuals or existing corporations that have sufficient accumulated capital so they will never need to borrow money to develop and expand such businesses as they may start. We must allow all companies a chance to make a reasonable return on their capital, borrowed money as well as equity, or our whole system of free enterprise will dry up.

The present bill is based on the erroneous theory that farmer who has a $4,000 equity and a $16,000 mortgage to pay on his farm should be taxed more heavily than a neighbor who has a $20,000 farm clear of debt.

In its present form the bill penalizes the companies least able to pay by taxing them on a proportionately much higher basis than the companies whose financial position and past earnings records make them much more abundantly able to pay the taxes that are needed.

The CHAIRMAN. Mr. Watson. Mr. Morris Watson.

STATEMENT OF MORRIS WATSON, NEW YORK, N. Y., REPRESENTING AMERICAN PEOPLE'S MOBILIZATION

Mr. WATSON. My appearance is on behalf of the American People's Mobilization, 1133 Broadway, New York City, of which I am the labor representative and a member of the national executive board. The A. P. M. as it is known, is made up of individual members, local councils and branches, and affiliate organizations which include labor unions, fraternal societies, nationality groups, and so forth. Because of some duplication, it is impossible to estimate the exact number of

persons represented. It has been variously estimated at somewhere between eight and twelve million. The organization or movement is supported by individual and group contributions. Its policies are set by a national council in consultation with local councils and affiliate organizations.

The primary concern of the movement is the complete military defeat of Hitler and the total destruction of fascism abroad and at home.

To that end, we are opposed to the tax bill now pending before you. We believe that increased production is a prime necessity. Such increase depends upon skill, muscle, and efficiency, and they in turn depend upon health and morale. Therefore, in our view, anything that lessens health and morale endangers the safety of the Nation.

We have the resources to build a strong Nation, and with that strength and our traditional love of democracy we can achieve victory over fascism and wipe fascism from the face of the earth. Let's start now in this tax business. The Treasury literally is pouring billions of dollars into the coffers of corporations. These same corporations, and others, are raising prices, by one device or another, and capturing more and more of the substance of the people. It is from these corporate profits that the Nation can get its taxes without impairing the national strength.

The position of my organization, in brief, is that the tax bill should:

1. Restore the proposed mandatory joint return for husbands and wives, and thus plug up the scandalous loophole through which the very wealthy have been able to dodge their share of taxation.

2. Restore the $1,000 exemption for single persons and $2,500 exemption for married persons and family heads.

3. Provide for an effective excess-profits tax of 80 percent or more on profits which are above 5 percent of invested capital; eliminate the "average earnings" option of computing excess-profits credits; place profit limitation on defense contracts; restore the undistributed-profits tax; and repeal the 20-percent amortization privilege.

4. Drastically increase all brackets for estate and gift taxes with exemption for not more than $10,000, plus a like amount of life insurance.

5. Tax all income from Government securities.

6. Tax capital gains at full rates, and disallow capital-loss deductions against ordinary income.

7. Eliminate excise taxes on consumers' necessities, and reject completely any notion of a sales tax or wage tax.

In other words, the new bill should tax those who can pay taxes and still eat and live like human beings.

A glaring example of the inequity and inadequacy of the present tax bill is found in the report of P. W. Litchfield, chairman of the board of Goodyear Tire & Rubber Co. In accordance with the provisions of the present bill this company has set aside $8,158,406 to pay its income and excess-profits tax from 1941 earnings. In the same period of 1940—that is, the first 6 months—the company paid $1,097,875 in similar taxes. The increase this year is 643 percent. That sounds like a lot. But wait. The net profit for the first period of this year, after providing for taxes and reserves, is $6,196,756, as against $4,142,892 in that period last year. A profit increase of 49 percent. But wait again. In the first 6 months of 1940 the company set aside no reserves. This year it set aside $3,500,000 in reserves.

In other words, the Goodyear Tire & Rubber Co., as well as a lot of other corporations waxing rich on the defense program, can pay a lot more in taxes than is provided in the bill, and still wax rich.

That is not so of the salaried people, the wage earners, the little people, the vast majority of the American people. They have no "nets" and "reserves." Prices of foodstuffs go up and they eat less. Rents go up and they crowd into smaller quarters. On top of these things, you legislators increase their taxes! Down goes their standard of living! They get sick and weak, and we say that's a heck of a way to run a nation in a time of great peril, or any other time.

The alarming number of rejectees of selective service demonstrate that already too many people in this country don't get enough to eat and don't live as they ought to live. Last May, Brig. Gen. Lewis B. Hershey, reported 380,000 rejectees out of 1,000,000 men examined. To do anything but strive for correction of this situation is to help Hitler toward enslavement of the peoples of the world.

Finally, we must confess complete lack of ability to understand a system of taxation which says the people shall live on less and the corporations on more.

I should like to put the report of the Goodyear Rubber Co. in the record.

I thank your committee for hearing me.

The CHAIRMAN. All right. Thank you.

(The report referred to and submitted by Mr. Watson is as follows:)

SOME FACTS ON THE FIRST HALF OF 1941 FOR STOCKHOLDERS AND EMPLOYEES

(By P. W. LITCHFIELD, chairman of the board, the Goodyear Tire & Rubber Co.)

FOREWORD

For the past several years I have issued a somewhat informal report of our operations to our employees and stockholders in conjunction with the formal annual report. In these informal reports I have sought to give a nontechnical explanation of the forces and factors with which management had been dealing and thus to provide both stockholders and employees with a better understanding of Goodyear.

Because the first 6 months of 1941 were unusual in so many respects and because the influences of those first 6 months will continue to exert themselves upon our operations for an indefinite period ahead, it was deemed advisable to submit the following comment at this time rather than to wait for the close of the year.

GENERAL COMMENT

The first half of 1941 broke all previous Goodyear records in such important matters as total sales, tonnage of rubber products produced, pay rolls, and personnel employed.

Even the figures for the first half of 1929, considered the all-time boom year in American business and industry, were substantially exceeded by those of the 6 months just ended.

Under normal conditions, an achievement such as this would be viewed with unbounded gratification. But we must recognize that the dominant factor in our operations during the first half of 1941 was the national emergency. National wage levels advanced substantially during the period, thus providing increased buying power, and prospects of shortages in various lines of goods stimulated business enterprises and individuals alike to "stock up." This served to create an abnormal market for goods of all kinds resulting in a situation akin to the first stages of inflation. It would be imprudent in the extreme were we to base our expectations for the future on such records as these. On the contrary, we

must interpret current figures as the forerunner of changes which will come with the return of more normal times. That is why we are now setting up substantial reserves and in other ways endeavoring so to manage our affairs as to emerge from the present unsettled period with strength to meet the new conditions.

The continuing interests of our stockholders and employees obligate us to such a course.

With that policy in mind, it may be of interest to stockholders and employees to review some of the detailed figures covering the first 6 months of the current year.

We realized from the sale of our products	$152,931,046
As compared with a figure for the same period of 1940 of	$101,055,607
An increase of—percent	51
On June 30, 1941, we employed in our world-wide operations, persons	[1] 58,411
As compared with same date last year—do	48,996
An increase of—percent	19
We paid out to our employees, in salaries and wages	[2] $39,651,708
As compared with a figure for the same period in 1940 of	$30,319,353
An increase of—percent	27
In accordance with provisions of the bill now pending in Congress, we have set aside out of 1941 earnings for United States income- and excess-profits taxes	$8,158,400
As compared with our domestic tax charges for the same period of 1940 of	$1,097,875
An increase of—percent	643
Our net profits after providing for taxes and reserves of	$6,196,756
Compare with those for the first half of 1940 of	$4,142,892
An increase of—percent	49
Out of the 6 months' receipts we have set up as reserves for contingencies	$3,500,000
As compared with reserves set up during the first half of 1940 of	None
The tonnage of rubber goods we produced was—pounds	453,610,000
As compared with a figure for the same period in 1940 of—do	352,568,000
An increase of—percent	28

[1] Including coolie labor employed on our rubber plantations in the Netherland India.
[2] This figure does not reflect substantial wage increases placed in effect in our domestic plants in mid-June.

DEFENSE WORK

Under the pressure of our country's defense needs, Goodyear is continuing to expand its efforts in this field.

Our subsidiary, the Goodyear Engineering Corporation, is under contract to operate a large powder bagging plant at Charlestown, Ind., construction of which is now being rushed to completion. This plant is wholly owned by the Federal Government through its Defense Plant Corporation. It is situated on a 4,500-acre tract adjoining one of the world's largest power manufacturing plants.

Our subsidiary has assisted in the supervision of construction and will take over its operation under a lease arrangement which involves no investment on our part. Personnel for the management of the plant is being drawn from the parent company.

Our largest single new activity is the fabrication of metal parts for airplanes. This work is carried on by our subsidiary, the Goodyear Aircraft Corporation. Currently 2,000 persons are employed in this work, our organization having been built during the past few months around a nucleus of technicians and skilled workers who had gained experience in the fabrication of light metal alloys during the construction of airships.

This organization will be expanded to probably 10,000 employees upon completion of plants which are now under construction on land adjacent to our airship dock at Akron Airport.

The output of this organization goes to primary manufacturers of airplanes, we serving as subcontractors.

We are under direct contract with the Navy for the production of nonrigid airships for coast defense patrol and are now in process of expanding our facilities for this work.

Another major expansion is going forward in our division of wheel and brake assemblies for airplanes. We have been in this business for a great many years since it naturally links itself with the manufacture and sale of airplane tires. Growing demand for our products has necessitated the planning of a new manufacturing building which is expected to be completed this fall.

A long list of other defense products, such as barrage balloons, life rafts, self-sealing fuel tanks and combat tires, most of which were enumerated in our annual report for 1940, are being manufactured at sustained or accelerated rates.

RESEARCH

For more than three decades, Goodyear has devoted much time and effort to scientific research and development in our endeavor to improve standard products and to develop new products. Defense needs have magnified the importance of such work to a marked degree.

Accomplishments in this division have ranged from the development of a widely used accelerator of rubber vulcanization, known as Captax, to our own type of synthetic rubber which we have named "Chemigum." The first successful rayon tire was worked out in our laboratories. A rubber resin, named Pliolite, was discovered by Goodyear and is now being used in the manufacture of improved lacquers, water resistant paper coatings and a number of other products. Soon another Goodyear plastic, Plioform, may be used in certain ways to replace aluminum and the scope of its eventual usefulness is wide indeed.

We have developed various other plastics which are finding application in many fields and our exclusive product, Pliofilm, is being used more and more widely in the packaging of foods and other commodities which require protection against evaporation or moisture.

In the immediate field of defense we have developed a very efficient bullet-sealing structure for airplane fuel tanks, a practical and compact airplane motor suspension, advanced types of barrage balloons, and a number of other items used in modern warfare, the details of which we are not permitted to discuss.

Much of the work we are now doing is likely to have application in future peacetime markets since our development of an outstanding synthetic rubber has vastly expanded the limits of scientific research. Combining the known elements of the natural rubber with those of the synthetic rubber we can clearly see opportunities for a whole series of new processes, new plastics, and new organic chemicals which lend themselves to specific application in fields as yet untouched.

The swing away from natural materials to synthetics is one of the most important developments our industry has ever known, and the benefits will be translated into terms of meeting the expanding needs of mankind.

THE SITUATION IN RUBBER

In a recent public statement, I ventured the opinion that there will be enough rubber, even under present restrictions now imposed by the Government's effort to build up its own stock pile for defense, to meet the legitimate requirements of the general public.

Until there is an adequate reserve for defenses, the amount of rubber which the Government will make available for public consumption will continue to be limited. Tire production during the next 6 months will be at a reduced rate as compared with the first 6 months, but since it now appears that the level will not be below that of 1940, I do not believe such reduction will work a hardship on the public or our dealers.

Bear in mind that there is no actual rubber shortage today. At least a 6 months' normal supply is on hand in America and the commodity is being received at our ports in amounts which exceed current needs.

The complications arise out of the possibility that our supplies, which come from Malaya and the Netherland Indies, may be reduced or shut off by subsequent developments of the war.

Meanwhile, our policy is in complete accord with the Government's program, and we are willing in every way to cooperate with this intelligent plan for preparing for the worst possible emergency that may arise.

(Whereupon, at 5:10 p. m., an adjournment was taken until 10 a. m., Monday, August 18, 1941.)

REVENUE ACT OF 1941

MONDAY, AUGUST 18, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Josiah W. Bailey presiding.

Senator BAILEY. The committee will come to order.

Senator George, the chairman, is necessarily detained for a short time. He requested me to act as chairman.

I wish to make several announcements. Several days ago, the committee voted to impose a time limitation not to exceed 10 minutes, on all witnesses, with the privilege of submitting a written brief or statement to supplement oral testimony.

Those wishing to file briefs in lieu of oral testimony must submit them to the clerk of the committee by August 23, Saturday, the closing date of the hearings.

On the calendar for today, and the remainder of the week, are a number of witnesses on the same item. Wherever possible the committee wishes that the witnesses consolidate their testimony and select one spokesman in order to avoid repetition and duplication and to expedite the hearings.

Now, the first witness this morning is the Honorable James Lawrence Fly, Chairman of the Federal Communications Commission.

We will hear Mr. Fly. I understand that there is no time limitation on him.

Mr. FLY. Thank you, Mr. Chairman.

Senator JOHNSON. Mr. Chairman, in regard to witnesses who are on the calendar and who do not appear to make an oral statement, there will be no objection to putting their briefs into the record?

Senator BAILEY. If they get them in by the 23d.

Senator JOHNSON. They can present them today, if they are here.

Senator BAILEY. They can present them if they are here.

All right, Mr. Fly.

STATEMENT OF HON. JAMES LAWRENCE FLY, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

Mr. FLY. Mr. Chairman, I am afraid it is a bit presumptious of me to come before this committee on a matter of this kind, because I know this is something on which there are many attendant problems, and I fully appreciate that this committee is far more expert in this field than I am, or than I may ever hope to be. Therefore, I do not want to be guilty of presuming too much here, or extending into a field where I have little competence.

I do think that where the committee will be interested in specific figures, it might be well if the committee would assign to me, or conceivably to some representatives of the broadcasters, the duty of working up those figures. We did spend some considerable time studying the effect of this tax upon the different classes of organizations in the business, but the results are not easily to be attained, in view of the fact that one must consider the combined effect of this tax in the light of income and excess-profits taxes.

As I understand the figures of the Treasury, while there has been some indication that this tax upon broadcasting will net around $12,000,000, I believe the Treasury has indicated it would be probably around 4½ to 5 million in terms of its net effect. Therefore, I am not talking about a relatively large sum. At the same time, even that sum placed upon the broadcasting industry is substantial, because despite the prominence of the industry and despite its great significance in the broad public service it renders, it is not a big industry in a money sense.

There are a few general observations that I should like to offer for what they may be worth to the committee, I am sure you are all familiar with the fact that the broadcasting industry renders a great deal of public service. Much of the time, and much valuable time, of the industry is devoted to public-service programs, and there I am not referring simply to the Farm-and-Home hour, and Toscanini, and that sort of thing, although they are highly valuable, but more in point is the extensive time devoted to public debate, to speeches of you gentlemen, and of other public figures in the discussion of the great issues of the day. That not merely occurs today, that is a continuing practice in the industry and has become, if not a rule, certainly a consistent habit of this industry to carry a great range of public-service programs, and they are limited not merely to the field of political discussions, affairs of state, but to various other civic, charitable affairs, and that sort of thing.

Perhaps one of the most valuable public services which the industry renders is the extensive news gathering and dissemination. We take it for granted on Sundays, when we hear broadcasts from Singapore, from Cairo, from Hong Kong, Tokio, Manila, Moscow, that that is a routine broadcast. Of course, that is hardly routine. That is not merely a highly technical and difficult operation, but a highly expensive one, and in terms of returns to the public, I think we will all agree it is a very valuable service.

Now, in addition to those general items of service which I have so crudely outlined——

Senator VANDENBERG (interposing). You omitted the fireside chats. They are very important.

Mr. FLY. Yes, sir; they should be included, Senator Vandenberg. A great deal of time nowadays is devoted to Government programs, to those programs having to do with the armed services, with the campaigns for funds.

Senator CLARK. Mr. Chairman, the Government departments even set up radio stations of their own for broadcasting their own praises—haven't they? Do not they do that, do not they have one in the Interior Department?

Mr. FLY. No sir. They do have a studio down there, and from there, of course, it is convenient to tie into one of the local stations, or to the networks. It is a very nice little studio, incidentally. But a great deal of this national-defense work is carried by these stations and by the networks over these facilities.

Now, I do not think there will be any discussion, at least as I see it today—I do not think there will be any discussion on the demands of this industry for public service. Of course, that is all in terms of immediate money returns. That is the loss to the industry with nothing coming in.

There is also the probability that additional burdens may be placed upon the industry in terms of additional equipment. These facilities may be useful for national-defense purposes in a more direct sense. It may be important to keep them on the air—well, let us say, for example, an air-raid warning service, and that sort of thing.

Senator VANDENBERG. When are you going to start that?

Mr. FLY. We hope not at all, sir; but in the job of preparation for possible eventualities, that is one of the things that must be considered, and an example of that situation is the demand for an auxiliary power supply for the stations in order that the station that might be depended upon in an emergency will not go out with the failure of the regular power supply.

So, we find the industry, in a period where the demands upon it may be more significant, perhaps more useful and certainly more burdensome. I think that it can hardly be denied that the service rendered by the industry is of a very vital character.

Now, there are some interesting points regarding the economics of the business. There are important fixed costs. Telephone lines, for example, is one of the important cost elements. There are others, such as talent, labor, studios, and various facilities.

Now, it is the very nature of broadcasting that it must be continuous broadcasting, and broadcasting must go on whether the returns come in or not. For example, conceivably the leading oil companies—and the East not having enough gasoline for sale anyway—should they determine to cut down on their advertising, selling time heretofore occupied by them on the air must be occupied, entertainment or some service must go out to the public. That would be true with the automobiles or with any industry where, because of the peculiar requirements of the present situation, the advertising demand may conceivably fall off.

Now, the percentage of net to the gross is not awfully high, so that with not a constant base in terms of amount but a continuing base of actual costs that will be there whether or not you are getting any return, you see you can easily run from a period like 1940 into the future days that may lie ahead of us, into a net loss, and depending upon the demand of the industry and the amount that this advertising might provide, of course, would be the amount of the loss in terms of decreasing revenue and sustained costs.

Now, the industry has also felt, I believe, that this tax in effect upon advertising would be something of a burden upon the distribution of goods. That is a matter which is frequently debated, and I need not do anything more than mention it here for what it is worth.

Conceivably, that might be important in a time of recovery, changing from an emergency situation back to a normal economy, to see that the free distribution of goods is not burdened.

Of more significance at the moment, however, is that competing advertising media are not taxed. I believe that is generally true of newspapers and magazine advertising, for example. In addition to that, of course, there is a heavy subsidy to the use of the second-class mailing privilege to the newspapers, and so forth, which assuredly redounds to their very great economic benefit. Of course I am not criticizing that privilege. That is a matter of policy on which I would offer no criticism, but when we start to evaluate the status of a competing media I think it is of some significance.

Senator CLARK. The fact is that radio advertising and newspaper advertising are competitive. Under the decision of the Supreme Court of Louisiana in a case that came before it, it would be of very doubtful constitutionality to tax newspaper advertising, and, therefore, the contention of the radio people is that it is unfair to tax them when they are not taxing their competing advertising media. Is not that the contention on the part of the radio people?

Mr. FLY. I believe that is their contention, sir.

Now, I am not going to burden you gentlemen with the detailed figures. In the first place, as I said at the outset, I do not want to presume competence in that field. Let me say before I do mention these in general outline, that we shall be glad to study the records at the Commission if the committee desires that we make the study, and to give some more specific estimates. I would imagine, however, that the Treasury would be definitely more competent than we to do that. Our facilities, of course, are available to the committee.

Now, the factors in the industry that will be most heavily hit by the tax will be the chain companies. I believe nine of the chain companies will be affected by the tax. Taking the gross figure rather than the net figure of the tax, for example, and, of course, the net will be substantially less, the nine chain companies and the stations licensed to them would have a gross tax under this bill of $7,815,000. Then there are 224 stations in addition that apparently would be affected by the tax, giving a gross result under this bill of $4,823,790.

Thus, arriving at the gross as distinguished from the net figure, a gross of $12,639,486.

Now, there are in that group about a total of 256 stations that seemingly would be affected by the tax. However, upon examination, apparently the tax would not hit in a substantial way many of the stations. There are a relatively few stations, but, by and large, they are not important.

Senator JOHNSON. Well, Mr. Fly, as I understand, the relationship between the stations and the networks, why would not the networks pass on this tax to the stations? Instead of passing it on to the advertisers—and it is generally anticipated, it seems to me, they will pass it straight on to the station and reduce the amount that they pay the station for the service that the station renders the network, so why will not every station be affected?

Mr. FLY. That, of course, would be a conceivably indirect result, but I believe the bill as drafted, Senator, places the tax on persons engaged in operating a radio broadcasting station, or engaged in net-

work broadcasting. Then the tax is immediately placed upon net time sales.

Senator JOHNSON. It is just a sales tax. It is a sales tax on advertising sales.

Mr. FLY. Roughly speaking; yes, sir.

So, the tax here as you have it before you, I believe, is placed directly upon the network. I do not know what plans the industry might have in mind for any distribution of it.

Senator JOHNSON. The network pays the station. The network does not do any broadcasting itself, it hires the station to do its broadcasting and it pays the station for doing that broadcasting.

Mr. FLY. Yes—may I say, "yes" and "no"? Of course, the studio work, as you know, Senator, is done in New York. The broadcast originates in New York, or some program, Senator, in Chicago or Los Angeles, or possibly some other point and that, of course, is likely to be a network business at that end. On the commercial programs you are right, the network pays the station for putting the program out but, if it be a sustaining program, that is one in which there is no advertising sale and no income, the payment will run for that, that is, for the commercial program.

Senator JOHNSON. There is no tax on sustaining programs on that kind of broadcasting?

Mr. FLY. No.

Senator JOHNSON. The tax all comes on the commercial programs?

Mr. FLY. I do not think there is any conclusive answer to your point. That is conceivably a way that it might be worked out under the bill, although I merely point out that in the outset, it is placed directly upon the station broadcasting on its net time sales and directly upon the network upon its net time sales, so there is the immediate impact.

Now the large networks will be substantially affected here. I do not want to say what the figure would be. I suspect on the 1940 figures it would be roughly around $2,000,000 each, that is, upon N. B. C. and Columbia. That would take a very heavy proportion of their net income, of course. Based upon—well, the 1940 figures, for example, that sort of a result would not be destructive, still taking either a longer view of it backward or a further view into the uncertain future, with the income in doubt and with the burden of public service in the increase, I think it sufficient to give us some pause there.

Perhaps it may be found that the more emphatic results will be upon some of the regional networks. You take the Don Lee Broadcasting System, for example, on the west coast, where there is a pretty extensive regional network, now that network is rather extensive and having a fairly heavy and important business. It is not composed predominantly of big, profitable stations, and a tax falling heavily in a situation of that kind might conceivably result in impairment, or abandonment of service at a number of the smaller stations that are reached at some expense by such a network.

Gentlemen, I believe, in view of the greater competence of many of the gentlemen who appear here, I shall not give any more specific statements regarding this matter. However, I am at the service of the committee.

Senator BAILEY. Are you finished?

Mr. FLY. I would be glad to try to dig up anything that the committee may instruct me to.

Senator BAILEY. Are there any questions?

Senator VANDENBERG. You are opposed to the tax, are you, Mr. Fly?

Mr. FLY. I think it is a pretty dubious tax, sir. I am awfully reluctant, when you have the burden of finding money, to say I am opposed to the tax.

Senator VANDENBERG. You want to save the radio industry in many other aspects. I would be interested in how you feel about that.

Mr. FLY. I think it is a dubious tax.

Senator DAVIS. If you put a tax on advertising in radio, will that not set a precedent for taxing advertising in newspapers?

Mr. FLY. I think it might very well do so.

Senator CLARK. You cannot conceivably tax a newspaper advertising under the Supreme Court decision in the *Louisiana case.*

Mr. FLY. We have given consideration to a tax measure in view of the notion that broadcasting companies are operating with a public franchise, in effect utilizing public property. But then, considering the heavy public service the broadcasting industry is rendering, and in view of the competition with other advertising media, I am inclined to think that in any tax measure it would be well to treat the broadcasting industry pretty much in a class with the other branches of the communications industry. We have been considering for some time a possible draft of a bill which would assess broadly upon the communications industry roughly the cost of regulation, but a tax of that kind—well, I doubt, for example, if the result of that would be more than say, around one-half of 1 percent of gross upon the broadcasting industry, and then a part of such a tax, a very important part would be thrown upon the telephone industry, and some upon the telegraph industry which, incidentally, is not in a position to pay any heavy taxes.

Senator JOHNSON. From the emphasis you put on the public service rendered by the radio station, it leads me to believe that you feel that this is a tax upon the freedom of expression. Am I right in reaching my conclusion, based on your testimony? You place great emphasis upon the fine public service that the radio industry is rendering.

Mr. FLY. I think, sir, that that is really an important offsetting argument on the point that the radio operates with a public franchise. In other words, conceivably the approach to this would be that, since the business is, in effect, based upon the license, upon the use of the publicly owned frequency, a special tax should be imposed. I think the notion of the public service is rather an anticipatory reply to that point, at least in part; also, in emphasizing the amount of time, and hence the amount of money devoted to the public service, and I am pointing to the fact that, with the increase in that type of service, and with various additional burdens upon the broadcasters, coming at a time when there is apt to be a decreased income, then any substantial tax in addition to those now imposed might be very detrimental to the service.

Senator BAILEY. What does the Radio Commission cost the Government? What was the appropriation?

Mr. FLY. Apart from the special national-defense work, sir, it would be roughly $2,000,000 a year.

Senator BAILEY. That is the appropriation to carry on your activity?

Mr. FLY. Yes.

Senator BAILEY. Who pays that?

Mr. FLY. That is out of the appropriations, sir. It is not assessed in any way.

Senator BAILEY. You do not collect any license fees?

Mr. FLY. We get no license fees at this time. As I said, in considering this business of a tax to cover the industry as a whole, and merely to cover the cost of regulation, that is one possible, logical approach, to have some sort of license fees and costs for the different procedures, and that sort of thing.

Senator BAILEY. A man who enjoys a Government franchise ought to be willing to pay for it, ought not he?

Mr. FLY. I think that is true to that extent, sir. I think if they were readily available, a formula for assessing in terms of a franchise tax, that might well be done, but of course, when you start looking for the formula, you get into trouble.

For example, you have stations of a given power who pay a certain amount of tax, we will take examples of a couple of large, powerful operations; you take WEAF in New York, you take KOB in Albuquerque, N. M., which at times is operated at 50 kilowatts also, and you will see it would be quite impossible to place upon those two stations the same amount of tax. That is the sort of problem you run into when you head into a franchise tax, based upon power. Conceivably, a more logical base would be in terms of coverage, that is, in terms of population that receive adequate primary service. At least, superficially, that would be a fairly sound approach, but even that is none too easy. The coverage is hard to determine with a great degree of precision, and it changes at various times with the seasons, the time of day, the sun-spot cycle, and a lot of other things, not to mention changes in the stations themselves. So, while that is not an impossible sort of problem, you can see it readily offers some difficulties.

Senator BAILEY. The franchises heretofore granted are very valuable in some instances, are they not?

Mr. FLY. Very valuable, sir.

Senator VANDENBERG. As long as they last they are valuable.

Senator BAILEY. What would the N. B. C. sell their franchises for today?

Senator CLARK. It depends on who is trying to buy them, does it not?

Senator BAILEY. Just give me a general estimate. The question of price always takes into consideration whether there is somebody ready to buy. What do you imagine the N. B. C. franchise is worth? They got it free. What do you think it is worth?

Senator VANDENBERG. It is worth no more than you want it to be, is it not?

Mr. FLY. That is not completely in our control, Senator. I do not know. You see, the N. B. C., for example, has several million dollars of properties, and it is an important going concern. There are various

facilities that are not directly attached to a license for particular stations. You see, a network operation is something that can be done entirely apart from a license, quite apart from any station; that is, in the same ownership. What they need is the facilities; they need a sponsor; they need a program; they need talent; they need studios and a point of origin, and then from that studio programs can be piped to any number of stations by wires. So, when you come to evaluate the licenses for the particular stations that are controlled by the network, you need to draw a line between those two classes of facilities and services.

Senator VANDENBERG. Don't you think they would be willing to pay something for a more exclusive sort of franchise than they now have?

Mr. FLY. I suspect they would pay substantially more.

Senator CLARK. On the other hand, take the Noble station, for example, the price might be lower?

Mr. FLY. Might be lower.

Senator CLARK. In other words, in the common gossip, the station sold for considerably less than the owner thought the station was worth?

Mr. FLY. Yes; that is common gossip. And that, I think, is a pretty good description of it, Senator. I think I can give you some specific answer to that. The price that was paid for that station was around, I think, $850,000, and I also understand there was under consideration at the same time and for the period of a couple of weeks during the negotiations another proposition involving $875,000, but that the second proposition involved a restraining clause that would restrain the owner from going into the broadcasting business for a period of 5 years, or some such time. So there was adequate ground there for the choice of the slightly lesser amount without the restraint.

Senator CLARK. Do you happen to know who represented Mr. Noble in that transaction?

Mr. FLY. Yes; I do. Mr. Dempsey and Mr. Koplovitz.

Senator CLARK. Was Mr. Corcoran of counsel?

Mr. FLY. Pardon me?

Senator CLARK. Was Mr. Corcoran of counsel?

Mr. FLY. I do not think so, sir.

Senator DAVIS. Can you give me the cost of the telephone charges, so to speak? Can you give me what the connection of the wiring-up of these different stations is? Can you give me what the radio pays to the telephone company?

Mr. FLY. No, sir; I cannot, offhand. I can get some useful figures. Of course, they would vary, depending upon the location of the studio and the amount of distance that is to be covered, and the difficulties encountered.

Senator DAVIS. Will you put them in the record?

Mr. FLY. I shall be happy to do that, sir.

(The following memorandum was submitted at the request of Senator Davis during the course of Chairman Fly's testimony:)

NETWORK TELEPHONE-CIRCUIT EXPENSE

Reports filed by the three major networks indicate that $6,398,772 in the aggregate was spent by them during calendar year 1940 for network line service and to provide studio-transmitter service and local loop service for their owned and oper-

ated stations in the cities of New York, Chicago, San Francisco, and Los Angeles. This amount is distributed as follows:

Columbia Broadcasting System, Inc	$2,181,623
Mutual Broadcasting System, Inc	621,931
National Broadcasting Co., Inc	3,995,218
Total	6,368,772

Figures showing expenses for network line service exclusively are not available, since the two larger networks lump in their reports both expenses for network line service and for local station purposes. However, officials of these networks estimate that 10 percent would closely approximate the amount included in the above over-all figure which is actually expended for station as distinguished from network purposes. Assuming the correctness of this estimate, the total charge incurred by the three major networks for the maintenance of permanent network service would be approximately $5,800,000 for the year 1940.

In addition to the three major networks, a number of regional networks maintained permanent program-transmission circuits. The aggregate amount spent by all regional networks for this purpose would not have exceeded $500,000 for the year 1940.

The accuracy of these figures is confirmed by the report of the American Telephone & Telegraph Co., in which it is stated that for the year 1940 the company had 16 customers employing 17 program-transmission circuits with 417 users over a total distance of 49,979 miles. The revenues derived by the company for this total service for the year was $6,664,248, according to its report. The slight increase between the amount reported by the telephone company and the amounts reported above results from receipts by the telephone company for temporary hook-ups as distinguished from the maintenance of permanent network connections.

The total expense to the broadcasting industry for program-transmission circuits in 1940 was approximately $9,000,000. This sum includes, in addition to amounts for permanent network service given above, the costs incurred for studio-transmitter circuits and local loop circuits.

Senator BAILEY. If there are no further questions, the next witness is Mr. Maurice Lynch, of Chicago, the financial secretary of the Chicago Federation of Labor. You have 10 minutes, Mr. Lynch.

Mr. LYNCH. I will not take that long.

Senator BAILEY. All right.

STATEMENT OF MAURICE LYNCH, CHICAGO, ILL., FINANCIAL SECRETARY, CHICAGO FEDERATION OF LABOR

Mr. LYNCH. My name is Maurice Lynch. I am financial secretary of the Chicago Federation of Labor and have been for the past 14 years. The Chicago Federation of Labor is the licensee, owner, and operator of Radio Station WCFL, the "Voice of Labor."

The Chicago Federation of Labor believes it against the public interest to have this proposed tax bill passed as it is now written.

Our objections are simple and fundamental: First, the measure places an unequal or discriminatory burden on radio broadcasting—and I believe billboards—and fails to include other advertising media. Second, this bill departs from the well-established precedent of not taxing income of "not for profit" organizations and labor unions. We do not believe this body has any intention to discriminate against certain selected advertising media or to favor any others. Yet, this bill as now written does just that. We do not believe this committee intends to depart from the carefully considered past policy of exempting "not for profit" organizations and labor unions—yet this bill does that.

When WCFL was first established the cost was taken care of by voluntary contributions from members of union labor of Chicago and vicinity.

Since its establishment the cost of operations has been met by voluntary contributions from unions and proceeds from the sale of time and annual benefit entertainments. The station has been operating at a loss almost every year from its inception until the year 1940. The operating loss for 1938 was $61,000 and $29,000 loss for the year 1939. The profit for 1940 was $20,163. When we saw that we were operating at a profit during 1940 we undertook to apply to the Federal Communications Commission for an increase in power from 5 to 10 kilowatts in order that we might be heard by more people and over a larger area. The Federal Communications Commission granted our application.

In order for us to increase our facilities to 10 kilowatts it necessitated committing ourselves to expenditures of approximately $46,000. Penalizing us to the extent which this proposed tax bill provides would prevent us from carrying on the service to the public which we intend to give. It was and is our intention to increase our power to 50 kilowatts, or more, if we were to become financially able, but with this proposed burden to be met those good intentions would have to be abandoned. Further than preventing future expansion, this proposed tax bill would limit our present operations and necessitate reductions of personnel, service to the public, and hours of operation.

We have donated, we do donate, and we expect to continue to donate valuable time to our Government to help publicize any and all of its activities, especially those relating to national defense and public welfare.

Our radio station, more than any other in Chicago, is available to the free use of national-defense and public-welfare organizations. This is not said critically of other stations. We can serve better than the other stations because the profit motive is not the object of our operations. It would not be just that the radio stations which donate so much time to Government agencies, be discriminated against, as they would be if this bill passes, just as it is.

Much of the "American way" comes from the activities of "not for profit" organizations. We urge you—do not depart from the well-considered and long-established policy of exempting those "nonprofit" organizations from income taxation, at a time when our Nation, more than ever, needs their support.

We have a tremendous national-defense debt to meet—as a Nation. We should meet this debt with all fairness and not with discrimination.

Gentlemen, I thank you for this opportunity you have given me to try to explain our case. If there are any questions you wish to ask, I will try to answer them.

Senator BAILEY. Are there any questions?

Senator CAPPER. May I ask, is there any other station owned by labor or by an agricultural or industrial group?

Mr. LYNCH. There is no station owned by labor. I would think there are some stations that might be called agricultural stations, like WLS.

Senator CAPPER. There is no other group that you know of?

Mr. LYNCH. No.

The CHAIRMAN. The next witness is Mr. Harold A. Lafount, Washington, D. C., representing the National Independent Broadcasters.

STATEMENT OF HAROLD A. LAFOUNT, WASHINGTON, D. C., PRESIDENT, NATIONAL INDEPENDENT BROADCASTERS

Mr. LAFOUNT. Mr. Chairman, and gentlemen of the committee, my testimony before your distinguished committee will be confined to that section of the bill (H. R. 5417) which lays on a graduated tax on the net time sales of radio broadcasters. I speak as a representative of the independent stations. Before attempting to discuss the problems arising out of this proposed tax, however, I would like to state briefly my own qualifications as a witness on this subject.

Radio has been my chief interest for 20 years. From 1921 to 1927, I was engaged in the manufacture of radio equipment, particularly loud speakers. Throughout that period, too, I maintained a radio laboratory. From 1927 to 1934, I served as a member of the Federal Radio Commission. In the course of my official duties, I visited almost every radio station in the United States, assisted in the preparation of rules and regulations governing their operation and otherwise helped to administer the law which the Congress had enacted to control radio broadcasting. From 1935 to date I have had direct charge of the operation of six broadcasting stations, and this experience has given me an excellent opportunity to observe conditions within the industry, to study its problems, to understand some of its difficulties and to share in its struggle to render an outstanding public service.

Now, there are three points I would like to impress upon you gentlemen in connection with the proposal to lay a tax on the sale of broadcasting time. First, the independent stations for which I speak do not oppose the enactment of heavier taxes. We fully appreciate the necessity of raising funds to defray the expenses of our national-defense program. We want you to know, also, that we are willing to cooperate within our means and even to the extent of giving our lives, if that should be necessary, for the preservation of our democracy. We agree that everyone must sacrifice in order that our security as a nation may be assured. All we ask is that the burden of financing this gigantic national effort be equitably distributed in the true American fashion.

That brings me to my second point, which is simply this: The bill, as it stands, discriminates against the broadcasting industry. It levies a special tax on the industry's only source of revenue, which has already been depleted in some measure because of the extensive services we are rendering to the Government. The tax is levied on "net time sales," whether those sales bring us profits or losses. Please remember that nearly 300 broadcasters operate at a loss in this country. In a great many instances, therefore, title VI of this bill would have the effect of taxing losses. As a rule Congress has heretofore refused to enact revenue legislation which so clearly ignores the sound principle of taxation in accord with capacity to pay.

As you doubtless know, the broadcaster is usually incorporated. He has his corporation taxes to pay. He must share the burden of any increase in the general corporation tax that Congress may approve. Any dividends he may receive from his business are taxed as personal income by both the Federal and State Governments. If he operates at a profit, there are excess-profits taxes to pay. I want you to know that we do not object to an excess-profits tax, when and if we make any profits to be taxed. Indeed, the broadcaster is willing to pay his share

of any general tax that Congress finds it necessary to enact. But we can see no justification for imposing on him another special burden that has no relation to his capacity to pay.

I appreciate the fact that the lower-income stations are exempted from this proposed tax. It would nevertheless cut into the operating funds of independent stations whose incomes are in excess of $100,000 but whose profits are little or nothing. It is the plight of these stations which I ask you carefully to consider. You can readily see that a broadcaster who is operating at a loss acquires no special capacity to pay an extraordinary tax merely because his gross income may exceed $100,000. I find it difficult to believe that Congress will lay down a policy of exacting a special contribution from those broadcasters who are unable to make both ends meet and at the same time maintain a high standard of public service.

Now I come to my third point, which has a very direct bearing, not only upon this proposed tax, but also upon the success of the defense program in general. Let us consider for a few moments the nature of the industry on which this burdensome tax would be laid. To a large degree broadcasting stations in this country are operated as quasi public utilities. Our licenses require us to operate in the public interest, convenience, and necessity, and practically every broadcaster in the United States is determined to fulfill that obligation. It is as sacred to him as his allegiance to the flag. Every broadcaster knows, moreover, that his programs must appeal to the public or his invisible audience will be lost. So our business necessarily consists of rendering service—we have nothing else to sell. Some stations make profits and others lose money, but all must continue to render public service so long as they are on the air.

Obviously, if the broadcaster is to serve the public well, he must sell enough time to meet all his legitimate expenses. I am sure we all believe that the broadcaster is worthy of his hire, but men who do not see the industry from the inside may not know the problems it is up against. May I mention a few of them. Radio broadcasting is still a comparatively new art, and therefore its continued development necessitates frequent changes in the rules and regulations laid down by the Federal Communications Commission. New rules often mean that our equipment must be adjusted, modernized, supplemented, or replaced. In addition, we must meet the costs of attending hearings and of hiring legal and engineering talent. These extra costs may be regarded as a special burden already imposed on the broadcasting industry. To these expenses must be added fees for authors, composers, performing artists, and guilds, as well as salaries for musicians, with the rate of pay and the number of musicians to be hired dictated by the union. Then, of course, we have regular overhead expenses such as rent, power, light, heat, salaries, news services, and so forth. The difficulty of meeting these expenses has increased, moreover, because the larger number of stations now operating intensifies the competition we must meet.

Now you gentlemen know that these expenses must be paid and that the only source of revenue we have is the sale of broadcasting time. If you increase our costs of operation still further, you will compel us to sell more of our limited broadcasting time and thus impair, to that extent, the service we can render to the public. It

is this point which I ask you to weigh with special care. If money goes for taxes, it obviously cannot be used to buy news features or to purchase or produce sustaining programs. In other words, this proposed tax would, in many cases, fall upon radio listeners in the form of lower quality programs. Some of the taxes in this bill are apparently designed to cut down consumer buying of materials that are needed for defense. But surely there would be no point in curtailing the flow of good entertainment over the air. On the contrary, the present emergency has intensified the need for high quality broadcasting.

The effect of this proposed tax on the quality of programs might not be serious, except for the fact that we are giving an enormous amount of time, in this period of national crisis, to governmental activities. Radio has become one of the greatest national mediums of communication. A broadcaster has only to read the thousands of letters that often come to his station in response to some request by an announcer to realize the great power that is in his possession. As a group we are using that power in the service of the Nation. We fully appreciate the necessity of maintaining the morale of our people at a high standard, and we know how important it is, in this great democracy, to keep the people informed as to the activities of their Government. We believe that in this national emergency our stations must be ever ready to serve as an impartial link between the Government and the people. So we have allocated more time than ever before to what might be classified as "public business." It may surprise some of you gentlemen to learn that at this very minute many broadcasters are sending more words out over the air for the Federal Government and the U. S. O. than for their advertisers.

In bringing this fact to your attention, I do not wish to be misunderstood. I am not complaining because a large portion of our time is given to this "public business." But this is how it works out. Every broadcasting station operates a specified number of hours at a fixed cost, exclusive of program expenses. Our big problem is always to work into this limited period entertainment, news and other features that will hold the public interest, along with commercial programs sufficient to pay our expenses. I am sure you realize that we cannot make one announcement after another and hold a listening audience. If a broadcaster makes 20 announcements a day for the Federal Government, each one must follow, say, 10 minutes of music or some other form of entertainment. So it requires 200 minutes to present 20 Government announcements, and we pay for the entertainment as well as give up the time, which might be sold to advertisers.

Time is also given to local Government activities, the U. S. O., various relief organizations, and so forth. While these calls upon our services vary in different communities, they average another 200 minutes a day. Thus the total time available for commercial broadcast is reduced from 30 to 50 percent, depending upon the number of hours the particular station operates. Since the cost of operation, including rent, power, light, heat, salaries, and so forth remains fixed, the shorter period of time that may be sold to advertisers must bring in sufficient revenue to pay that cost and finance our sustaining programs. So you can readily see what will happen if Congress decides

to increase our expenses while we are carrying this extra load of "public business."

We sometimes hear people complain that there is too much advertising on the radio. Gentlemen, it is not our fault. If our expenses are increased and our available commercial time reduced, we simply have to crowd in the commercials. And if this practice is continued, or by necessity intensified, we shall inevitably lose; listeners cannot easily be changed. So this bill brings us face to face with a dilemma. Our loyalty to our country and our sense of public responsibility prompt us to give a large portion of our broadcasting time to the cause of national defense. If the United States should become an actual participant in the war, much greater demands upon our facilities would be made, and certainly every request would be cheerfully granted. Yet we must face the fact that costs are rapidly mounting, and incidentally we are losing some of our advertisers, because, in a few instances, raw materials are no longer available to them.

The principal thought I would like to leave with you, gentlemen, is that the broadcasting industry is already making an enormous contribution to the cause of national defense. If the independent stations were to be paid for the programs and announcements broadcast for the Government, they would be very profitable, and in that case should be taxed accordingly. But please do not require us to pay the discriminatory tax proposed in this bill—plus corporation taxes and personal income taxes—while we are giving so much free time to the Government and paying for the entertainment necessary to hold our listeners. That levy would impose an unfair burden upon an industry already making a heavy sacrifice to the cause of national unity and strength in this emergency. More important still, it would tend to impair the quality of radio programs and thus weaken a great system of public communication at a time when it should be strengthened.

In behalf of the independent broadcasters, I ask you to eliminate this discriminatory and unreasonable tax.

Senator VANDENBERG. You all put great emphasis on your public service. Did you ever try to reduce that to dollars and cents? For instance, what does a fireside chat cost all the radio broadcasters in the United States?

Mr. LAFOUNT. If it was sold at the regular price charged anyone else, of course, it would cost several thousand dollars, Senator, depending on the number of stations that carry it.

Senator VANDENBERG. Did you ever make an estimate of what it would cost?

Mr. LAFOUNT. No, sir; I have not.

Senator VANDENBERG. It would be interesting.

Senator BAILEY. Are there any further questions? If not, the next witness is Mr. Ellsworth C. Alvord, representing the National Association of Broadcasters.

STATEMENT OF ELLSWORTH C. ALVORD, WASHINGTON, D. C., NATIONAL ASSOCIATION OF BROADCASTERS

Mr. ALVORD. Mr. Chairman and gentlemen of the committee, I appear on behalf of the National Association of Broadcasters in strenuous opposition to title VI of the House bill. This title imposes the

so-called radio-broadcasting tax. I have a rather detailed memorandum, Mr. Chairman, which I do not desire to read, but which I would like to submit as a part of my remarks.

Senator BAILEY. You wish that to be put into the record?

Mr. ALVORD. I wish that to be incorporated in the record, and I trust if there is any doubt left in the minds of the committee as to the propriety of the tax, the memorandum will be studied very carefully. Certainly it answers every conceivable argument for the tax which has been made, and I might say that every basis which has been suggested is quite unjustified and inadequate.

I oppose the tax for four very substantial reasons: First, it is the first embarkation by this Congress, and the first embarkation by any Congress, with but one very minor exception, of a tax upon gross receipts. I have advocated for many, many years, various types of taxes. I trust that the demands of the Treasury will never be such that I will ever be compelled to recommend or to acquiesce in a tax upon gross receipts. Gross receipts, as you gentlemen know, merely means the number of dollars coming in. It has absolutely nothing to do with the expenditures required to bring those dollars in. It hits solely on the basis of dollars received. It has nothing to do at all with ability to pay, or any principle that I know of, or which I have read, or heard of, which could underly the taxing policy of this Government.

Second, I am quite convinced that this tax on gross receipts will impose a discriminatory tax upon a portion of the advertising expenditures of this country. So let me speak for just a moment with respect to a tax upon advertising generally, if I may.

Certainly, as I have said, there is no conceivable justification for singling out important elements in the advertising field, such as outdoor advertising and radio, and taxing them and not taxing all advertising. But let me assume that you impose a tax upon advertising generally. As Senator Johnson has already indicated, that type of tax is nothing more than a tax upon the dissemination of information, upon the dissemination of news. It would be again an unprecedented embarkation by the Congress, an embarkation upon the restriction of the free dissemination of news. Substantially every news-disseminating agency must rely for its revenues upon advertising. That is the only source from which they can receive substantial revenues. That is true of radio; that is true of newspapers; that is true of magazines. The moment you attempt to tax their principal source of receipts, once you impose a tax based solely upon the amount of their receipts, you necessarily impair the effectiveness of their service, you restrict them in their activities, and I would assume this Congress would prefer not to restrict those activities but to encourage them.

Third, as the chairman of the committee has indicated, a very substantial activity of the radio industry is directed toward the public benefit. It is rendering an important public service. For example, the use of the radio by the Government is tremendous. These Government broadcasts, the educational and cultural programs, the news broadcasts, and other spreading of information, take roughly two-thirds of the time of the radio industry, leaving to that industry but one-third of its time for commercial programs on which it receives its income. I cannot believe that the Congress would so desire to hamper,

even jeopardize, the service which the radio industry is now performing in the interest of the public.

Fourth, it is an exceedingly unfair burden to impose upon any industry a tax of this kind, and I come back somewhat now to my gross receipts feature. Every gross-receipts tax necessarily hits the winners and losers, and unfortunately, as in every industry, there are and must be a substantial number of losers, and a very substantial number on what we might call the marginal line.

For example, one network whose profit now ranges about 9 percent would be thrown substantially in the red. A tax of 15 percent on its gross receipts would convert its profit of about $155,000 into a loss of about $90,000. In addition, there are roughly 300,000 individuals in this country dependent for their livelihood on the radio industry. Again I doubt seriously whether you desire to jeopardize the welfare of those 300,000 people.

Now let me address myself, for just a minute, to the discussion which I heard before the committee this morning with respect to a franchise tax. I would assume that the radio industry could not object to a nondiscriminatory general franchise tax.

Senator VANDENBERG. If they got an important return for it.

Mr. ALVORD. That may be true, sir. However, before you decide to embark upon a general franchise tax, based upon the theory that the regulated should pay the cost of the regulation, let me point out that certainly the radio industry should not be the first industry for that experiment. The Federal Government now is regulating—perhaps it would be easier to indicate those who are not regulated—but generally, you are regulating railroads, busses, trucks, airplanes, power, public utilities, banks, investment bankers, and many others. Substantially every industry in the country is regulated, in part at least, by the Federal Government. If you were to embark upon this policy of forcing the regulated to pay for the regulation, again I say I doubt seriously whether the radio industry could object, but I would suppose, instead of being the first, it could well be the last, because again you are faced with the question whether you should attack the free dissemination of information and news.

I will be very happy to answer any questions which the committee desires to put, or attempt to answer them.

Senator VANDENBERG. Can you give me this figure? Suppose I were to buy a half hour's time on every radio station in America, how much would it cost me?

Mr. ALVORD. If that is related to the question which you asked Commissioner Lafount, I have been told the cost would be between $50,000 and $100,000; but again, bear in mind that two-thirds of the time of the radio-broadcasting industry must be spent on what is called the sustaining program.

Senator BAILEY. I think you make a distinction between radio and these other businesses which are regulated under the interstate commerce clause. I agree with you that under the new interpretation, every business and every activity in America is now subjected to regulation, and practically every business in America is dependent now upon the appropriation or the borrowed money of the Federal Government, but the radio enjoys a license, it is something in the nature of an exclusive right, or monopoly. Now that is costing the Govern-

ment $2,000,000 a year—that system. What would you say to a franchise tax properly levied, with a view to the service rendered locally and generally, to raise that $2,000,000? I do not like this tax at all, but I am thinking that we might have a tax that would discharge the Federal expense of $2,000,000.

Mr. ALVORD. Let me answer, first, that it is my estimate that not more than one-fifth, probably one-sixth, of that $2,000,000—that was Chairman Fly's estimate—is chargeable to the radio industry as such. Bear in mind that the Federal Communications Commission does a good many things other than regulate the commercial broadcasting stations.

Senator BAILEY. It does give out the frequency and the licenses.

Mr. ALVORD. It does issue the licenses governing the frequency and the power, but, as Senator Vandenberg indicated, it is a rather temporal license. Under the statute it can be no longer than 3 years. The policy of the Commission is to limit the license to 1 year, and each station must come in and prove to the Commission that it is entitled to a renewal.

Senator JOHNSON. Speaking of that, in your experience with the radio industry, can you cite many cases where the franchise has been interfered with? It is more of a club back of the door than it is a case of actually being exercised.

Mr. ALVORD. I think the club feature is perhaps the most important one, very much like the policeman: The fact you might be arrested probably keeps many of us from doing things which we might wish to do.

Senator VANDENBERG. It is very much in plain sight most of the time.

Mr. ALVORD. It is in plain sight very much of the time; yes, sir.

Senator JOHNSON. Yes; but it is necessary also.

Mr. ALVORD. Yes. I am making no objection to that in the slightest. For example, I do not believe radio has any greater monopoly than the airplane. Your airplane companies must also get licenses, they must operate at places or over routes designated in the license, their stations are designated, where they can alight, the commodities they can carry, and so forth. The railroads also must get certificates of public convenience and necessity in order to expand or contract their lines.

Senator BAILEY. Would not a reasonable license tax tend to protect the radio industry? That is, you have got an increasing demand for local stations that are coming up here from my State, and they go down to see Mr. Fly, they file an application, and you have to have some way to limit that do you not? Why would not the license tend to limit them?

Mr. ALVORD. I do not think that would be an important limitation. I think I can answer you more specifically, Senator Bailey, by saying in my opinion the industry could not justly object to a nondiscriminatory license or franchise tax imposed at nominal levels, spread equally and equitably, based upon the cost of regulation.

Senator BAILEY. If you tell me what you conceive to be a proper amendment, nondiscriminatory in character, I would be inclined to substitute it for this present section.

Mr. ALVORD. I would much prefer, if I may make the suggestion, to strike this provision out and afford to all parties interested ade-

quate time to prepare that sort of franchise tax. It is not a simple thing to do.

Senator BAILEY. You mean not for this legislation but for some future legislation?

Mr. ALVORD. Some future legislation; yes.

Senator BAILEY. We need the money right now.

Mr. ALVORD. I doubt seriously whether the demands on the Treasury are enough to justify this tax.

Senator BAILEY. I am not saying that either.

Senator JOHNSON. Mr. Alvord, can you say who will pay this tax that will be imposed by the language of this bill?

Mr. ALVORD. Senator, I think that question has got to be approached very practically. Unquestionably a very large number of stations will find it utterly impossible to pass the tax on. A few may.

Senator TAFT. You mean pass it on to the advertisers?

Mr. ALVORD. Pass it on to someone, certainly. I do not think the networks can pass it on to the stations, for example, because they are pretty well covered by contract.

Senator JOHNSON. They are pretty loose contracts.

Mr. ALVORD. That may be, but they still run quite a period of time.

Senator JOHNSON. It is a one-way contract. The contract comes from above. The station has very little to say about its contract. The network imposes the contract. It can cancel it at its leisure and pleasure. The station does not have the same right, so the station is very much at the mercy of the network, and it just occurred to me it would be perfectly natural for the network to pass on to the station the tax, since it cannot pass it on to the advertiser.

Mr. ALVORD. There are very few stations, Senator, who can afford to pay even a small part of the tax.

As to the question of passing it on to the advertisers, I think the answer to that is again a practical answer, that if radio rates could be increased, probably they would already have been increased. Advertising rates seek their own level. For advertising on the radio, for advertising in the newspapers or in the magazines, or for advertising in various other miscellaneous media the advertiser is going to pay so much, and only so much to radio as he considers justified in the light of the rates of other advertising media, as well as in the light of the results which he hopes to obtain.

Senator BAILEY. Do you think advertising appropriations or allotments are likely to be increased now or decreased?

Mr. ALVORD. I think Chairman Fly gave you the best opinion on that which there is in the industry. The future is probably more uncertain now than it ever has been.

Senator BAILEY. Going back to your experience now, in 1918 we passed the excess-profits tax for the first time.

Mr. ALVORD. In 1917, sir.

Senator BAILEY. It went into effect February 19, 1918, according to my recollection.

Mr. ALVORD. That was the 1918 act, sir; 1917 was the first one.

Senator BAILEY. Speaking of the 1918 act particularly, immediately the taxpayers saw they were going to run into excess profits they greatly increased their advertising allotments in order to keep out of the excess-profits taxes. Is that likely to happen now?

Mr. ALVORD. I have heard that statement made a good many times, Senator, but I am sorry, from the point of view of being able to predict the immediate future, I am sorry that that statement at least does not fit the statistics. You will find, I think, that there was no substantial increase in advertising. We heard a great deal about it and we know it was studied from the point of view of tax liabilities, but I do not think the figures generally show an increase.

Senator BAILEY. You do not think the statement is well founded?

Mr. ALVORD. I do not think the statement is well founded, sir. Certainly as to the immediate future, we have quite a different situation than we had back in 1918. We have priorities, we have rationing, we have probably in the future a very severely regulated system of demand and supply. I cannot conceivably understand, for example, why the manufacturers of silk hose would want to do a great deal of advertising with their silk being unavailable, other than perhaps to keep their name before the public so that some day when the supply of silk is renewed they will still have the advantage of their trade name.

I wonder if I could make one more remark concerning this tax on advertising? I should think that solely from the Treasury fiscal point of view, this committee would view with considerable caution a tax upon advertising. For example, Mr. Stam will tell you that some four or five billions of dollars are to be collected annually in the form of sales taxes. Sales follow advertising. I think that the general ratio is that for a dollar of advertising, you get about $30 worth of sales. You would not have to reduce your retail sales by more than one-half of 1 percent—and this comes back to the effect upon the Treasury, Senator—you would not have to reduce the retail sales by more than one-half of 1 percent to cost the Treasury more than the gross amount involved in this tax, 12½ million dollars.

Senator BAILEY. Are there any further questions?

Senator DANAHER. I would like to ask one, Mr. Chairman.

I wonder if you are able to give us, Mr. Alvord, the figure on the cost of the second-class mail privilege accorded to newspapers and magazines?

Mr. ALVORD. I would have to give it out of my head, Senator Danaher, but I think it would run somewhere between $80,000,000 and $85,000,000 a year.

Senator DANAHER. Which the Government pays?

Mr. ALVORD. Which is a charge against postal receipts. But there again bear in mind you do not grant second-class mail privileges based solely upon cost or lack of cost of the privilege.

Senator VANDENBERG. You might double the second-class mail rates and cut your revenue in half.

Mr. ALVORD. That is very true, sir. Certainly, as long as I have been out here, I have never heard of the second-class mail privilege discussed solely from the point of view of the revenue or expense involved.

Senator VANDENBERG. You will not so long as we have popular elections.

Mr. ALVORD. Probably so.

Thank you.

(A memorandum submited by Mr. Ellsworth C. Alvord, on behalf of the National Association of Broadcasters, is as follows:)

MEMORANDUM SUBMITTED BY ELLSWORTH C. ALVORD ON BEHALF OF THE NATIONAL ASSOCIATION OF BROADCASTERS

This memorandum is presented to the Committee on Finance on behalf of the National Association of Broadcasters, the trade association of the radio broadcasting industry. It concerns title VI of the pending revenue bill (H. R. 5417), imposing a tax on gross receipts derived from radio broadcasting. This title was added to the bill during the final stages of its consideration by the Committee on Ways and Means of the House of Representatives, and the House retained the provision.

I. THE PROPOSED TAX

The proposed tax is to be imposed upon the operators of radio broadcasting stations, and upon those engaged in network broadcasting. Although designated an excise tax, the amount of tax payable by any given station or network is measured by its gross receipts from the sale of broadcast time. These gross receipts are designated as "net time sales," and are defined to include the gross amount received or accrued from the sale of time. The amount so received or accrued cannot logically include discounts or rebates actually allowed, of course. The bill specifically provides for the deduction of a maximum of 15 percent for agency commissions, and, in the case of the networks, of any amounts paid to individual stations for the time used. No other deductions are permitted.

Where the gross receipts are between $100,000 and $500,000 per year, the tax is 5 percent of those receipts. If the receipts are between $500,000 and $1,000,000 per year, the tax is 10 percent of the receipts. If the receipts are $1,000,000 per year or over, the tax is 15 percent of the receipts. Where the gross receipts are less than $100,000 annually there is no tax.

The Committee on Ways and Means estimated that the tax would produce gross revenues of about $12,500,000 in its first full year of operation.

II. ANALYSIS OF WAYS AND MEANS COMMITTEE REPORT

The report of the Committee on Ways and Means attempts to justify this tax on three grounds:

First, that "radio broadcasters possess a valuable monopolistic privilege, awarded to them free of charge";

Second, that "the principal operators in commercial broadcasting earn high rates of return on relatively small investments" and thus "possess unusual taxpaying ability"; and

Third, that "radio broadcasting requires public regulation * * * at public expense." (See H. Rept. No. 1040, pp. 34 and 35.)

None of these alleged grounds justifies the imposition of this special tax on radio broadcasting.

1. *Monopolistic privilege.*—The committee states that because of the technical limitations of the broadcasting band, the number of broadcasters is limited, so that the right to operate in particular areas "carries with it a measure of monopolistic privilege and the opportunity for an extremely profitable investment." It asserts that by exercising this privilege and exploiting that opportunity many broadcasters make substantial profits and derive other "less tangible benefits in the form of publicity and good will."

In the first place, a license to operate a radio broadcasting station confers no monopoly on the licensee. Monopoly, of course, involves a lack of competition, and there is no lack of competition in the radio broadcasting industry today. Virtually no locality in the country lacks competitive broadcasting. No licensee has a monopoly of the listening public. Every licensee faces vigorous competition from other licensees, and some must compete with a score or more.

Secondly, under the Communications Act of 1934, licenses may not be granted for longer than 3 years; and the Communications Commission actually limits them to a single year. Renewal is more than a mere formality. It must be obtained on the merits. The licensee must show that continued operation will serve "the public interest, convenience, or necessity" (see sec. 309 (a)). Furthermore, the licenses confer no right of ownership, and can be assigned or transferred only with the consent of the Commission (see secs. 309 and 310).

Third, improvements in the art are constantly making more frequencies available, and such developments as frequency modulation promise even wider opportunities in the future. The saturation point has not yet been reached; at January 1, 1935, there were 605 licensees; at January 1, 1940, 814; today there are 903. Relatively few applicants who have the financial resources to build and maintain the physical equipment, and survive the inevitable initial operating losses, and the energy, initiative, and managerial ability necessary to operate a station have been denied licenses.

In the fourth place, the broadcasting industry's only substantial source of income is from advertising, and radio certainly has no monopoly of advertising media. Radio broadcasting must compete with the newspapers, with the magazines, including the business magazines and farm journals, with outdoor displays, with direct-mail solicitation, and with various miscellaneous devices. In 1924 the aggregate expenditure for advertising in the United States was a little more than $2,000,000,000. Radio got none of it. In 1940 the amount spent was about $1,660,000,000. Radio got about $200,000,000. Newspapers took about $560,000,000, nearly three times as much as radio. Magazines of all kinds got about $210,000,000, a little more than radio. Direct mail advertising took at least $300,000,000, one and one-half times radio's share. Radio thus commands less than one-eighth of the advertisers' dollar, and it must fight every inch of the way for that share.

It is clear that radio broadcasting is a truly competitive business which should not be singled out for special tax on the theory that it is enjoying any "measure of monopolistic privilege."

2. *Rate of return on investment.*—The second argument presented by the Committee on Ways and Means is that the principal operators in commercial broadcasting earn high rates of return on relatively small investments. This, the committee indicated, gives them "unusual taxpaying ability," and renders it proper for them to be subjected to special taxation in view of the Government's present revenue requirements.

It is true that the initial investment required to provide the physical equipment of a radio station is relatively moderate, but it is by no means insubstantial. The physical equipment for a 250-watt local station will cost at the outset perhaps $25,000. That for a 50,000-watt station, providing a much wider coverage, may require an initial outlay of as much as $500,000. However, while in some businesses the original outlay for physical equipment will suffice for many years, the radio broadcaster is in a field in which technical improvements may render his equipment obsolete almost overnight. As those improvements come along, he must put them into effect, even though a complete duplication of his physical facilities may be required. The new technique of frequency modulation, for example, has already forced extensive and costly additions to equipment.

The cost of physical equipment is not the only cash outlay required of the licensee of a new radio broadcasting enterprise. Obviously, no station can be expected to be profitable from its inception. In almost every case substantial operating deficits will be incurred for several years; and in a large number of instances these losses will continue for many years. In 1940, for example, 187 of the 765 stations in operation during the entire year incurred losses. These losses are not mere paper losses; they must be met, in cash, by the operator. They represent investment in the business just as much as the expenditure for physical equipment.

The necessity for a very substantial investment over and above the cost of physical equipment is expressly recognized by the Communications Commission. The Commission has authority to prescribe the qualifications of licensees (sec. 303 (1)); and one of the more important requirements prescribed is that the licensee establish its financial responsibility. For example, in the case of even the smallest station, the Commission will require the applicant to show that it has available, for operating capital, at least $50,000 over and above the cost of physical equipment. This operating capital must be in cash; contracts for future advertising will not suffice.

As the Senate Finance Committee has repeatedly recognized, the rate of return earned on capital invested is not a fair single test of taxpaying ability. Capital is only one income-producing factor. Far more important than capital are the intangible factors, such as energy, imagination, initiative, managerial ability, and above all, just plain hard work. A successful radio station is peculiarly the creature of these other factors. The human thought and labor

required are enormous. It would be a long backward step in tax policy to impose a discriminatory penalty on profits which are due primarily to individual effort and ability.

Furthermore, it must be borne in mind that this special tax is in addition to all other taxes. It is not imposed in lieu of any other tax. Corporate normal taxes, corporate surtaxes, corporate excess-profits taxes, and all individual taxes, continue to apply to radio broadcasters. Those taxes are intended to be graduated on the basis of ability to pay, and that they adequately reflect that ability should be a fair assumption. A gross-receipts tax is not the way to reach excess profits. If they exist in the broadcasting industry, the income and excess-profits taxes will reach them, just as they will reach the profits of every other industry.

3. *Public regulation.*—The third consideration cited by the Committee on Ways and Means was the necessity for public regulation of radio broadcasting. This regulation, at public expense, was asserted to be of great benefit to the industry, without any special costs to it.

Public regulation of the radio broadcasting industry came about for one very simple reason having nothing to do with the virtues or faults of the industry. The ether had certain limitations, just as a highway has limitations. Traffic on the ether, just as on a highway, had to be controlled so that it could proceed in an orderly and efficient manner. The Radio Act of 1927, and later the Communications Act of 1934, became the traffic law; the Radio Commission at first, and later the Communications Commission, the traffic police.

The Federal Government regulates many industries, not radio broadcasting alone. Among them are the railroads, busses, and trucks, commercial aviation, shipping, the electric-power industry, the telephone industry, and the telegraph industry. It has not been thought that the necessity for public regulation of these industries justifies a special tax upon them. The functions of the Federal Government, insofar as they represent regulation of business for the benefit of the public, have been consistently financed through general rather than special taxation. There is no valid reason for an exception in the case of the radio-broadcasting industry.

The radio-broadcasting industry will readily concede that if the long-standing policy of the Government is to be changed, and businesses regulated for the benefit of the public are to bear the cost of their own regulation, then the radio-broadcasting industry should bear its fair share. It insists, however, that it should not be singled out as the sole object of such a change in policy.

In no event can the propriety of a charge to cover the costs of regulation be offered as a justification for the tax proposed by the bill. As against the $12,500,000 to be raised by the proposed tax, the entire appropriation for all the work of the Federal Communications Commission (excluding only its special national-defense activities) for the fiscal year 1942 is only $2,340,000. This amount, of course, provides not only for the Commission's regulation of radio broadcasting, but also for its regulation of the telephone and telegraph industries, and for its regulation of amateur radio communication, as well as point-to-point and ship-to-shore communication by radio.

III. PRINCIPAL OBJECTIONS TO THE TAX

Apart from the fact that none of the justifications advanced by the Committee on Ways and Means are valid, the tax should not be imposed for the following principal reasons:

First, it is discriminatory; and second, it imposes a burden which will imperil a vital public service.

(a) Discrimination.—The tax proposed by title VI on radio broadcasting differs in one essential respect from the various excise taxes imposed by title V, namely, the ability of the primary taxpayer to pass on the tax.

The principal characteristic, and, in fact, the principal justification, of an excise tax is that it can be passed on to the ultimate user of the goods or services taxed. The excise taxes imposed on playing cards, safe-deposit boxes, distilled spirits, tires, sporting goods, luggage, refrigerators, musical instruments, club dues, admissions, communications, and on all the other articles or services listed in title V, are not intended to be absorbed by the manufacturer or enterprise singled out. They are indirect taxes on the ultimate consumer, and it is intended that they shall be added to the price of the product or service.

Thus, for example, when an individual buys a package of cigarettes, he pays 6½ cents Federal tax; when he buys a gallon of gasoline he pays 1½ cents Federal tax; when he pays 39 cents to see a motion picture, he pays 4 cents of that amount

to the Federal Government. In reality the consumer pays the tax. The cigarette manufacturer, the gasoline producer, and the motion-picture theater merely serve as convenient collection agencies. It is this feature of an excise tax—the ability to pass it along to the ultimate consumer—that prevents it from becoming an instrument of destruction and avoids hardship and discrimination against the industry manufacturing or supplying the article or service subjected to tax.

The Treasury and the Congress have studiously avoided gross-receipts taxes—excise taxes which cannot be passed on. The proposed radio-broadcasting tax would represent a departure from this sound policy, for the industry cannot pass on this tax and still maintain its competitive position.

It has already been pointed out that radio commands today a little less than one-eighth of the total amount spent by business for advertising, the remainder being distributed among newspapers, magazines of all types, outdoor displays, direct mail solicitation, and various miscellaneous media. Radio's share has been built up by vigorous effort over the past 15 years. At its inception, the very novelty of radio aided it in obtaining a foothold, and its early growth was for this reason fairly rapid. However, after the novelty wore off, radio had to meet the competition of the other media solely on the basis of its own effectiveness in the field. In recent years radio's rate of growth has shown a distinct tendency to level off.

That the competition among the several advertising media is vigorous and constant is conclusively shown by the fact that no significant changes have occurred in the past 3 years in the share of any medium. In 1938, advertisers spent a total of about $835,000,000 for advertising in newspapers, and magazines (excluding business magazines and farm journals), and over the radio. In 1939 they spent about $875,000,000, and in 1940, about $937,000,000. Newspapers accounted for 65.1 percent of the total of the three in 1938, 63.1 percent in 1939, and 60 percent in 1940; magazines for 17 percent in 1938, 17.4 percent in 1939, and 17.8 percent in 1940; radio for 18 percent in 1938, 19.5 percent in 1939, and 22.2 percent in 1940. Although newspapers lost a few percentage points of the aggregate between 1938 and 1940, both 1939 and 1940 were each better in volume than the previous year. Magazines improved their position both absolutely and relatively. Radio enjoyed a slightly larger relative gain, but this was modest.

Radio certainly has no peculiar advantage in the matter of rates. Advertising rates in each medium naturally tend to reach a level which will be in line with the other media in terms of consumers reached. A newspaper fixes its rates on the basis of its circulation. A magazine does the same. Billboard rates are determined on the basis of traffic density; and car and bus card rates on the basis of passengers carried. Similarly, radio rates are determined on the basis of listens reached. In the case of a particular station, this will depend on its frequency, its power, the attractiveness of its programs—comparable to the make-up and editorial character of a newspaper—and the habits and economic condition of the population of the area served.

In its early days, radio was able to attract many advertisers because its effectiveness was constantly increasing in terms of coverage of markets. Illustrative of this, in 1934 about 57 percent of the homes in the country had radio sets; in 1936, 71 percent; in 1938, 80 percent; in 1940, 83 percent. It is estimated that family coverage today is about 85 percent, and in the principal markets, of course, it is even higher. It is clear, certainly, that only a negligible number of new homes can be added in the future; the saturation point is near, if it has not already been reached.

Advertising managers are a hard-boiled fraternity. They will not spend more for radio advertising than it is worth. Modern surveying methods enable them to determine with uncanny accuracy the effectiveness of the various advertising media. Such surveys are being conducted constantly. When they show that radio is not producing as much per advertising dollar as another medium can produce, radio must either reduce its rates or the other medium will get the business.

There can be no question but that any effort on the part of the radio broadcasting industry to pass the burden of this proposed tax on to the advertisers will simply drive those advertisers to the use of other media not subjected to such a special tax. In order to preserve its competitive position, the industry would be forced to absorb the entire burden of the tax. As will be shown, this cannot be done without grave damage to the industry and consequent serious deterioration of the great public service which it performs.

The imposition of this special tax upon radio broadcasting, without corresponding taxes upon competing media, makes it impossible for the industry to maintain its competitive position and still pass on the tax. The same is true of the tax upon outdoor advertising, and these taxes thus repreesnt direct discriminations which cannot possibly be justified.

The only conceivable justification for a direct discriminatory tax upon any business would be that the public interest required its abolition. Radio broadcasting is at the other end of the scale. The public interest clearly requires not only its maintenance but its encouragement. Any departure from this sound policy would be disastrous. A direct discriminatory tax upon radio broadcasting would be such a departure.

(*b*) *Burden upon public service.*—The radio broadcasting industry performs an outstanding and important service to the American public. This tax would impose upon that service a heavy and unreasonable burden, which must inevitably result in the deterioration of that service, to the detriment of the public. The industry cannot look forward to increased revenues; and reduction of its expenses without adverse effects upon the service rendered is utterly impossible.

1. *Radio's public service.*—The extent of the use of radio by the American public is almost unbelievable. Some 50,000,000 receiving sets are estimated to be in use today. Eighty-five percent of the families in the country own at least 1 set. Thus about 29,000,000 American homes have direct access to radio broadcasts. Of these radio-owning families, 83 percent listen at some time every day. The average daily use, as a matter of fact, is over 4½ hours. It is more than that in the rural areas. Radio broadcasting is the principal source of information and entertainment in America today. The Elmo Roper organization recently sought the answer to the question, "From which source do you get the most of the daily news—the newspapers or radio news broadcasts?" It was found that 39.4 percent of the people on the average, and considerably more in sparsely populated sections, rely on the radio as their chief source of news; that an additional 26.2 percent rely on both radio and the newspapers; and that 31.2 percent rely mainly upon the newspapers. The same organization discovered that listening to the radio is the most popular recreation in the country today. On the average, 27.5 percent of the people, and again even more in the rural areas, enjoy listening to the radio more than any other recreation. In this respect, radio is the leader. It enjoys the favor of half again as many people as its closest competitor, the motion picture, which is the chief attraction for 19.3 percent of the people.

This immense popularity of radio did not come about by accident. It came about because the radio broadcasting industry has always had a deep sense of public responsibility, and because radio has met that responsibility. The public, after all, is the final arbiter and censor of radio service. It knows the standard of service it ought to receive; it knows whether the service measures up to that standard, and what to do if the standard is not met. In this country, the public may still listen or not, as it chooses. The simple fact that American radios can still be tuned out instantaneously does more than anything else could do to guarantee that radio will continue to serve the public interest.

Radio's public service contribution is well illustrated by the part it is playing in the national-defense program—a participation which brings radio not a dollar of revenue. First, radio provides prompt, accurate, and comprehensive news broadcasts of events at home and abroad. These give the public the information it needs to form its opinions as to what policies this country should adopt. Second, radio provides the widest possible forum for public debate. Thus the principal arguments on both sides of public issues can be fully tested, so that the final acceptance of one policy or the other can be more reliably regarded as the will of the majority. Third, radio provides education, not only for the young, but also for the adult population, in American history, in the ideals of democracy and liberty, in the workings of the Government and its agencies, and even in technical fields, many of its noncommercial educational programs being used for classroom instruction in thousands of schoolrooms. Fourth, radio provides a means, and the only means, by which, in military or other emergency, the entire Nation can be reached almost instantaneously.

Countless specific examples could be cited of the part radio plays in furthering the national-defense effort. They would include such programs as those carried out under the auspices of the Civil Service Commission, which resulted in the placement of over 500,000 skilled and technical defense workers in 1 year; those prepared and produced to assist the aluminium-collection campaign; those devoted

to the campaign for the sale of defense bonds; those given to facilitate the operation of the selective-service system; and many others. Other programs have explained the history and functioning of the Army, the Navy, and the Marine Corps. Still others have set forth the part various industries and groups play in national defense.

The War Department has already made it clear to the industry that it considers the uninterrupted maintenance of normal radio broadcasting of the utmost importance to public morale in time of emergency. To this end, and also to the end that instantaneous communication with the entire country will be possible whenever the necessity arises, the industry, in cooperation with the Defense Communications Board, has developed extensive plans to insure continuous operation of broadcasting stations under emergency conditions. A potential supernetwork is being established, with alternate interconnections and transmission facilities, so that interruptions can be minimized. Plans are being made for linking stations to defense centers, so that warnings and announcements can be instantaneously given.

These national-defense programs cost the Government nothing. The industry looks upon them as a contribution in the public interest. The attitude of the broadcasters is well expressed in a resolution recently adopted by the governing body of the National Association of Broadcasters. This resolution is as follows:

"In view of current trade publicity being given to a proposed advertising campaign in behalf of the Navy Department to be placed through one of the large advertising agencies, the executive committee feels that the purchase of time by defense agencies might tend to restrict rather than enhance the most effective utilization of broadcasting during the present emergency.

"Therefore we wish at this time to reaffirm the industry's desire to continue its present practice of making its facilities available at no cost to Government agencies engaged in promoting the national-defense program.

"To inform the public of the industry's position, it is suggested that an announcement that all Government defense programs are carried without charge be used once each day by all cooperating stations."

This policy of refusing compensation for time devoted to Government broadcasts has been an industry policy from the beginning, and it is one which the industry hopes it can maintain permanently, despite the fact that various Government agencies spend hundreds of thousands of dollars for advertising in other media.

Government programs are not the only ones which go to the public without producing revenue for the broadcaster. On the average, only about one-third of a station's operating time is devoted to commercial revenue-producing programs. The balance is devoted to noncommercial, or "sustaining" features such as educational and cultural presentations, unsponsored news broadcasts, political speeches, Government programs, national-defense features, and the like, none of which produce revenue for either the stations or the networks. Yet all these noncommercial programs are costly. They require just as much physical apparatus as the commercially sponsored programs (on occasion the expense of wire lines and similar facilities is even greater), just as many employees, just as careful planning and production, and whereas the sponsor pays the cost of talent in commercial programs, the station or network must bear the cost of any professional talent required in noncommercial programs.

Nor is radio's contribution to the public limited to what goes out over the air waves. The industry is constantly engaged in extensive and costly research looking to the improvement of transmission and reception, to the improvement of programs, to the development of new techniques, such as television, international short-wave broadcasting, frequency modulation, and the like. All this is in line with the declared policy of Congress, which in the Communications Act of 1934 admonished the Communications Commission to "generally encourage the larger and more effective use of radio in the public interest" (see sec. 301 (g)). Although their cost is enormous, these activities produce no appreciable income today, and there is no assurance that they ever will in the future. At best, it will be many years before they produce even a modest profit.

According to figures recently released by the Federal Communications Commission, some 238 broadcasting stations had net time sales, in 1940, sufficient to bring them within the orbit of this proposed tax. These stations, together with the three national and five regional networks, had net time sales of about $112,500,000 in 1940. The aggregate direct broadcast expenses of these stations and networks was about $92,500,000. This tax, if applicable in 1940, would

have imposed upon this portion of the industry an additional burden of direct expense amounting to about $11,500,000.

It is readily apparent that such an addition to the burden of direct expense which the industry already carries would inevitably do serious damage to the service which the American public expects and is entitled to receive from radio. This service, it must be remembered, is being performed today by all the stations, and not by the prosperous ones alone. The tax will be an intolerable burden upon the losing stations (the number of which will inevitably be increased), and upon the marginal stations. These stations, too, serve the public. This tax strikes hardest at them, though they are least able to stand the blow. It has no relation whatever to ability to pay.

2. *Decreased revenues in prospect.*—Since the competitive situation is such that the broadcasting industry could not reasonably expect to pass on the tax through increased rates, its only hope of absorbing it successfully would be through increased volume or a reduction of expenses. The prospect, however, is for a decline, rather than an increase, in the volume of business. Similarly, a substantial reduction of expense is not a practical possibility.

Substantially all of the revenue of the radio-broadcasting industry comes from the sale of advertising; and most advertising is done, naturally, by the sellers of consumer goods. Advertising stimulates demand; and fosters sales, distribution, and production. Supply in this country has typically outrun the effective demand, and the function of advertising has been to stimulate demand, so that production could be maintained or increased. However, when the demand is greater than the supply, it becomes uneconomic to stimulate that demand further. For this simple reason, the very real prospect is that advertising expenditures will be drastically curtailed in many lines.

The national-defense program will not benefit radio broadcasting. On the contrary, the prospect is that the effect of that program upon radio will be quite the contrary. It has been estimated that out of 100 principal national adverisers, the production of at least 24 will be seriously affected by priorities and material shortages, and 23 of these 24 are or have been important radio advertisers. Radio broadcasters can hardly assume that advertising budgets will not be affected by this situation. Nor can it be assumed that the Government's efforts to avoid inflation and control spending, by such devices as the restriction of installment buying, will not also result in the reduction of advertisig in many lines.

Unfortunately, the radio broadcasting industry cannot reasonably anticipate increased revenues during the emergency period. In many lines, advertising is sure to be cut, for obvious reasons, some of which have already been mentioned. Automobiles and oil are specific examples. In many other lines, the prospect is wholly uncertain, though the principal indications are that a decline rather than an increase is to be expected.

One further fact should be noted. Many national advertisers, finding it necessary to curtail production and thus left without any motive to stimulate the immediate sale of their product, may nevertheless engage to some extent in what is called institutional advertising, designed simply to keep the name of the product before the public with a view to reawakening demand in the future. While radio advertising is unsurpassed as a current sales stimulant, it has not yet gained popularity as a medium for institutional advertising. An occasional magazine or newspaper page will accomplish the purpose of an institutional campaign, whereas spasmodic radio programs, on the other hand, are difficult to schedule, and likely to be ineffective. Accordingly, radio cannot expect to offset its revenue losses with any substantial share of institutional advertising expenditures.

3. *Expenses cannot be reduced.*—The radio broadcasting industry is in a peculiarly difficult position in the matter of reducing expenses. It cannot offset an increase in one item by a decrease in another. It cannot hold its over-all expense down when its volume of business declines. The fact of the matter is that expenses actually increase with a decline in the volume of business.

The major networks and stations are on the air 17 hours a day, and their listeners expect them to stay on the air for this entire period. Stations which operate less than full time must nevertheless use all the time available to them or lose listeners. In addition, every Communications Commission license specifies the hours during which the station must operate, and no reduction can be made without permission from the Commission. All this makes it necessary

for radio broadcasters to provide a full schedule of programs every single day of the year. As matters stand today, only about one-third of the available broadcasting time is sold to advertisers—so that only this one-third produces any revenue. The broadcaster must fill up the balance of the time—all of it. A newspaper, faced with the loss of advertising, can drop pages, and thus effect a substantial reduction in expense. A magazine can do the same. The radio broadcaster, however, must publish the maximum number of pages every day; and in the case of the radio broadcaster, every commercial hour lost means not only reduced revenue, but a substantial additional expense, which he would not otherwise incur, in supplying a noncommercial program.

In 1939 the direct program expenses of the 519 individual stations reporting time sales of over $25,000, amounted in the aggregate to about $25,500,000. This figure includes only salaries and wages of the program departments, talent expenses, royalties and license fees, wire services, and the like, and does not include technical, promotion, or general administrative expenses (amounting in all to about $43,500,000). Some $9,500,000 of this $25,500,000 expenditure was expended for talent, but commerical sponsors reimbursed the stations for $4,500,000 of this amount, leaving a total net program expenditure of about $21,000,000. Of this amount, only $7,500,000 was attributable to commercial programs. The balance of $13,500,000 was spent for non-commercial, non-revenue-producing programs. The networks' direct program expense amounted to about $14,450,000, including about $5,375,000 for talent, of which $1,150,000 was reimbursed, leaving a net program expenditure of about $13,300,000. (Technical, etc., expense amounted to about $13,800,000.) Of this total program expense, over $9,800,000, or nearly 75 percent, was attributable to noncommercial programs.

By reason of the fact that such items as talent expense, as well as a number of others, must be borne by the broadcaster in the case of noncommercial programs, the latter cost the broadcaster considerably more to produce than commercial programs. As a consequence, any reduction of the volume of business, any reduction in commercial programs, in addition to adding to the broadcaster's over-all expense, casts a disproportionate burden upon the noncommercial programs. Such a result would be especially unfortunate in view of the fact that it is the noncommercial programs, in the main, which provide the coverage of important events, the discussion of public issues, the educational and cultural features, and the governmental and national-defense broadcasts.

Other broadcasting expenses cannot be materially reduced. Salaries and wages account for by far the greater part of the expenses of the radio broadcasting industry. In 1940 the industry employed about 22,000 full-time workers, at a weekly wage aggregating over $1,000,000. In addition, about 4,000 part-time workers were employed by the industry, and this figure does not include talent under contract to the networks, to stations, to advertising agencies, or to individual sponsors. (Most of the talent employed in important commercial programs is under contract to the advertising agencies.) It is estimated that if this talent were included, some 50,000 persons would be found to be employed by the industry directly. No reduction of employees or pay rolls can or should be made.

Indirectly, the broadcasting industry is responsible for the employment of perhaps 250,000 other workers in the radio manufacturing and distribution industries. A healthy broadcasting industry is thus the key to the livelihood of some 300,000 wage earners. They will properly challenge any threat to their security.

Similarly it is obviously not in the public interest for broadcasters to reduce the heavy expenditures they have made in the past, and budgeted for the future, for the perfection of physical apparatus, for the improvement of programs, for research and development in new fields and new techniques, such as television, international short-wave broadcasting, frequency modulation, and others. The industry, in past years, has expended large sums for improvement, research, and development along these lines, and even greater sums must be expended for many years in the future before there can be hope for any return whatever. One network, for example, has budgeted over $2,000,000 for 1942 alone for the development of television, short-wave broadcasting, and frequency modulation. Furthermore, as new techniques are developed, individual stations must be financially able to adopt them, and extend their benefits to the public. As has already been pointed out, technical improvements may require overnight replacement of equipment, at heavy cost. These expenditures are clearly in the public interest. They must be maintained and even increased. Any tax policy which creates pressure for their reduction is unsound.

IV. CONCLUSION

The Committee on Ways and Means predicted that this proposed tax will produce $12,500,000 in its first full year of operation. This figure, of course, represents the gross revenue to be produced by the tax. Since it will be deductible for income and excess-profits tax purposes, the net revenue will naturally be somewhat less.

The tax is novel in form and unsound in principle. It discriminates against and imposes an undue burden upon an industry which renders a real public service in normal times, and whose efficient functioning in times of emergency is of the utmost importance. Even without the tax, the industry is facing a difficult and uncertain period, for the defense program necessarily involves dislocations and disruptions of normal business activities. This special tax would only multiply the difficulties. Its imposition would at best be an experiment, and an experiment which even a much larger amount of revenue could not conceivably justify.

Overshadowing all these considerations is a major consideration of broad public policy. Radio broadcasting has become the most important medium of disseminating information to the public, and the greatest forum for public debate. It must be kept free; the necessity for this freedom is clearer today than ever before. This freedom cannot be preserved by special taxation.

Title VI should be stricken from the bill.

Senator BAILEY. The next witness is Mrs. Emily Holt, national executive committee, American Federation of Radio Artists.

STATEMENT OF MRS. EMILY HOLT, NEW YORK, N. Y., REPRESENTING THE AMERICAN FEDERATION OF RADIO ARTISTS

Mrs. HOLT. Mr. Chairman and gentlemen, I am here as the representative of the American Federation of Radio Artists, which is affiliated with the American Federation of Labor. I think all of you know the service which artists and performers in this country render in a community in patriotic spirit.

Presently there is a great deal of that contribution being made by our membership. Community drives, community chest drives, Red Cross drives, hospital drives—all kinds of public organizations are supported by the gratuitous services of our membership, and the use of the talent of our artists and performers is greatly increased in this day when many subscription-seeking organizations are resorting to radio.

This is related directly to the opportunities for employment which our members have. There are only so many hours of time on the air. Many are devoted to programs of civic and educational nature; more are being devoted now to benefits and drives; many are devoted to musical programs, and a few—we think too small a percentage—to talent entertainment programs.

It is our function to initiate collective bargaining agreements for our 12,000 members to insure them a living. Our members support their organization by payment of a sliding scale of dues, so we have constantly before us the evidence of their income possibilities in radio. The overwhelming majority of them are people with an income of $2,000 a year and less; then the next category brings us up to almost 85 percent of our membership, earning between $2,000 and $5,000 a year. Only between 10 and 15 percent of our people earn $10,000, $25,000, and so on up to the upper brackets. With the increased cost of living, $2,000 a year and between $2,000 and $5,000 in the different

parts of this country are not figures that our membership can look upon and not leave them disturbed at all. We think this tax will disturb us, and we shall tell you why. If the tax is imposed, as now contained in the bill, two possibilities may occur. It may be passed on, in whole or in part, to the sponsors of our employers on commercial programs. If it is, it is our considered opinion that it will curtail the existing limited opportunities of our membership. If it is absorbed in whole or in part by the management, we feel it will impair our ability to secure and maintain uniform minimum scales, especially in view of the rising costs of living. For that very simple reason, involving the livelihood of the actors, singers, announcers, and sound effects men, who entertain the public of the United States, we feel that this tax is an injustice. I have just come from our convention, our fourth annual convention in Detroit. We had delegates there from radio stations all over the country, and this matter was discussed on the floor of the convention.

I was asked to read to you the resolution which was adopted on the floor of that convention:

Resolved: That A. F. R. A. vigorously protests against the special tax levied against the radio industry, adopted by the House of Representatives in section 601 of title VI of the Revenue Act of 1941, and now under consideration by the Senate Finance Committee. This proposal is discriminatory legislation against the radio industry which therefore concerns the welfare of every radio performer, who will, in the last analysis, pay part of this tax in the form of wage adjustments. Radio performers now pay their income and emergency taxes to meet the national crisis, just as do all other loyal Americans. There is no justice or equity in imposing this special tax upon the industry in which we work, and our national executive secretary is instructed to place our organization on record before Congress in opposition to the radio tax.

I thank you very much. Are there any questions, sir?

Senator BAILEY. Any questions?

(No response.)

Senator BAILEY. Lawson Wimberly, international representative International Brotherhood of Electrical Workers. Mr. Wimberly?

STATEMENT OF LAWSON WIMBERLY, WASHINGTON, D. C., INTERNATIONAL REPRESENTATIVE, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS

Mr. WIMBERLY. Mr. Chairman and gentlemen of the committee, my name is Lawson Wimberly. I appear here as the representative of the International Brotherhood of Electrical Workers, a labor organization affiliated with the American Federation of Labor.

We wish to be recorded as being opposed to the tax proposal contained in House bill 5417, with respect to advertising sales by radio stations. Let me make it clear, however, that we do not wish to be understood as opposing any tax that may be necessary, so long as the tax is equitable and not discriminatory.

That brings me to the basis of our opposition to the proposed tax on radio advertising. I think we should keep in mind, in that connection, some of the things which have been said by other speakers here on this subject: That there are many other forms of advertising—newspapers, magazines, streetcars, busses, and various other mediums of advertising—which the present bill does not propose to

tax. Our opposition to the tax on radio time sales is that it singles out radio advertising and burdens it with what is almost an exorbitant tax.

And there I want to say just a word about how the thought of taxing radio broadcasting originated in the House of Representatives. Mr. Connery, of Massachusetts, introduced a bill which proposed to levy "an amusement tax" on radio time sales. That bill, H. R. 4806, was never acted upon, but most of its text was incorporated in the bill now before your committee. That particular measure, H. R. 4806, was proposed by the printing-trades workmen who apparently thought they were being denied some earning opportunities, and possibly some employment opportunity, by reason of increased advertising by radio broadcasting. I think they were mistaken in that view, and I think the very fact that it is a punitive measure discredits the proposal to tax radio broadcasting advertising.

There has been some question as to the position of the American Federation of Labor on this matter, and I want to say to the committee that the executive council of the federation, in its meeting last week in Chicago, voted a resolution opposing this measure. It has been represented, as I understand it, by some of the representatives of the printing trades that the federation is in favor of this tax. That is not true, and I would be glad to furnish the committee with a copy of the resolution adopted by the federation.

Senator BAILEY. You may put it in the record.

Mr. WIMBERLY. In that connection, I would like permission to file a brief statement of our position in this matter; I realize the time which the committee has is limited here. With that statement I will include a copy of the resolution adopted by the federation.

I think I have just about outlined the basis of our opposition to this tax. I would like, however, to underline some of the things already said regarding this being a discriminatory tax. We believe it is one that will seriously impair the earning opportunities of our members in the broadcasting industry.

I wish to thank the committee very much for this courtesy.

(The resolution of the American Federation of Labor and the supplemental statement referred to above are as follows:)

EXTRACT FROM MINUTES OF THE MEETING OF THE EXECUTIVE COUNCIL, AMERICAN FEDERATION OF LABOR, CHICAGO, ILL., AUGUST 4–13, 1941

"While labor believes that the United States Government should levy extra taxes on the people to pay for defense work, we do not believe in punitive and discriminatory taxation such as a special levy on radio advertising broadcasts."

Motion carried.

STATEMENT BY LAWSON WIMBERLY ON BEHALF OF THE INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS (AFFILIATED A. F. OF L.)

In re H. R. 5417, title VI, Radio Broadcasting and Network Tax.

This statement is presented to the Senate Finance Committee on behalf of the International Brotherhood of Electrical Workers, and American Federation of Labor affiliate, in opposition to the proposed tax on radio-advertising sales contained in title VI of H. R. 5417. Time allotted for our appearance before the committee did not permit detailed discussion of the various phases

of this matter. We therefore wish to present some additional facts with respect to our objections to a tax being imposed only on radio advertising.

Undoubtedly everyone realizes that a radio station, like a newspaper, magazine, or any other business must compensate its employees with income from some source. A radio station, like a newspaper or a magazine, derives its principal income, with which employees are paid, from advertising sales. While in the advertising field, the radio utilizes an entirely different type or form of sales appeal, it still must compete with all the other advertising mediums. For Congress to tax one medium of advertising without taxing all would certainly be discriminatory.

It is interesting to look into the background of the proposal to tax radio advertising and not tax newspaper, magazine, or periodical advertising, which really constitutes the large volume of advertising sales. This proposal originated in the Ways and Means Committee of the House of Representatives when an agent of the International Allied Printing Trades Association, an organization of five unions in the printing industry, complained to the House committee that radio advertising was reducing the earning opportunities of members of the unions comprising the association.

The records available do not support this allegation. If we can take the record of the number of members on which these unions have paid per capita tax to the American Federation of Labor as a standard of comparison, their membership has actually increased in the period of radio's greatest expansion. The following with respect to the number of members reported is taken from the official proceedings of the American Federation of Labor for the years shown:

	Name and membership of respective unions				
	Typographical	Printing pressmen	Bookbinders	Photoengravers	Stereotypers
1925	71,000	40,000	13,600	7,200	6,800
1930	77,600	40,000	13,900	8,900	7,800
1935	73,400	42,000	11,700	6,700	7,900
1940	[1] 79,400	43,700	18,700	10,500	8,400

[1] Figure in 1939. This union not affiliated with American Federation of Labor in 1940.

It should be interesting to note the number of broadcasting stations which were licensed for operation during the above period. From reports of the Federal Communications Commission we find that the number of standard commercial broadcast stations were as follows:

	Stations licensed		Stations licensed
1925	571	1935	605
1930	612	1940	814

Figures could be given to show how the number of radio receiving sets in use in the United States has risen from a few hundred thousands to over 50,000,000 at the present time. We could also list authentic figures to show the tremendous increase in circulation of newspapers and magazines during the past 20 years; we could quote statistics to show that hundreds of thousands have been provided employment as a result of the development of radio, but we do not feel that is necessary, especially when this information is general knowledge.

The printing industry workers in attempting to have Congress enact a punitive tax on radio advertising, have selfishly disregarded these obvious facts. They have also apparently ignored the fact that the radio broadcasting industry each year spends several millions of dollars for printed promotional activities. The radio manufacturing industry spends considerably more for its sales and promotional work.

When the proposed tax was first broached, it was termed "an amusement tax" by its sponsors. The fact that it was so designated emphasizes the existence of inherent deficiencies which render such a disguise necessary. A properly formulated tax on amusement would impose the tax burden upon those who are the beneficiaries of the particular entertainment or amusement. The proposed tax would be imposed upon the broadcasting stations and networks—upon the producer, not upon the consumer—and would have a detrimental effect directly

upon employees in the broadcasting industry. The only measure of the amount of the tax would be the amount of revenue, irrespective of the quantity or quality of amusement afforded to any listener. While perhaps radio offers more entertainment with the advertising it carries than do newspapers with their advertising, there is no substantial basis upon which an amusement-tax levy could be made upon radio.

Another fact regarding radio advertising that is generally overlooked is the type of advertising carried by the radio which requires the services of many vocations, including not only technicians and engineers, but musicians, actors, script writers, announcers, and others. The annual wage bill of radio broadcasting amounts to several millions annually.

In view of these facts, we submit that there can be no justifiable reasons for taxing radio time sales unless there is an equal rate of taxation on all other forms of advertising. A radio advertising tax alone would have a very serious effect upon the earning opportunities of the members of this organization employed in the broadcasting industry, as well as thousands of others in broadcasting and other allied industries. This situation would not prevail to such a degree if the tax is made applicable to all forms of advertising.

We would like to reiterate our statement before the committee to the effect that we are not opposing any tax that may be necessary—so long as that tax is equitable and applies to all alike. We submit that the tax proposed on radio broadcasting in this bill is a punitive tax, unreasonable, discriminatory, and partaking of the character of class legislation, violative of the fundamental democratic principle of equality under law. It should be stricken from the bill.

Senator BAILEY. This finishes with the proposed radio tax. We now come back to the capital stock tax and excess-profits tax, and the next witness on the calendar is Claude Dudley, Millers' National Federation.

STATEMENT OF CLAUDE W. DUDLEY, WASHINGTON, D. C., REPRESENTING MILLERS' NATIONAL FEDERATION, CHICAGO, ILL.

Mr. DUDLEY. Mr. Chairman and committee members; my name is Claude W. Dudley, and I represent the Millers' National Federation. It is a national trade association of the flour-milling industry. We have about 480 members and produce about 80 percent of the flour commercially produced in the United States.

I want to make clear, at the outset, that we are heartily in accord with the general proposition that the revenues of the Government must be very substantially increased. Three and one-quarter billions is not too much; it may be too little. I realize full well that failure to take a realistic view of the fiscal situation at this time might lead to very serious consequences in the future.

There are only three features of this bill which I want to call to your attention this morning, and I am going to ask that I be permitted to file a statement which I shall leave here this morning.

The first of these items to which I wish to direct your attention is the capital-stock tax and the declared-value excess-profits tax. We have previously urged, and again urge, that these taxes be abolished. They are very unscientific taxes. The amount of tax which the corporation pays, either as a capital-stock tax, or as a declared-value excess-profits tax, depends not so much on the corporation's ability to pay as it does upon the good luck of its management in guessing accurately, over a period of 1 year, 2 years, or 3 years, as the case may be, the amount of its earnings. I think one of the witnesses referred to it a few days ago as a crap-shooting contest. In my opinion, the tax is

entirely unscientific. With the addition of a graduated excess-profits tax at high rates, which this bill contemplates, and which we do not oppose, the declared-value excess-profits tax serves no longer a useful purpose and it and its companion, as I have said, should be abolished.

Senator BAILEY. What would you substitute for it?

Mr. DUDLEY. Senator, I have no specific suggestion. First, I should say that the feeling we have is that something should be substituted for it because it involves $150,000,000, which we think should not be lost. Whether the committee should add to the normal and surtax rates of corporations or should add to the graduated excess-profits tax or adopt some other method, we leave to the judgment of the members of the committee.

Senator BAILEY. Your objection, primarily, is to the base?

Mr. DUDLEY. Yes; we think, as I have said, it is an unscientific tax; it is unsound.

Senator BAILEY. Just give us a little analysis on that point; just elaborate on it; tell us why you think that.

Mr. DUDLEY. We think it is unsound in this respect, Senator. We are to declare a value between now and September 29 of our capital stock. As you know, that declaration needs to be related in no way to the actual value of our capital stock. A corporation whose stock has $100,000,000 of value in the quoted security markets may, if it so desires, declare the value at $1,000,000, or may declare its value at $1,000,000,000, and the Government accepts whatever value is declared. The purpose of a corporation, in declaring a high capital-stock value, is to get a large credit for declared-value excess-profits tax purposes.

At the present time, under the present law, it is intended that that value which we declare now shall be effective for the next 3 years.

Senator BAILEY. I might say that that yield now is $215,000,000.

Mr. DUDLEY. Thank you. Now, that value which we declare now is to be effective for 1941, 1942, and 1943. Who can really estimate, with any degree of expertness at all, the earnings of any corporation for the next 3 years under such conditions as we have now? And it is that estimate or guess which determines what value a corporation shall place on its capital stock for purposes of this tax. I think, by all means, if you decide that the tax should be continued, an annual redeclaration of value should be provided for in the bill. I think that should be provided for at all times, and I think it is especially true in these times. We don't know much about what the situation will be in July 1942.

Senator BAILEY. You would be satisfied with that? With that annual declaration?

Mr. DUDLEY. Well, Senator, I think that with a graduated excess-profits tax at high rates—and they must be high—this bill contemplates rates from 35 to 60 percent—with a special excess-profits tax at some rate—10 percent it is in this bill; that tax, incidentally, we oppose—that a corporation should not have to worry with capital-stock tax and declared value excess-profits tax at all; and, incidentally, it is quite an additional worry. As you know, there is no provision for filing consolidated returns for capital-stock taxes or declared-value excess-profits tax. As you know, a railroad system, for instance

can file a consolidated return for income-tax purposes and for ordinary excess-profits tax. Every railroad system involves a number of subsidiary corporations in this, that, or another State operating a part of its lines. Everyone of those railroad systems must make, separate for each individual small company, a capital-stock return and file a declared-value excess-profits-tax return. I think the taxes should be consolidated as much as possible. We should have fewer, rather than more of them, even though it means an increase in the rates in those retained.

Now the second change to which I desire to direct your attention is the graduated excess-profits tax. The rates are graduated from 35 to 60 percent. We have no objection to that whatsoever. It is the method which we think is unsound.

As the bill stands, the rate is graduated merely upon the basis of size, dollar income, without any relation whatsoever to the percentage increase of such corporations earnings in comparison with what you might call the normal or ordinary return. The excess-profits-tax laws of 1917 and 1918 both recognized the principle, and adopted the principle that a corporation whose earnings are say, 100 percent above normal, should pay a higher rate of graduated excess-profits tax than a corporation whose earnings are say, 25 percent above normal.

Thus, two corporations might pay exactly the same tax under this bill, notwithstanding their earnings were far apart because the graudation is based upon dollar excess profits—that is, taking into consideration their credits——

Senator BAILEY (interposing). What would you suggest for normal, as to base?

Mr. DUDLEY. I think that the bill very properly recognizes two alternative bases for determining the normal; a normal net income based upon a past period, or a minimum return on invested capital, which the bill has placed at 8 percent for the first $5,000,000, and 7 percent above $5,000,000. I think we are very unfortunate in the base period which was adopted in the 1940 excess-profits-tax law. I think one of the difficulties now is due to the fact that that base period, 1936 to 1939, was very subnormal.

For instance, for the industry which I represent, the milling industry, the earnings for that industry for the base years 1936 to 1939 were far lower than they were for the previous so-called depression years of 1931 to 1935; decidedly lower, and that is true in many other industries, but I do think that an alternative base should be provided. It is perhaps too late now to have changed the base period which was adopted after very lengthy consideration last year.

Now I come to the point our industry is very, very much interested in, and that is the special 10 percent excess-profits tax which is placed upon those corporations which choose the invested-capital method of determining their excess-profits-tax crdit. That tax will fall extremely heavily on the milling industry and any other industry which happened to be unfortunate enough to have a very poor record of earnings in the base years, 1936 to 1939.

Now, to give you one or two figures from the milling industry: The mills reporting to our trade association had a net profit of 8.35 cents per barrel during the base period, 1936 to 1939. Com-

paring that with the 6 years, 1931 to 1936, which, as you gentlemen will see, included the worst depression years, the industry, as represented by these reporting mills, had a net profit of 15.7 cents per barrel in that earlier depression period.

In other words, the profits of the milling industry during the base period 1936 to 1939 were not more than half what they were during the depression, so-called, depression period.

Now one reason for that, of course, is the fact that the so-called processing tax, under the Agricultural Adjustment Act, intervened and threw the industry into confusion for a number of years. Another big reason, of course, is the fact that, throughout the base period, 1936 to 1939, you had a world-wide surplus of wheat with its attending depressing effect on the milling industry. As to return on invested capital, our reporting mills show a return of 3.04 percent on their invested capital during the base period 1936 to 1939, as compared with a return of 5.8 during the 6 years from 1931 to 1936.

Now, of course, you gentlemen realize that where you have such an average return, it must include many companies that have no net earnings at all for the entire base period 1936 to 1939.

Senator BAILEY. You are a few minutes overtime.

Mr. DUDLEY. May I have 2 minutes?

Senator BAILEY. I have already given you 2 minutes because I interrupted you. I don't like to be disagreeable but we will have to keep within the rule.

Mr. DUDLEY. May I finish with two sentences?

Senator BAILEY. Yes; two sentences.

Mr. DUDLEY. This 10-percent excess-profits tax falls most heavily on those least able to pay. For this very special reason, we urge the abandonment of that tax.

(Mr. Dudley's prepared statement is as follows:)

STATEMENT OF CLAUDE W. DUDLEY

I represent the Millers' National Federation, which is a trade association of flour milling companies. The federation has approximately 480 members, which produce approximately 80 percent of the flour commercially produced in the United States.

The federation is keenly aware of the necessity for substantially increased revenue and does not protest the increases in rates which have been generally provided for in the House bill. We realize full well that a failure to increase taxes sufficiently to pay from revenue a substantial part of the defense expenditures would invite troubles which might ultimately be far more serious than the tax burden itself. We do think, however, that a substantial reduction of nondefense expenditures should be made and hope that it may be possible for the Congress to achieve that end.

There are two features in the excess-profits tax provisions of the House bill to which I wish to direct your special attention. We think that they are inequitable and that they should be revised. The first of these relates to the special 10 percent excess-profits tax applicable to that part of the current earnings which exceeds the base period earnings but does not exceed the invested capital credit. This tax will fall extremely heavily on the milling industry and other industries which have had meager earnings during the base period. It will fall most heavily on those least able to pay. It runs directly contrary to the well-accepted principle that income taxes should be levied in accordance with the ability to pay them.

During the base period years the milling industry was seriously affected by the processing tax and the confusion resulting from its invalidation, by the large world-wide surplus of wheat, and by other factors tending to reduce profits to a minimum. The mills reporting to the federation had average net earnings of 8.35 cents per barrel of flour during the base period, as compared with 15.7

cents for the 6 years from 1931 to 1936. In other words, the base-period history for the milling industry is worse than the earlier depression years.

The reporting mills earned only 3.04 percent on their invested capital during the base period in comparison with 5.8 percent during the 6 years from 1931 to 1936.

It must be remembered that the 3.04 percent average return reflects the operations of many companies which had losses during the base period and which have no base period net earnings credit. To such mills the special 10 percent tax will apply on all their earnings (if any) for the current year. This simply means a net increase of 7 percent in the effective rate of income taxes on a class of corporations which are least able to bear a disproportionate share of the tax burden. Most of the companies which have no base period credit are small- and medium-sized companies upon whom the burden will fall very heavily.

An excess-profits tax should be based on an excess above normal, measuring the normal either in relation to a normal average net income or a normal minimum return on invested capital. Where there were no net earnings in the base perid, the tax ceases to be an excess-profits tax and becomes merely a special additional income tax.

Where the earnings of an industry for the base period are less than a necessary minimum normal return to permit continuance in business, some other method of fixing the minimum normal before applying the special 10 percent tax should be provided.

The milling industry will not benefit in any substantial measure from the defense program. The use of their products is related to national defense in that bread is a staple food which contributes to the health of the Nation, but it is not expected that the consumption of flour will be substantially increased because of the defense effort nor that any increase in profits of the milling companies as compared with the base period will be due to the defense program. If an increase of profits is effected, it will be a natural upswing from a period of abnormally low profits to a reasonably normal profit.

We oppose the imposition of any special tax on corporations which had low base period earnings and are not now earning more than a certain minimum return on invested capital. Certainly it cannot be said that a return of 4 percent on invested capital is an excess profit and we do not believe that any company which is earning less than 4 percent on its invested capital should be called on to pay an excess profits tax. Under the House bill a company which had no net earnings in the base period and which earns 1 percent on invested capital in the curent taxable year will be required to pay a special excess-profits tax of 10 percent on all of its earnings during this taxable year. We regard this as a very inequitable tax burden on those taxpayers least able to bear a special burden.

There is one other point with respect to the excess-profits tax. In the House bill the graduated excess-profits tax with rates from 35 to 60 percent is graduated merely with respect to the size of the income. We think that the graduation should be in relation to the corporation's percentage return on its invested capital. This principle was followed in the excess profits tax laws of 1917 and 1918. We regard it as sound and think that it should be restored in the current law.

Respectfully submitted.

MILLERS' NATIONAL FEDERATION,
By CLAUDE W. DUDLEY.

AUGUST 15, 1941.

Senator BAILEY. Mr. A. Harding Paul, on surtax rates, strategic metals application of capital gains tax to personal holding companies.

(Thereupon, at 11:45 a. m., Senator George resumed the chair.)

STATEMENT OF A. HARDING PAUL, ATTORNEY AT LAW, WASHINGTON, D. C.

Mr. PAUL. My name is A. Harding Paul. I am an attorney at law, practicing in Washington, D. C.

Mr. Chairman, I have adopted the expedient of making some tax notes. When the committee abbreviated the time for making the

statement to 10 minutes, I didn't think it was possible to make any complete statement, yet I would like to have incorporated in the record these tax notes which I have prepared.

The CHAIRMAN. Yes; you may do that.

Mr. PAUL. I will simply advert to two or three things contained in the notes, after which, if there are any questions, I would be happy to submit any information which I have.

I submit that the first thing of note is that Government is to be as usual, except for defense. In other words, we are making no reductions in expenditures and, for that reason, we are going to have a deficit for the fiscal year of $10,700,000,000. Any reduction in nondefense expenditures would cut that deficit. There is no program and no conceivable program which will produce the necessary revenue to bring revenues to two-thirds and borrowings to one-third during the fiscal year 1942. The necessary revenue to be collected by June 1942 would be $5,266,000,000.

The second thing of note, it seems to me, is that if we could get on a $90,000,000,000 income, the revenues which were projected in the President's Budget message of 1940, plus the amount added by the two Revenue Acts of 1940, we would get $15,400,000,000.

Now, the 1942 Budget estimates say we are only going to get $9,400,000,000. This is undoubtedly due to the fact that there have been income diversions into nontaxed or undertaxed channels. This diversion is to be seen by remembering that there is $14,000,000,000 increased income this, over last year. The Commerce Department last week issued estimates that current national income is running at the rate of $88,000,000,000 per annum and that wages, through June 30 are up $5,500,000,000 over the first 6 months of 1940. Wage increases will probably represent $12,000,000,000 of the $14,000,000,000 expected total increased income.

Now, it seems to me that if you could get, of that $14,000,000,000, one-third, or even but 10 percent of that increase, you would be able to make many changes in this bill which would bring it better in accordance with people's abilities to pay.

I have made a specific suggestion, therefore, that you impose a gross income tax and withhold it at the source, or else that you should impose—perhaps both these taxes should be imposed—an excess-profits tax upon the increased earnings.

Now, it is entirely feasible to impose this latter tax. I don't know at what rate, but I think the people who have increased earnings are better able to pay, and to meet a current tax bill, than those who have been getting along on the same income from year to year. The best way to tap this new ability to pay and reduce its inflationary spending is by an excess-profits tax directly on the increases. The public will support such tax, even at low-income levels, as the Gallup poll shows.

The argument has been made, and before this committee, that the low-income groups pay hidden taxes. That argument is contained in monograph No. 3 of the T. N. E. C., Who Pays the Taxes. This argument is based upon assumption and you cannot trust those hidden tax figures. For instance, they show that on an income of between $1,000 and $1,500, 5.6 percent in hidden taxes is paid to the Federal Government. That same monograph shows that on $20,000 incomes

and up, 37.8 percent was paid in total taxes. With 1940 and H. R. 5417 increases, the tax percentage of the latter group is up to 54 percent. Now I don't believe that anybody getting $20,000 will feel that he is to pay 54 percent in taxes, even after this bill. I don't believe you can trust these figures. They are based on too many assumptions that are theoretical. I come now to some specific suggestions.

I think it ought to be clear that alimony and separation payments should be allowed as a deduction to the person who makes those payments and taxed to the person who receives them. There are 250,000 divorces granted each year in this country, for causes, many of which are not subject to moral censure. To the extent alimony or separate maintenance is payable from current income, the payor is deprived of ability to pay taxes on amounts he cannot control. Recipients of alimony should be taxed thereon, ending one glaring tax exemption. If held not to be income to recipient, payor should be taxed on such amount separately, in recipient's rate bracket. Complete confiscation and inordinate hardship otherwise results.

The cases of *Helvering* v. *Fuller* (310 U. S. 69) and *Helvering* v. *Leonard* (310 U. S. 80) show an absurd tax pattern. Confusion in this field is now rampant. There is litigation going on every day now as to whether the man divorced in Nevada should be taxed and the man divorced in New York, exempted. It depends on where you get your divorce. If two people, neighbors in New York, get divorces, one in Nevada and the other in New York, the one who gets the Nevada divorce doesn't have to pay the income tax on his wife's alimony, but the one who lives in New York does. With the rates that you have in the bill, it leaves the man who has been generous in providing for his former wife and children at the complete mercy of these high tax rates. In some cases he has no income left. I also think that you are making a mistake in not extending the capital-gains provisions of your act applicable to corporations. You have increased the rates on corporate incomes to 30 percent. The individual can realize capital gains at the present time at 16½ percent. The corporation will be discouraged in its realization of such gains and that factor enters into your revenue. When you come to personal holding companies, you find that the rate can reach 82½ percent and I think that no one would suggest that capital gains will be realized if the person who has the privilege of saying whether or not that gain shall be taken must pay an 82½-percent tax on the amount of the gain.

There is another thing that should be done; that is, corporations should not be made to reduce earnings and profits by nontaxable capital losses so as to make it impossible to pay dividends. That is true with liquidating dividends which should be allowed as credit against any corporate undistributed—including personal holding company—income. These remedies should be retroactive to 1936 for open cases and thus end confusion arising from the decisions in the cases of *Foley Securities Corporation* v. *Commissioner* (106 Fed. (2d) 731) and *Pembroke Realty & Securities Corporation et al.* v. *Commissioner*, decided by the Circuit Court of Appeals August 4, 1941.

I think you ought to provide for consolidated returns for normal as well as excess-profits taxes. If you fail to do this, you will find that there is utter confusion in determining the credits. The bill provides

that you may spread the excess-profits tax against the normal tax but if you have a deficit corporation you cannot determine how to spread this tax.

The CHAIRMAN. Your 10 minutes is about up.

Mr. PAUL. May I have just 1 more minute in which to say a word about new corporations and companies formed during the base period?

As to these, I suggest a specific remedy. It is to take the number of years they have been in existence and provide credits based on average earnings during that period, including 1940, not exceeding 4 years, ignoring the deficit years and ignoring such years as they have not earned the minimum excess-profits tax which this bill permits them to earn. For corporations starting after 1940, where capital is not an important factor, provision should be more for 1 year's exemption from excess-profits tax unless such company's profits arise out of defense; namely, out of contracts or subcontracts for defense materials. New corporations with capital can earn 10 percent (slightly less if capital exceeds $5,000,000), but this does not help new corporations with little or no capital.

(The following additional statement was submitted by Mr. Paul:)

STATEMENT OF A. HARDING PAUL

Fiscal year 1942 expenditures:	
Latest forecast for defense	$15,000,000,000
Government—as usual	7,000,000,000
Total, not less than	22,000,000,000
Revenues expected (Budget Bureau estimate) under present laws (based on estimated income of $88,000,000,000)	9,400,000,000
Deficit	12,600,000,000
House bill (H. R. 5417) increases tax collections for fiscal year (calendar year $3,200,000,000)	1,900,000,000
Deficit, fiscal year 1942	10,700,000,000

Necessary additional tax collections to produce two-thirds expenditures by June 1942, $5,266,000,000. No revenue program advanced or suggested by Treasury, or which can conceivably be adopted at this time, can meet the formula of two-thirds taxes and one-third borrowing during the fiscal year 1942, and for the time being at least the formula should be forgotten.

There is no magic in such formula. During the last war expenditures were met by borrowing to the extent of two-thirds. Taxes produced only one-third—exact reverse of what Treasury now urges. (See report of War Policy Commission.)

Treasury requested Ways and Means Committee to increase taxes by $3,500,000,000 divided on following basis (all figures approximate):

Corporation tax	$900,000,000
Individual income, gift, and estate	1,400,000,000
Excise	1,200,000,000
Total	3,500,000,000

Ratio of ability to pay and consumption taxes, two-thirds ability to pay—one-third consumption.

House bill provides increases as follows:

Corporation tax	$1,350,000,000
Individual income, gift, and estate	1,000,000,000
Excise	875,000,000
Total	3,225,000,000

Ratio of ability to pay taxes to consumption taxes is 75 percent ability to pay—25-percent consumption.

Despite Treasury's increased estimate of expenditures from $19,000,000 to $22,000,000, Finance Committee's object should be to raise not more than $3,500,000,000 and to improve House bill.

Bring ability to pay taxes with relation to consumption taxes back to two-thirds—one-third ratio by increasing specific excises and adjusting surtax rates, i. e., revise in lower and reduce in middle brackets.

NOTE.—Pay-roll taxes are sometimes considered excises. They are, however, compulsory savings frequently wholly paid by employer for sole benefit of employee. Raising them substantially may accomplish three good purposes: First, it will reduce power to spend where it is increasing and thus reduce threat of inflation; second, it will produce substantial immediate revenue; and third, it will cushion post-defense deflation shocks.

ABILITY TO PAY IN LONG RUN RESTS ON A WILL TO PRODUCE—NO TAX LEVIED ON EARNINGS CAN BE PRODUCTIVE AT LEVELS SO HIGH INCENTIVE IS DESTROYED

Query.—Will a tax of more than 50 percent on earnings above $27,000 curtail productive effort? Prior to 1940 the highest Federal tax rate on earnings above $27,000 was 24 percent imposed by the Revenue Act of 1918, i. e., 12 percent normal—12 percent surtax. Between 1919 and 1940 the rate never exceeded 23 percent. In the latter year the rate was raised to 37.4 percent. Pending bill imposes 50.6 percent on amounts between $27,000 and $33,000 and reaches 60 percent above $45,000.

The public does not support such rates, as witness balloting of Gallup poll. On $10,000 incomes, poll suggests tax of $1,123—the bill $998; on $50,000 incomes, poll's tax is $10,000 against $19,527 under the bill.

Second query.—Can taxpayers at a $27,000 level meet personal budgets and pay a tax (most of it retroactive) equal to 30 percent of total income? Previous budgets call for taxes not in excess of 20 percent. The increase at this level is over $3,000 a year or $250 per month. This is a too severe and too sudden jump. Added to the 1940 increase of over $1,600, the total increase in 2 years is $4,500.

Suggestion.—Eliminate present earned-income credit and provide maximum rate under 50 percent for reasonable earnings, i. e., $75,000 per year and under. Keep rates on investment income as in the bill.

Excess-profits tax should apply to bracket and not dollar incomes above credits. Failure to adopt this reform merely penalizes small stockholders.

Strategic metals.—Strike out section 206 of the bill. You cannot get new necessary production in this country of tungsten, chrome, manganese, and quicksilver with an excess-profits tax leveled against the hazard of prospecting. In 1918 war law exempted profits derived from mining these metals, as did the 1940 act. The House mistakenly removed exemption. High taxation of the profits of producers of strategic metals is opposed by the Office of Production Management and the Reconstruction Finance Corporation. Further, it is a breach of faith to tax now after expenditures induced by exemption of the 1940 act have been made.

Lower surtax rates in middle brackets and impose excess-profits tax on earnings above those of highest previous year, including 1940. Or impose gross-income tax of 5 percent collectible at source on all incomes up to $5,000. Exempt salaries below $750. Lower base to $750 and $1,500. Secretary Morgenthau states there is to be $14,000,000,000 new national income this year over last. If one-third of this increase can be collected in taxes everyone should be happy. The best way to tap this new ability to pay and reduce its inflationary spending is by an excess-profits tax directly on the increases. The public will support such tax even at low-income levels, as the Gallup poll shows. The argument on hidden tax burdens of low-income groups is fallacious. Monograph No. 3 of the T. N. E. C. Who Pays the Taxes shows that on 1938-39 incomes between $1,000 and $1,500, only 5.6 percent in hidden taxes was paid to the Federal Government. It also shows that on $20,000 incomes, and up, 37.8 percent was paid in total taxes. With 1940 and H. R. 5417 increases the tax percentage of latter group is up to 54 percent. Don't trust any figures involving hidden taxes. Costs of living absorb all of them and in America wages will keep pace with cost of living.

Business expenses incurred in producing and conserving income should be deductible from gross income, otherwise gross income is taxed. This law should

be retroactive to allow continuance of Treasury practice, interrupted by the Supreme Court decision in *Higgins* v. *Commissioner* (312 U. S. 212).

Capital gains.—Make individual capital gains tax plan applicable to corporations. High rates interfere with realization of capital gains and hence reduce revenue. Personal holding companies' assets are peculiarly frozen. They cannot liquidate—they cannot operate. Result—stagnation and no revenue. Personal holding companies are in the main incorporated pocketbooks of individuals and should be taxed as individuals.

The CHAIRMAN. Mr. Alger B. Chapman, representing the Controllers Institute of America.

STATEMENT OF ALGER B. CHAPMAN, NEW YORK, N. Y., REPRESENTING THE CONTROLLERS INSTITUTE OF AMERICA

Mr. CHAPMAN. My name is Alger B. Chapman. I am appearing on behalf of the Controllers Institute of America. In view of the time limit per witness and the fact that many of the points have previously been argued before this committee, I would prefer to submit the detailed statement of the institute for the record and merely summarize the more important points that are pertinent to the pending bill.

The CHAIRMAN. You may do that. We are contemplating that witnesses would take that course.

Mr. CHAPMAN. In the first place, the institute is unalterably opposed to any application of the excess-profits tax to normal profits. It believes that the only justification for an effective corporate tax of 72 percent is to recapture excess profits which might otherwise be accumulated out of the Government's own expenditures for national defense. It submits, therefore, that the revenue-raising capacity of the excess-profits tax is limited to that which can be collected from excess profits resulting from the defense program.

Accordingly, the institute is opposed to the provision of the House bill which proposes an extra 10-percent tax on the normal earnings of invested capital corporations and an indirect reduction of the invested capital credit from 8 percent to 5.6 percent on the first $5,000,000 and 4.9 percent on the remainder. These provisions reach beyond the revenue-raising limits of a true excess-profits tax.

The institute firmly believes that this committee should approach the excess-profits-tax problem by first examining the present law, eliminating the present defects in the average earnings, invested capital, special relief, and other basic provisions, and then determine how much revenue can be collected from the excess-profits tax and how much must be collected elsewhere. By reason of the defects in these provisions, the excess-profits tax is already being imposed upon normal earnings, and this situation should be corrected.

So far as the average-earnings credit is concerned, the institute makes the following recommendations:

1. Average earnings should be determined by averaging any 3 of the 4 years in the base period. The fact that all 4 years were not average is recognized in the law, but normal earnings cannot be measured by taking 3 years, in the case of a loss year, and dividing by four.

As the chairman knows, the averaging of 3 out of 4 years in the base period was the recommendation of the Senate committee last year

and was in the bill as it passed the Senate. It was changed in conference. We think provision for a 3- out of 4-year average should be adopted now.

2. The normal-growth provision should be extended to supplement A corporations, that is, corporations which have acquired other corporations in tax-free liquidations or other tax-free reorganizations since 1936. As the law now stands, in order to use the normal-growth provision, these corporations must exclude the base-period income of their component corporations in computing their own average earnings. Supplement A is defective in many respects but this is the worst defect and the easiest one to remedy.

3. Where abnormal income is excluded from the income of the taxable year under section 721 and is attributable to a base-period year, it should increase the base-period income. As the committee knows, this treatment conforms to its own interpretation of section 721 as stated in the committee report on the 1940 act.

So far as the invested capital credit is concerned, the following principal recommendations are submitted:

1. The present rate of 8 percent should be retained and should not be reduced indirectly by a reversal of the deductions for normal and excess-profits taxes.

2. Cost rather than tax basis should be employed in determining invested capital resulting from the acquisition of property for stock.

3. Sections 718 (a) (5) and (b) (4) prescribing adjustments to a parent corporation's invested capital on account of tax-free liquidations of subsidiaries should be revised to conform to the policy adopted in the consolidated return regulations. Under the present provisions, where a corporation acquires the stock of another corporation and thereupon effects a liquidation of the latter corporation, an adjustment is required which completely distorts the invested capital of the continuing corporations.

4. Where property is acquired for stock prior to 1913, either the 1913 value should be used, or the adjustments for depreciation should be based on the original cost of the property to the taxpayer rather than the 1913 value.

The principal defect in the special relief provision is that it fails completely to afford relief to new corporations which are of a type for which the invested capital credit is not adequate, or for old corporations of this same type which have come into production after the base period. Since these corporations have no average earnings experience upon which to determine a normal profit from its current operations, a general relief provision should be included in the law which would permit a comparison to be made with other corporations in the same industry.

Senator VANDENBERG. We had that.

Mr. CHAPMAN. The old special assessment provisions used comparisons for the purpose of determining a tax rate. By reason of that feature of the earlier special relief provisions, they produced rather unsatisfactory results in a great many cases. But something has to be done for these corporations that came into existence or into production after the base period. Since these corporations have no base period earnings record of their own, I think a comparison must be made with the earnings record of other corporations in the same business.

The law should also be revised to permit adjustment for abnormalities in invested capital.

Under section 722, corporations should be permitted to pay their estimated excess-profits tax on the basis of this section in the first instance rather than the tax computed without reference to the section.

In addition to the foregoing, there are a few basic amendments such as the schedule of the graduated excess-profits tax rates which should be based on the ratio of the excess profits to the excess-profits credit and not on the dollar amount of the excess profits. If the provision of the 1940 Senate bill is adopted in lieu of the present law, the small corporation will be protected without penalizing the larger corporation.

It seems to me that the provisions of the Senate bill are meritorious and should be adopted; in order to protect small corporations, I do not think it is necessary to penalize the large one.

Section 734, the inconsistency provision, should be repealed or at least should not be retroactive beyond 1936, the beginning of the base period.

In addition to the foregoing, the detailed statement which I have asked permission to submit contains a number of additional recommendations such as repeal of the declared-value excess-profits tax, or allowance of an annual redeclaration, and restoration of the consolidated return provisions for normal tax purposes. I trust that some of the more technical recommendations contained in this statement will receive consideration when consideration is given to the bill following this pending bill.

(Mr. Chapman's detailed statement referred to is as follows:)

STATEMENT OF CONTROLLERS INSTITUTE OF AMERICA

To the COMMITTEE ON FINANCE,
United States Senate,
Washington, D. C.

The Controllers Institute of America is a professional organization composed of the chief accounting officers of corporate enterprises throughout the country. The corporate accounts are maintained and the tax returns are prepared under their supervision. Accordingly, on them falls the principal responsibility for complying with and interpreting the Federal tax statutes affecting corporations.

The members of the institute were closely associated with the workings of the 1917, 1918, and 1921 excess profits and war profits tax laws. In addition, they have given careful study and have applied as best they could the complicated provisions of the present excess-profits-tax law. They have also had experience with and observed the operation of the excess-profits-tax laws in foreign countries. The recommendations contained in this statement are based on this background of extended experience and observation.

The institute recognizes fully the magnitude of the problems with which the Congress is confronted in framing a new tax act (especially as relates to the tax on excess profits) and wishes to make it clear that it is in accord with the desire of the Government to provide as large a part of the cost of the defense program from current revenue as is consistent with the welfare of the Nation. It also recognizes that corporations must carry their fair share of the burden.

In pursuance of the policy established at the time of its organization, the institute has no comments to offer on the amount of additional revenue to be provided, nor is it making any suggestions regarding the various taxes on individuals or miscellaneous taxes proposed by the House bill.

The main purpose of this statement which has been prepared from the suggestions of our membership, is to recommend revisions in the provisions of the

House bill and the present law relating to corporate taxes, with the following objectives in mind:

(*a*) More equitable distribution of the corporate tax burden among corporate taxpayers, especially as the hardships resulting from inequities in the present act will be greatly multiplied with the increase in tax rates and the increase in amount of income subject to excess-profits tax under the House bill.

(*b*) Simplification and clarification so far as possible of the complicated and obscure provisions in the present act in order that there may be less uncertainty, delay, and litigation in the ascertainment of the tax liability (the complexities of the tax law are increased rather than reduced by the House bill).

(*c*) Improvement in the administrative provisions of the tax laws.

Specific recommendations, many of which were included in the Institute's statement of May 12, 1941, to the Ways and Means Committee of the House of Representatives, are as follows:

I. The excess-profits credits in the present act should not be reduced.

II. In ascertaining the excess-profits credit under the income method, corporations should be permitted to use any 3 of the 4 years in the base period.

III. The schedule of graduated excess-profits-tax rates should be based on the ratio of the excess profits to the excess-profits credit and not on the dollar amount of the excess profits.

IV. Where property is acquired by a corporation for stock in a transaction on which gain or loss is not recognized to the transferor, the property should be included in invested capital at the value of the stock issued for the property and not at the basis of the property to the transferor.

V. Section 734 (inconsistency provision) should be repealed or at least should not be retroactive beyond 1936, the beginning of the base period.

VI. Sections 718 (a) (5) and 718 (b) (4) prescribing adjustments to a parent corporation's invested capital on account of tax-free liquidations of subsidiaries, should be revised so as to conform to the policy adopted in the consolidated return regulations.

VII. For invested capital purposes, the basis for determining gain (not loss) should be used, or, in any event, sections 718 and 720 should be revised so that the adjustments to "unadjusted basis" will be consistent with the "unadjusted basis" to which they are applied.

VIII. The normal-growth provision should be extended to determination of average base period net income under Supplement A.

IX. Supplement A should be revised so that in the determination of average base period net income the net income or constructive net income of the taxpayer and its component corporations will be included for the entire base period.

X. The requirement for daily determination of invested capital should be repealed.

XI. Income attributable under section 721 to a base period year but not realized until a later year should be included in the base period net income.

XII. The unused excess-profits credit should be carried back (in addition to carried forward) against net income of the two previous years in the excess-profits-tax period.

XIII. Section 752 should be revised to eliminate certain unwarranted excessive reductions of highest bracket amounts.

XIV. The relief provisions in section 722 should be broadened.

XV. Corporations to which section 722 applies should be permitted to pay their estimated excess profits tax in the first instance on the basis of this section instead of the excess-profits tax computed without reference to this section.

XVI. The amortization provisions in section 124 should be simplified and the restrictions in subsection 124 (f) should be modified.

XVII. The present system of capital stock and declared value excess profits taxes should be abolished or, in the alternative, redeclaration of the capital stock values should be permitted each year and capital gains and losses should be excluded from the income subject to declared value excess profits tax.

XVIII. The general provision for consolidated income tax returns should be restored.

XIX. Worthless securities should be eliminated from the capital-asset provision.

XX. The requirement for charging-off bad debts should be eliminated or modified.

XXI. Section 719 (a) (2) which covers inclusion in borrowed capital of advances received from governments should be broadened and clarified.

XXII. No part of dividends received by one domestic company from another should be subjected to income tax.

XXIII. The law should be amended to provide that any waiver which extends the statutory period of limitation for assessment of additional taxes shall automatically extend for an equivalent time the period during which an effective claim for refund may be filed.

XXIV. The rate of interest accrued after the date of the enactment of the Revenue Act of 1941, on deficiencies should not exceed 3 per centum and when this is done the rate of interest on refunds should be reduced correspondingly.

I. RETENTION OF AT LEAST PRESENT EXCESS-PROFITS CREDITS

The Institute believes that it would be most unfair and economically unwise to reduce the 8-percent credit on invested capital or the 95-percent credit on base period income provided for in sections 713 and 714 of the Internal Revenue Code. H. R. 5417 proposes reductions in these credits, either direct or indirect, which should not be adopted.

It was stated last year that the Excess Profits Tax Act of 1940 was enacted for the purpose of preventing the "creation of new war millionaires or the further substantial enrichment of already wealthy persons because of the rearmament program" (House of Representatives, 76th Cong., 3d sess., Rept. No. 2491, p. 3; Rept. No. 2894, pp. 1, 2). It was designed to avoid excessive benefits accruing to persons directly or indirectly from spending under the defense program. On February 24, 1941, the House Ways and Means Committee again pointed out that one of the purposes of the Excess Profits Tax Act was "to prevent the rearmament program from furnishing an opportunity for the creation of new war millionaires or the further substantial enrichment of already wealthy persons" and concluded as to such act that "the weight of the burden imposed carries with it a commensurate need for restricting its application to the cases for which it was designed" (House of Representatives, 77th Cong., 1st sess., Rept. No. 146, p. 1). The report of July 24, 1941, of the same committee on H. R. 5417 (the proposed Revenue Act of 1941) seems to affirm that this still is the only scope of the act (Rept. No. 1040, pp. 23–26).

An important consideration in connection with the excess-profits tax may now be its production of revenue. However that may be, the restriction of the coverage of the Excess Profits Tax Act to cases to which it was designed to apply, it is submitted, requires at least the credits now provided in sections 713 and 714 of the code. It should be remembered that the 8-percent return on invested capital is an average for all taxpayers and is not above a normal average return. The yield of the tax as now constituted even for 1940 apparently will be substantial notwithstanding the fact that the rearmament expenditures in that year were just getting started. All indications point to a large increase in the Government's revenues from the present excess-profits tax for 1941 due to the expansion of the rearmament program.

H. R. 5417 proposes to amend section 714 of the Excess Profits Tax Act to reduce the invested capital credit from 8 percent to 7 percent on all invested capital over $5,000,000. It proposes a special 10-percent tax in the case of taxpayers using the invested capital credit, which in effect is simply a reduction of that credit. The bill proposes to prohibit in the future the deduction of the normal income tax in determining excess-profits-tax net income, regardless of which credit is to be used, and to allow instead a deduction of any excess-profits tax in arriving at income tax net income. The House Ways and Means Committee suggests in its report No. 1040 (p. 24) that such change would reduce the 8 percent invested capital credit to an effective credit of 5.6 percent and the 7 percent invested capital credit to an effective credit of 4.9 percent. Obviously, the taxpayer using the base period income credit to compute its excess-profits tax would also find its tax increased by this proposal. The House committee's reason for this change is that it "seems unfair to allow that part of the income tax which is computed on income which is not subject to the excess-profits tax to reduce the excess-profits net income" (Rept. No. 1040, p. 24). It would seem, however, that the more important consideration is how much of its net earnings a corporation shall be permitted to retain before being subjected to excess-profits tax. The Congress should not adopt any changes in the Excess Profits Tax Act of 1940 which would, directly or indirectly, reduce either the base period income credit or the invested capital credit originally enacted in that act.

The Institute is strongly of the opinion that all of the following factors must be carefully studied in determining at what point the excess-profits tax shall begin:

1. The tax should be imposed only on earnings in excess of a fair return on invested capital or in excess of normal earnings. For this purpose, the rate of return expected by the investor in a corporation is not a proper criterion because in making his investment he is guided by the average return over a period of years, good as well as bad, and not by the earnings of the corporation in peak years alone.

2. Corporations must be permitted to build up sufficient resources to withstand losses in bad years. Unfortunately, most corporations, especially those engaged in the steel and other heavy-goods industries, are of the prince and pauper variety, the poor years being more numerous than the profitable ones in recent times. The failure to provide out of profits for ensuing losses will lead to many bankruptcies and will intensify the unemployment problem after the present peak production.

3. If a grossly disproportionate part of earnings in good years must be turned over to the Government, many corporations will be unable to pay even a meager return to their stockholders and investors in unprofitable years. This would give rise to a serious economic problem.

4. As shown in point IV below, under the present act, many corporations must use in the determination of their invested capital the cost of the property to those from whom it was purchased for stock and not its value when acquired by the present owner. In these cases, even an 8 percent return on statutory invested capital is equivalent to only a much smaller rate on the actual invested capital.

5. Any reduction directly or indirectly of the present excess-profits credits under sections 713 and 714 would not only intensify the so-called hardship cases already abundant but will add a flood of new hardship cases. This will necessarily call for added relief provisions which because of their very nature must be complicated as evidenced by the present act.

If due consideration is to be given to the foregoing factors, a reduction in the present excess-profits credits cannot be justified.

II. AVERAGE BASE PERIOD NET INCOME

Under the Excess Profits Tax Act of 1940 as originally adopted the average base-period net income was the average for the years 1936 to 1939, inclusive, except that if there was a deficit for 1 or more of these years zero could be substituted for the year of the largest deficit.

The excess-profits-tax amendments of 1941 recognized that in many cases this method did not result in a fair yardstick for measuring normal earnings. However, these amendments provided correction for only the following situations:

1. Where the income for the second 2 years of the base period exceeded the income for the first 2 years (sec. 713 (f)).

2. Where the character of the business on January 1, 1940, had changed, from that engaged in during one or more of the years in the base period or where in one or more of such years production, output, or operation was interrupted or diminished because of the occurrence of events abnormal in the case of such taxpayer (sec. 722). In these cases, provision was made for constructing the income that would have been realized had the operations during the years 1936 to 1939, inclusive, been typical.

In 1936 we were only emerging from a long depression, and for many industries earnings for the period 1936 to 1939, inclusive, were on the average far below normal. Section 713 (f) provides some adjustment for companies with larger earnings in the second half of the base period than in the first half. However, because the earnings for the year 1938 were subnormal for many industries, especially the heavy-goods industries, section 713 (f) will have only limited application. In order to offset in part inequities which will result in case of those companies which are now required to use the actual income for the full 1936–39 period for determining base period earnings, the Institute urges that corporations be permitted to use any 3 of these 4 years. As indicative of the soundness of this recommendation, it is noted that the Canadian excess-profits-tax law was recently amended to provide that in determining average profits for the standard period (1936 to 1939, inclusive) the taxpayers shall be

given the choice of its 3 best years if the profits of the fourth standard year were less than 50 percent of the average of the profits of the other standard years.

Except where section 713 (f) is applicable, the present act provides for the substitution of zero for the year of largest deficit in the base period but requires dividing the resultant aggregate net income for the 4 years by four. As a result, the determination of the normal rate of earnings is distorted. This defect would be corrected if the act is amended as suggested herein to permit the use of the average earnings for 3 out of the 4 years in the base period.

III. SCHEDULE OF EXCESS PROFITS TAX RATES

The schedule of graduated excess profits tax rates under the present act and under the House bill is based on the amount of excess profits rather than on the ratio of the excess profits to the excess-profits credit. In other words, two corporations with the same amount of excess profits are required to pay the same excess-profits tax even though one of them earns, say, many times 8 percent on its invested capital or its base period earnings whereas the other corporation earns only slightly more than the amount of its exemptions. Under a true excess-profits tax law, it would be eminently more equitable to base the excess-profits tax rates on the ratio of the excess profits to the excess-profits credit provided a fair amount of the excess profits is allocated to the lower brackets of tax. This basis was recommended to the House Ways and Means Committee on page 8 of the report dated August 8, 1940, by their subcommittee and the same principle was adopted in the excess-profits tax laws of 1917, 1918, and 1921, and in the recommendations made to the House Ways and Means Committee on May 19, 1941, by Hon. John L. Sullivan, Assistant Secretary of the Treasury.

When the conference report on the second revenue bill of 1940 was under consideration by the Senate, Senator George made the following statement concerning the inequity of applying the graduated excess-profits tax rates on the basis of the dollar amounts of excess profits. (Congressional Record of October 1, 1940, p. 19503):

"While I have agreed to the report upon the basis that there must be agreement in order to obtain a report, I want my record to be perfectly clear, that this arrangement of the excess profits upon a mere dollar-bracket basis, is one of the most unsound, one of the most inequitable, and one of the most indefensible provisions that ever was written into a harsh bill such as the excess profits tax bill, and it is done for the sole purpose of taxing bigness according to somebody's idea of bigness, without any possible consideration of how the burden falls upon the individual owner of stock which must be made less valuable and less productive under such a crude arrangement as this."

If it is desired not to subject small corporations to the excess profits tax rates in the higher brackets, this could be accomplished by adopting a schedule of alternative excess profits tax rates based on dollar amounts of excess profits or their ratio to the excess-profits credit. This method was used in section 710 of the excess profits tax bill of 1940 as passed by the Senate last September.

IV. USE OF TRANSFEROR'S BASIS WHERE PROPERTY ACQUIRED BY CORPORATION IN TRANSACTION ON WHICH GAIN OR LOSS IS NOT RECOGNIZED

We urge that certain modifications should be made in section 718 (a) (2). Under this section property paid into a corporation in a transaction where the gain or loss to the seller is not recognized, must be included in invested capital not at the amount by which the capital of the corporation is actually increased, but the basis of the property to the seller.

For example, a corporation acquires a plant by issuing its own stock to the seller. Clearly the corporation's actual capital is increased by what it paid for the plant; namely, the then value of the stock issued therefor. However, because the transaction was a reorganization where the gain or loss to the seller was not recognized, the act includes the plant in the purchasing corporation's invested capital, not at its cost to the corporation but at its basis in the hands of the transferor which might have been much less. The property might have been acquired by the transferor many years previously.

The whole concept of the act is that invested capital should be computed at the money or money's worth actually invested in the corporation. Property purchased by a corporation in exchange for its own stock is an addition to capital

(in the amount of its cost) just as much as additional cash paid in for stock. There is no justification whatsoever, so far as an excess-profits tax is concerned, for going back of the cost of the property which is being added. Purchases by corporations for their own stock in transactions where the intent is to avoid excess-profits tax should, of course, be disregarded, and the cost to the transferor govern. Obviously, this limitation should not apply to acquisitions made long before the excess-profits tax was even thought of, because otherwise the acquiring corporation and a large proportion of its stockholders would be penalized for a nontaxable transaction in whose benefits they did not share.

The income-tax law applicable to the calculation of gains and losses on the sale of capital assets (gains and losses which are not subject to the excess-profits tax) should not be applied to a definition of invested capital. If property is added to the capital of a corporation, invested capital should be increased by the value added, and it should make no difference whatsoever whether the seller of the property or its stockholder did or did not realize taxable gain or loss when the property was transferred to the corporation.

It is true that in an exchange where gain or loss is not recognized the transferor is not required to pay income tax on the appreciation in the value of the property transferred. However, it must not be overlooked that when the transferor disposes of the securities he received in this transaction, the previously untaxed profit on the exchange becomes subject to tax. The stockholders of our corporations, other than close corporations, keep constantly changing.

Inasmuch as tax on the profit to the transferor on a transaction such as that herein described is ultimately imposed, the denial to the transferee of the right to include in invested capital the actual cost to it of the property at the time of the exchange, in effect results in double taxation. Furthermore, if the excess-profits tax which under the House bill runs as high as 60 percent is to be imposed in accordance with the taxpayer's ability to pay, the excess profits of the transferee should be measured by its own investment and not by what the transferor paid for the property many years ago.

The report (No. 1040) of the House Ways and Means Committee on the revenue bill of 1941 contains the following on page 23:

"It is well recognized that there has been a large turn-over in the stock of many corporations. The present owners in many instances acquired such stock on the basis of the earning record of the corporation at the time of purchase. To conclude that they have realized excess profits on the basis of what the original owners paid for the stock seems contrary to equity and justice."

It is equally contrary to equity and justice to conclude that a corporation has realized excess profits on the basis of what the previous owners from whom the property was acquired by the corporation paid for the property many years ago.

Accordingly, the institute recommends that property paid in to a corporation for its own stock be included in invested capital at the cost of the property to it, which is the true measure of the addition to invested capital where property is acquired for stock.

Failing relief, as prayed for above, then it would seem that the least the taxpayer could expect in fairness is that for invested capital puroses, the basis for property previously paid in for stock should be determined and fixed in accordance with the law in force for the year the property was paid in and not under modifications made in the law for subsequent years. In this connection, it would appear that all that would be necessary to accomplish this small measure of justice to the taxpayer would be to add, after the second sentence of section 718 (a) (2), the following:

"For invested-capital purposes, such basis shall be determined and fixed in accordance with the law in force at the time said property was paid in."

V. INCONSISTENCY PROVISION

Section 734 added to the Excess Profits Tax Act of 1940 by the 1941 amendments provides that if in the determination of the excess-profits credit (measured by base period income or invested capital) an item is treated in a manner inconsistent with the treatment accorded such item in the computation of the income tax or wartime excess-profits-tax liability of a corporation, or even a predecessor, for the years 1913 to 1939 inclusive, the tax returns for any of these years shall be reopened to correct the improper treatment of the item

and the additional tax shall be paid or refund made, together with interest thereon, as a part of the excess-profits tax. These adjustments are to be made only if the party, the taxpayer, or the Commissioner, who asserts or maintains the inconsistent position in the determination of the excess-profits tax under the 1940 act is the one who would be adversely affected by reopening the returns for the earlier years.

Section 734 is directly contrary to the logical and fair principle expressed in the following provision originally in section 711(b)-1 of Regulations 109 issued by the Treasury Department under the Excess Profits Tax Act of 1940:

"The amount to be used in the correct normal tax net income or special class net income, as the case may be, regardless of the amount shown in the return for such year and regardless of the fact that the assessment of a deficiency or the allowance of a refund may be barred by the statute of limitations."

As a result of the adoption of section 734, the Commissioner has eliminated the above provision from Regulations 109.

For many years our revenue acts have recognized through the statute-of-limitations provisions that within a reasonable period the taxpayer and the Treasury Department shall know with finality the amount of tax due. This policy is essential in order that the taxpayer will know what its financial condition is and in order that the Government will be able to ascertain its revenues. Yet section 734 ignores this policy and in effect, reopens tax returns for years as far back as 1913 to correct errors which occurred in these determinations. It must be remembered that the final settlements of the tax liability for the earlier years were made in the light of the then interpretations of the law and that neither the taxpayer nor the Commissioner should be penalized because these interpretations later proved incorrect. In addition, in many cases, the taxpayer or the Commissioner yields on an item affecting its tax liability as a compromise for another doubtful item in order to effect a final determination of the tax liability. Furthermore, it must not be overlooked that the use of the base period income or invested capital in the determination of excess-profits tax under the 1940 act is solely for the purpose of determining the normal earnings of a corporation or a fair return on its capital. The fact that the taxable income of the corporation as previously agreed upon for earlier years between the taxpayer and the Commissioner was understated or overstated should not be used to distort this purpose. Section 734 is therefore believed to be indefensible and the Institute urges that it be repealed.

The Commissioner's regulations under the excess-profits-tax amendments of 1941 do not define the term "item" as used in section 734. Section 3801 of the Code also provides for reopening tax returns for earlier years to correct inconsistent treatment but the items to which the section applies are specifically mentioned therein. In addition, under section 3801, returns for years prior to 1932 cannot be reopened. If section 734 is retained, its application should be made definite and it should not be retroactive beyond 1936, the beginning of the base period.

Section 734 provides for not only an adjustment of tax for the earlier years but also for the payment of interest by the taxpayer or the Commissioner on such adjustment. However, the interest paid by the taxpayer is not allowed as a deduction from taxable income nor is the interest paid by the Commissioner treated as taxable income. This is contrary to the treatment of interest on tax adjustments for years on which the statute of limitations has not yet tolled. There is no reason for a contrary treatment of the interest under section 734.

VI. RESTRICTION OF SECTIONS 718 (A) (5) AND 718 (B) (4) SOLELY TO CASES WHERE PROPERTY ACQUIRED FROM SUBSIDIARY IS THEREAFTER DISPOSED OF

Sections 718 (a) (5) and 718 (b) (4) of the present act require the adjustment of invested capital by the difference between the cost of the stock of a subsidiary liquidated under section 112 (b) (6) and the basis to the subsidiary of the net assets conveyed to the parent company in the liquidation. Thus, for example, where one company acquires the stock of another company and thereupon liquidates it, there is included in the invested capital of the acquiring company not the amount it has paid for the stock of the liquidated company but the cost or other tax basis of the assets to the liquidated company. This is contrary to the principle adopted by the Commissioner in the consolidated excess-profits tax regulations which include in invested capital the amount paid by the parent company for the stock of a subsidiary and not the cost of the assets of the subsidiary.

There is no apparent reason why this principle of the consolidated excess-profits tax regulations should not apply also to the determination of invested capital of a company acquiring the assets of another in the manner described above. Adjustments should be made only for any increase or decrease in the aggregate tax basis of the assets in the hands of the liquidated company from the date of the acquisition of its stock by the parent company to the date of liquidation.

VII. USE OF BASIS FOR DETERMINING GAIN (NOT LOSS) OR, IN ANY EVENT, REVISION OF SECTIONS 718 AND 720 TO PRESCRIBE PROPER BASIS ADJUSTMENTS

The Institute urges that, if the original property paid into a corporation was acquired prior to March 1, 1913, when our income-tax form of taxation was adopted, the corporation should be permitted to include such property in invested capital at its March 1, 1913, value. (March 1, 1913, values are usually available because of their use for depreciation and depletion purposes.) This result can be obtained by providing for use of the basis for determining gain, rather than for determining loss.

If the present law is not changed in this respect, however, then, in any event, sections 718 (a) (2), 718 (a) (5), 718 (b) (4), and 720, to the extent they provide for use of adjusted basis, should be revised to prescribe adjustments which would be consistent with the use of the basis for determining loss. For example, assume that after March 1, 1913, the taxpayer corporation acquired property in a tax-free reorganization from a predecessor corporation which had originally acquired the property prior to March 1, 1913. The original cost of the property to the predecessor was $100,000 and its March 1, 1913, value was $200,000. If, at the date of acquisition by the taxpayer, the depletion adjustment for the period since March 1, 1913, amounted to $60,000 based on cost, then it would amount to $120,000 based on March 1, 1913, value. (For the sake of simplicity, it is assumed no depletion was sustained prior to March 1, 1913.) As section 718 (a) (2) now reads, the taxpayer would be required to start with the $100,000 cost basis in determining invested capital and then adjust for $120,000 of depletion—thereby producing a zero invested capital.

It is believed that this incongruous result under section 718 (a) (2) is due to an oversight in drafting. In any event, it should be corrected, and similar corrections should be made in the other sections referred to above.

VIII. EXTENSION OF THE NORMAL GROWTH PROVISION TO DETERMINATION OF AVERAGE BASE PERIOD NET INCOME UNDER SUPPLEMENT A

Section 713 (f) added to the Excess-Profits Tax Act by the excess-profits tax amendments of 1941 very wisely permits the determination of average base period net income in a special manner in cases where the net income for the last 2 years of the base period exceeded the net income for the first 2 years of such period. Section 713 (f) is essential to a fair determination of the normal earning capacity of the so-called normal-growth corporations.

There is no apparent reason why the principle of section 713 (f) should not be extended to acquiring corporations which under Supplement A of the present act include in their base period net income the earnings of their predecessors during this period.

IX. INCLUSION IN BASE PERIOD NET INCOME OF NET INCOME OR CONSTRUCTIVE NET INCOME OF THE TAXPAYER AND ITS COMPONENT CORPORATIONS FOR ENTIRE BASE PERIOD

The purpose of the base period net income method of determining the excess-profits credit is to obtain a measure of the normal earnings of the corporation prior to the emergency period to be compared with the present earnings. To accomplish this purpose in the case of a corporation which has acquired in transactions described in section 740, a business in existence during any part of the 4-year base period, the net income of the former owners from this business during the base period should be included in determining the average base period net income of the acquiring corporation.

The exclusion of any part of the net income of the acquiring corporation or its predecessors during the base period results in a distorted measure of the normal earning capacity of the business now conducted by the acquiring corporation. Yet this is precisely the effect of the following sections of the present act:

Section 742 (a) (2) which permits the inclusion in the base period net income of the acquiring corporation of the income during such period of a component corporation only if the latter is a qualified component corporation. A qualified component corporation is defined in sec. 740 (c) as a corporation which was in existence on the date of the beginning of the base period of the acquiring corporation or had acquired the assets of another component corporation in existence on the aforementioned date.

Section 742 (f) which excludes from the base period net income:

"(*a*) The net income of an acquiring corporation not actually in existence at the beginning of the base period, for the portion of the base period before it first became an acquired corporation.

"(*b*) The net income of a component corporation which became a qualified component corporation by reason of having acquired a component corporation in existence at the beginning of the base period, for the period before it became an acquiring corporation."

These limitations were consistent with the policy in the excess-profits tax bill of 1940 as passed by the House, which did not permit the use of the base period net income method unless the corporation was actually in existence at the beginning of its base period or had acquired the assets of a corporation actually in existence on such date. However, in the Excess-Profits Tax Act of 1940 as finally adopted, the use of the base period net income method was extended in section 713 to corporations in existence during only a part of the base period and as a matter of fact such corporations were permitted to compute constructive income for the portion of the base period they were not in existence.

It is true an acquiring corporation is given the option of determining its average base period net income under the general provision in section 713 without reference to the base period net income of its component corporations. However, the use of section 713 in such a case does not produce a fair measure of the normal earning capacity of the present business because the net income of the component corporations is excluded.

Accordingly, the aforementioned limitations in sections 742 (a) (2) and 742 (f) are inconsistent with the general policy of the act and should be repealed. Furthermore, in order to effectuate the policy of the act, constructive income should be provided for the component and acquiring corporations for the portions of the base period prior to the time they came into existence, to the extent this would not give rise to duplication.

X. ELIMINATION OF REQUIREMENT FOR DAILY DETERMINATION OF INVESTED CAPITAL

Section 716 requires the determination for each day of equity invested capital and also of borrowed capital. In addition, corporations having inadmissible assets are called upon to determine their admissible assets and their inadmissible assets for each day. This means making daily determinations of inventories, all other assets and depreciation, amortization and depletion, sustained to the end of each day. This is impossible because, except in an insignificant number of cases, the accounts of corporations are not maintained in a manner to reflect this information. In addition, even if it were possible to make these daily computations, it would involve hundreds of thousands of calculations. The capital invested in a business cannot be determined with complete accuracy regardless of how many technical and involved formulae are prescribed. Therefore, the daily computations of invested capital can only serve to increase the uncertainty of the final tax liability and to make the preparation of excess profits tax returns a nightmare.

Section 715 now provides:

"If the Commissioner finds that in any case the determination of invested capital, on a basis other than a daily basis, will produce an invested capital differing by not more than $1,000 from an invested capital determined on a daily basis, he may under regulations prescribed by him with the approval of the Secretary, provide for such determination on such other basis."

This provision is not of much help because to determine whether or not the difference in invested capital would be more than $1,000, practically all the work involved in making the daily computations would be necessary anyway.

Recognizing the almost impossible task involved in the requirement for daily computations, the Commissioner, in his regulations, has provided in some measure for practicable compliance with this requirement. However, this solves the problem only partially.

The Institute recommends therefore that there be adopted the following amendment approved by the Senate when the 1940 Excess Profits Tax Act was before it last September:

"The Commissioner may, under regulations prescribed by him with the approval of the Secretary, permit, in the computation of invested capital, the use of averages or ratios on a monthly, annual, or other appropriate basis, where in his opinion the circumstances do not require daily computations."

XI. INCOME ATTRIBUTABLE TO A BASE PERIOD YEAR BUT NOT REALIZED UNTIL A LATER YEAR

Section 721 of the Excess Profits Tax Act wisely makes provision for transferring certain classes of income received in one year to either the prior or subsequent years to which the income is attributable. In this connection, the Senate Finance Committee Report No. 2114, p. 16 contains the following:

"If it is determined that the income received in the taxable year is attributable to years in the base period, the amount of such income so attributable to such years will have the effect of increasing the base period net income and thus the credit under the average-earnings method."

This treatment is entirely proper because the income is attributed to an earlier year only because it is deemed properly includible for that year.

However, section 721-1 of Regulations 109 issued by the Treasury Department provides that:

"SEC. 721 has no effect upon the computation of base period net income or of earnings and profits and therefore does not affect the computation of the excess-profits credit."

There is no apparent justifiable reason for this regulation and it is directly contrary to the clearly expressed intent of Congress. It is recommended, therefore, that a clarifying amendment be made to the act in order to make certain this intent will be carried out in the administration of the law.

XII. APPLICATION OF UNUSED EXCESS PROFITS CREDIT AGAINST INCOME OF TWO PREVIOUS YEARS IN EXCESS-PROFITS TAX PERIOD

For accounting to stockholders, reports to various governmental agencies, and for taxation, corporations must prepare income statements for each year. However, it is realized that except in the simplest form of enterprise, the determination of income on an annual basis must depend in a large measure on estimates and at best does not produce an accurate picture.

The imposition of excess-profits tax at very high rates solely on an annual basis is clearly unjustifiable. In one year, a corporation might have substantial earnings in excess of the excess-profits tax exemption, whereas in another year its earnings might be far below the exemption. To subject the earnings of the very profitable year to an onerous excess-profits tax without reduction by reason of the meager earnings for the other year is contrary to the ability to pay principle.

The amendment adopted in 1941 permitting the unused excess-profits credit to be carried forward for a period of 2 years represents only partial recognition by Congress that for excess-profits-tax purposes the emergency period should be considered as a whole. Thus, in order to give full effect to this principle, the Institute recommends that in addition the unused excess-profits credit should be carried back for at least 2 years.

XIII. REVISION OF SECTION 752 TO ELIMINATE CERTAIN UNWARRANTED EXCESSIVE REDUCTIONS OF HIGHEST BRACKET AMOUNTS

The purpose of the highest bracket amount provisions in section 752 of the present act is to prevent corporations from obtaining multiple advantage from the lower excess-profits tax rates applicable to excess profits of less than $500,000 by reorganizing, by nontaxable transactions, into groups of small corporations. The Institute is in accord with this purpose.

However, in their actual application, the provisions of section 752 result in some cases in unwarranted and probably unintended penalties. For example, if a corporation transfers property (in a transaction to which sec. 752 applies) to another corporation the highest bracket amount of the transferor is reduced (except in certain of the cases falling under sec. 752 (b) (3))

even though the transferee corporation has excess profits on properties already owned of more than $500,000, and therefore the excess-profits tax on the earnings from the properties acquired from the transferor corporation is no less than if the properties had remained with the transferor.

Section 752 fixes the highest bracket amount of the transferee. In certain cases such highest bracket amount will be less than the amount the transferee was entitled to before receiving additional properties from a transferor, even though the transferee has excess profits on properties already owned of more than $500,000. In addition, section 752 does not provide for any future change in the highest bracket amount of the transferee established by that section unless it is a party to another exchange falling under section 752. In other words, the highest bracket amount of the transferee fixed under section 752 will not be increased even though, subsequent to the transaction dealt with in that section, the invested capital of the transferee is increased as a result of properties acquired in transactions to which section 752 does not apply.

Sections 752 (b) (4) and (c) (4) also work out inequitably insofar as they apply to transactions where one or more individuals in addition to one or more corporations are involved in a section 112 (b) (5) transfer to a corporation. Each of the corporate transferors is required to contribute a portion of its highest bracket amount to the transferee, the aggregate amount so contributed not to exceed $500,000. However, even where the aggregate amount of the highest bracket amount so contributed is less than $500,000 no additional highest bracket amount is allowed the transferee notwithstanding the fact that some of its earnings are from properties received from the transferors who are individuals. If only individual transferors were involved the full highest bracket amount would be allowed to the transferee. Accordingly, the effect of the formula prescribed in sections 752 (b) (4) and (c) (4) is to allow the transferee an insufficient highest bracket amount (where the amount allowed is less than $500,000) and to deprive the corporate transferors of more of their highest bracket amounts than they should logically be called upon to surrender.

Therefore, the institute recommends that section 752 be amended so that—

(1) The highest bracket amount of a corporate transferor will not be reduced in cases where no saving in excess-profits tax will result to the transferor and the transferee combined from the transfer of the property.

(2) Where the transferors include both individuals and corporations the highest bracket amounts of the transferors and transferee will be fairly determined in such a manner as to give recognition to the fact that individuals also contributed property to the transferee in the section 112 (b) (5) transaction. For this purpose the ratios of the property contributed by the corporate transferors and by the individuals would afford a fair basis for making an equitable adjustment of the highest bracket amounts of the corporate transferors and the transferee.

XIV. ADDITIONAL RELIEF PROVISIONS

The relief provisions in the excess-profits tax amendments of 1941 represented an improvement over those in the original act in that they made the application of these provisions more definite. The act in its present form provides some relief in the following cases:

1. Where companies had either abnormal deductions in the base period, or abnormal income in the taxable year.

2. Where the character of the business on January 1, 1940, had changed from that engaged in during one or more of the years in the base period or where in one or more of such years production, output or operation was interrupted or diminished because of the occurrence of events abnormal in the case of the taxpayer.

However, the relief provisions of the present act leave a wide gap with respect to many meritorious cases not specifically provided for therein. Among these are the following taxpayers:

(*a*) Taxpayers which by reason of old long-term contracts or other causes (not now provided for in the act) had inadequate earnings during all or a part of the base period.

(*b*) Taxpayers which as a result of special situations had unsatisfactory earnings during the base period as compared with other companies in the same industry.

(c) Taxpayers which acquired property for securities prior to the enactment of the excess-profits tax and are required to use transferor's basis for determining their invested capital.

(d) Taxpayers deriving income subsequent to January 1, 1940, from natural resources which were in the development stage or undeveloped as of January 1, 1940, but had no earnings from such properties during the base period.

In addition, it is not possible to anticipate all cases of abnormal situations for which relief should be provided.

At the time Congress adopted the 1941 amendments it recognized it had not dealt with all cases entitled to relief and indicated it would make additional provision for these situations if a further study showed the necessity for such action. Possibly, the most practical solution would be for the addition to the present act of a general relief provision patterned somewhat along the lines of section 722 of the original 1940 Excess-Profits Tax Act to be effective only upon application of the taxpayer, with appeal from the Commissioner's decision permitted to the Board of Tax Appeals.

XV. PAYMENT OF TAX IN CASES TO WHICH SECTION 722 APPLIES

Section 722 (e) of the present act prohibits a corporation to which the relief provisions of section 722 apply from estimating the tax on this basis in its original return. Instead it is required to pay the tax in the first instance without reference to these relief provisions and to later submit application for determination of the reduced tax under section 722. The only exception provided for is that where the average base-period net income of the taxpayer is finally determined under section 722 for 1 year, or if permission is granted by the Commissioner of Internal Revenue after a determination which has not become final, such taxpayer may use the average base-period net income so determined, in computing its excess-profits tax in any return required to be filed thereafter.

In some cases, the operations of a taxpayer will be seriously impeded due to lack of working capital if it is required to overpay its tax and to wait for a refund under section 722 until the Commissioner has acted on its application for relief under that section.

The Institute recommends, therefore, that the act be amended to permit a corporation affected by section 722 to pay its tax originally on the basis of a reasonable percentage of its net income, the amount so payable in no event to be less than the amount that would be payable if the application for relief is granted in full. Such a provision should not, of course, apply to cases where collection of any additional tax due would be jeopardized by a delay in collection.

XVI. MODIFICATION OF THE ADMINISTRATIVE PROVISIONS AND RESTRICTIONS RELATING TO AMORTIZATION DEDUCTIONS

We urge that section 124 be modified in order to improve and simplify the administrative provisions. Numerous restrictions which bar deductions for amortization contrary to the implied congressional intent should be amended or removed.

We believe that section 124 should be simplified to secure a clearer enunciation of the principle of allowing equitable deductions for amortization of defense facilities against the related taxable income. Among other changes, we suggest the repeal of subsection (i) which is essentially impracticable of administration. It also unnecessarily embraces in a tax statute a provision relating purely to procurement policy. This could be more appropriately fulfilled through direct contract provisions in procurement, as indicated by Hon. William S. Knudsen, Hon. John D. Biggers, and Hon. Leon Henderson, of the Advisory Commission to the Counsel of National Defense, in their testimony before your committee at the hearings during September 1940 on the Second Revenue Act of 1940 and in the letters addressed to your committee under date of September 5, 1940, by Hon. Henry L. Stimson, Secretary of War, and Hon. James Forrestal, Assistant Secretary of the Navy.

While the draft of the joint resolution recently submitted by the Secretary of War and Secretary of the Navy to the Speaker of the House of Representatives contains many desirable revisions of section 124, it will not provide a satisfactory solution of the problem presented by subsection (i) of that section.

XVII. ABOLITION OF PRESENT SYSTEM OF CAPITAL STOCK AND DECLARED VALUE EXCESS-PROFITS TAXES OR, IN THE ALTERNATIVE, PROVISION FOR ANNUAL REDECLARATIONS AND EXCLUSION FROM INCOME SUBJECT TO DECLARED VALUE EXCESS-PROFITS TAX OF CAPITAL GAINS AND LOSSES

The capital-stock tax and the related declared value excess-profits tax should be abolished. The high rate of income and excess-profits taxes has greatly weakened the effective yield of the capital-stock tax and thus there remains, even under today's need for revenue, little to commend the continuance of this guesswork tax.

The capital-stock and declared value excess-profits taxes are universally recognized as wrong in principle because they are predicated on the taxpayer's guesswork. In July of each year when capital-stock tax returns are normally due it is difficult enough to attempt a forecast of the earnings for the balance of that year without having to guess what they will be for the ensuing year or two. This has been true in recent years because of the wide swings in business activity and profits and because of the disturbed world conditions in the years immediately ahead, forecasts of future earnings are impossible. The inclusion of capital gains and losses in income, which in most cases are unpredictable, adds to the inequity of this part of our present revenue system.

Under the code, corporations are required to declare a value for their capital stock in their 1941 capital-stock tax returns and such value with certain adjustments is binding in their 1942 and 1943 capital-stock tax returns. In 1938, corporations were last required to declare capital-stock values for a 3-year period but in 1939 the law was amended to give corporations the option of increasing in that year and in 1940 the capital-stock values which they would otherwise have been required to use for these years based on the values declared in 1938. However, as the law now stands, the 1941 values will govern for 1942 and 1943 also.

The Institute urges that the capital-stock and declared value excess-profits taxes be abolished from our revenue system. If, however, this does not commend itself to the Congress, a redeclaration of the capital-stock value, either up or down, should be permitted every year and the taxable income for declared value excess-profits tax purposes should be computed without reference to capital gains and losses.

XVIII. RESTORATION OF THE GENERAL PROVISION FOR CONSOLIDATED INCOME-TAX RETURNS

The reasons which actuated Congress to permit an affiliated group of corporations to file consolidated excess-profits tax returns apply with equal force to income-tax returns. Therefore, the Institute urges that the consolidated return privilege be extended to income-tax returns.

Primarily as a result of the tax on intercompany dividends which became effective in 1936, many companies have integrated their business through the dissolution of their subsidiaries wherever it was practicable to do so. The Institute believes that generally where the subsidiary has been retained its dissolution has been found impracticable either because of legal requirements or business necessity.

A consolidated statement is not only ordinary business practice for a related group of corporations; it is regarded by businessmen, accountants, stock exchanges, and the Securities and Exchange Commission as essential to the fair presentation of the financial position and earnings of a consolidated group. It is only logical that this should be the rule, because a subsidiary which is owned 95 percent or more by the parent company is generally to all intents and purposes merely a branch of the business and should be treated in the same manner as a separate department of a single company.

The Institute is without information as to whether the abolition of the consolidated-income-tax-return privilege has brought the Treasury substantial, if any, additional revenue. The taxation of a group of related companies on a separate return basis has the effect of taxing intercompany profits and allowing intercompany losses which may never be realized, considering the business as a whole. Regardless of the effect on the revenue, however, the denial of the consolidated return privilege is basically wrong and results in an unwarranted penalty on corporations which are compelled to conduct a part of their operations through subsidiary companies.

The requirement for separate returns has in many cases complicated the preparation of income-tax returns and probably increased the amount of tax litigation. In addition, it has made the audit of income-tax returns more cumbersome, because more returns must be reviewed and the auditor must be satisfied that transactions among members of the group have been on an arms-length basis.

The determination of the income-tax liability of an affiliated group of corporations on a consolidated basis would also simplify the administration of the consolidated excess-profits tax provision of the act.

XIX. ELIMINATION OF WORTHLESS SECURITIES FROM THE CAPITAL-ASSET PROVISION

Prior to 1938, the losses on corporate securities which became worthless were allowed without limitation. However, by sections 23 (g) and 23 (k) of the 1938 act, these losses were placed in the same category as sales and exchanges of capital assets. The result now is that where a corporate security held by a corporation for 18 months or less becomes worthless, the loss is subject to the limitations of section 117 and thta if the corporate security is held for more than 18 months the loss is unallowable for excess-profits-tax purposes. There is a fundamental distinction between a loss on a sale or exchange and a loss from worthlessness of securities. The time to make a sale or exchange lies within the discretion of the owner and may be made at a time calculated to yield the least tax. However, in case of worthless obligations or stocks, the loss itself or the time of its occurrence is beyond the control of the owner.

The institute recommends therefore that sections 23 (g) (2) and (3) and 23 (k) (2) and (3) be repealed so that losses from worthless securities will be allowable without limitation for normal income-tax and excess-profits-tax purposes.

XX. ELIMINATION OR MODIFICATION OF REQUIREMENT FOR CHARGING OFF BAD DEBTS

A large percentage of the disagreements between the Commissioner and the taxpayer and also of tax litigation involves the question of the year in which debts became uncollectible and securities worthless. In some cases, these facts can be ascertained with almost mathematical accuracy because of some identifiable event, such as a bankruptcy, which ordinarily unmistakably established the year when these losses were sustained. However, in other instances, the situation is not clear and the year of loss is a matter of opinion.

In many cases the Commissioner of Internal Revenue denies the bad debt or security loss in the year claimed on the ground it was sustained in some other year, usually one in which the taxpayer cannot have the benefit of the loss because of the statute of limitations or for some other reason. In this way, the taxpayer is deprived of its right, contrary at least to the spirit of the tax law, to deduct losses from bad debts and worthless securities in the ascertainment of its taxable income, even though the Commissioner agrees that the taxpayer actually suffered these losses. The bad debt deduction has been disallowed by the Commissioner even in cases where the taxpayer charged it off in his accounts prior to the year it was ultimately held sustained for tax purposes.

To bring relief to the taxpayer from this inequitable treatment, never intended by the framers of the revenue acts, the institute makes the following recommendations:

(*a*) Removal of the charge-off requirement from section 23 (k) of the Internal Revenue Code, or, in the alternative, revise the section to require that the charge-off be made not later than the time when the taxpayer first claims the loss. This alternative would afford sufficient confirmation of the taxpayer's sincerity in its allegation that the debt is uncollectible.

(*b*) Broaden section 3801 of the Internal Revenue Code to permit reopening a year closed by the statute of limitations if bad-debt and worthless-security losses claimed by the taxpayer in another year are denied on the ground they belong in the closed year.

OTHER RECOMMENDATIONS

Other improvements which the institute recommends and which were included in its memorandum of May 12, 1941, to the House Ways and Means Committee are as follows:

XXI. Section 719 (a) (2), which covers inclusion in borrowed capital of advances received from governments, should be broadened and clarified.

XXII. No part of dividends received by one domestic company from another should be subjected to income tax.

XXIII. The law should be amended to provide that any waiver which extends the statutory period of limitation for assessment of additional taxes shall automatically extend for an equivalent time the period during which an effective claim for refund may be filed.

XXIV. The rate of interest accrued after the date of the enactment of the Revenue Act of 1941, on deficiencies should not exceed 3 percent and when this is done the rate of interest on refunds should be reduced correspondingly.

Respectfully submitted.

CONTROLLERS INSTITUTE OF AMERICA.

The CHAIRMAN. Ed Kuykendall, president, Motion Picture Theater Owners of America.

STATEMENT OF ED KUYKENDALL, COLUMBUS, MISS., PRESIDENT, MOTION PICTURE THEATER OWNERS OF AMERICA

The CHAIRMAN. You are appearing for the motion-picture theaters?

Mr. KUYKENDALL. That is right.

The CHAIRMAN. Which organization?

Mr. KUYKENDALL. Motion Picture Theater Owners of America.

The CHAIRMAN. You are president of that organization?

Mr. KUYKENDALL. Yes.

The CHAIRMAN. They are the exhibitors?

Mr. KUYKENDALL. May I explain, Mr. Chairman, my name is Ed Kuykendall. I live in Columbus, Miss., and I am president of the Motion Picture Theater Owners of America. I have a very brief prepared statement. I know you are very busy and my presentation is brief and there is nothing complicated in it.

The Motion Picture Theater Owners of America is a national organization of theater owners with representation in every State of the Union. It is a voluntary trade association by which theater owners hope, by advisement and cooperation with each other, to better serve their communities as a group and we yield to no one when it comes to a matter of patriotic service to our country.

I come before you in reference to the admission tax, not to ask any special consideration, but merely for the correction of what, to us theater owners, is a serious injustice. We are not here to oppose the admission tax as such. The attendance at theaters during recent months has decreased considerably and what I propose to you here will be most helpful to us in bringing back this attendance to a normal average. What I refer to is the text of the proposed admission tax that you gentlemen are now considering wherein we are forced to collect whatever the top bracket of admission tax happen to be on so-called reduced admission prices. As an example, if we offer a reduced price to those of juvenile age, such as high-school students, and so forth, we are forced to collect from them a tax on whatever the highest admission price may happen to be. In further explanation, if we admit the high-school student for 20 cents and the established top admission is 40 cents, the law forces us to collect a tax on the 40-cent admission basis. This is manifestly unfair.

The CHAIRMAN. You say that is the way the present law works out?

Mr. KUYKENDALL. That is the way it works out.

Senator JOHNSON. You mean you are asked to collect the tax, not on the actual admission, but on the theoretical tax?

Mr. KUYKENDALL. That is right.

The tax should be based on whatever the admission charge may be. I further emphasize the importance of this by calling to the attention of gentlemen the fact that when a child of 12 years and under grows out of this age your proposed law forces us to immediately charge them with a tax, based on a 40-cent admission, as an example—this youngster jumped from a 1-cent tax to a 4-cent tax. The shock and difficulty of this proves a detriment to their continued attendance and helps to restrict their theater-going habits. Theaters everywhere, both large and small, are starting a so-called junior admission price schedule, same being a reduction of the top admission price.

Wherever this has been tried it has brought about a wholesale increase in attendance at the theaters involved. We, the theaters, are badly in need of this increase and it would naturally increase admission tax revenue. Therefore, rather than taking away from the revenue derived it will increase this tax revenue.

I further call to this committee's attention that thousands of theaters in this country do not have a balcony or separate section in which these reduced admissions could be seated.

Time prohibits my going into detail as to section 1700 of the Internal Revenue Code as amended. There are many angles to it that really should be discussed, but I know your time is limited. Again, may I remind you that we are not trying to evade any tax whatsoever but merely trying to distribute it properly in such a way that the revenue which you gentlemen are charged with the responsibility of raising will not be adversely affected; but in our sincere and honest opinion, will be increased, and at the same time the theaters will materially benefit by it.

May I again emphasize that the basic thought I am trying to convey to this committee is that the tax charged should be based absolutely on the admission price charged. If there is something I have left out because of the time limit given me in making this staement I shall be delighted to furnish any member of this committee any such information he may desire either by mail or in person.

May I also respectfully call the attention of this committee to the provision in the proposed new tax schedule wherein 9-cent tickets are exempted from taxation. This, in our humble opinion, is a serious mistake. This, in our humble opinion, is a serious mistake. The tax should apply down to the last penny and I submit that language similar to the following should be written in this—

That there be a tax of 1 cent on each 10 cents or fraction thereof, eliminating entirely in this way the 9-cent exemption which will deprive you of revenue and cause considerable competitive confusion.

I don't presume to tell these distinguished gentlemen what to write in the tax bill, but I respectfully suggest that what I have suggested will eliminate considerable competitive confusion.

I deeply appreciate the consideration given me before this committee and with the permission of the Chair I would like to leave this statement for the record.

Senator RADCLIFFE. In the hearings before the House what argument was advanced for the proposition that the tax should be levied on

the highest admission price rather than on the reduced price charged?

Mr. KUYKENDALL. We have never heard a reasonable argument on that, sir. I have never known of and have never been able to obtain a satisfactory explanation of the reasons for any such tax.

Senator RADCLIFFE. You say that you haven't heard any reasonable argument on the point: Was any argument advanced at all why the tax should be based that way?

Mr. KUYKENDALL. I don't have any knowledge of any such argument; if it was made I never heard it.

Senator RADCLIFFE. Was it discussed in the hearing?

Mr. KUYKENDALL. I don't know of any such discussion.

Senator TAFT. Is it possible to administer an exemption for the benefit of children under 12; would it create confusion at the administrative end?

Mr. KUYKENDALL. I know of no reason why it should.

Senator TAFT. What about exempting soldiers and sailors?

Mr. KUYKENDALL. There has been no confusion in that connection; we are glad and willing to do it.

The CHAIRMAN. That exemption is in the bill as it came from the House, Senator, at the reduced rate.

Thank you very much, sir. Mr. Ebersole?

STATEMENT OF ROBERT L. McKEEVER, WASHINGTON, D. C.

Mr. MCKEEVER. Mr. Ebersole thought it would be better to have an actual alley operator speak to your committee, gentlemen. Mr. Ebersole has a memorandum or brief which he would like to file with you for such consideration as you may desire to give it. We say we the representing the duck pin industry. "Industry" is too big a name for the bowling alley business. "Industry" conveys the thought of a big business and we are a little business. I think I will convince you of that when I give you some of the figures as to the volume of business done by our different establishments.

The CHAIRMAN. How do you describe your business?

Mr. MCKEEVER. It is a bowling alley business wherein alleys on which small balls and small pins, instead of large ones, such as are employed in the tenpin industry, are used.

The CHAIRMAN. Alleys for children and old men?

Mr. MCKEEVER. I find it is pretty strenuous, just about as much so as the large ones.

We realize the need for increased taxes and are perfectly willing to do our part, but there are two different taxes imposed by this bill, an excise tax adding 10 percent on the cost of our supplies and there is a second tax—I don't know what you call it—a privilege tax putting $15 in taxes on each alley bed, so that a 10-alley bed establishment would, under this bill, have to pay a tax of $150 annually.

Senator CLARK. A use tax.

Mr. MCKEEVER. Maybe, but I don't know why it should be on an alley and not on a drug store or shoe store or some other sort of store. We don't object to the first tax but we do to the second because we think it is discriminating and unfair.

I would like to give the committee some slight history of this industry. Twenty-five years ago bowling alleys were conducted under

such conditions that when you thought of a bowling alley you thought of a barroom. Something happened about 20 years ago when the duck pin and bowling alleys were put in and installed separate and apart from the old barroom; separate from the poolroom, and it became a different kind of business entirely. Then about 10 years ago they started improving the atmosphere of these places, dressing them up; and prior to that time we saw very few women patrons. Today 40 to 50 percent of the business comes from women and you find a better class of people seeking recreation in healthful, pleasant surroundings in bowling alleys throughout this country.

In the duckpin business there are approximately 7,000 alley beds in 615 or 620 establishments. Some few of those establishments have as high as 30 or 40 beds and I believe one or two of them 50 alley beds.

Senator TAFT. Why do you speak of the duckpin business solely?

Mr. MCKEEVER. I am speaking only for the duckpin industry and am only trying to speak for that, because I will be followed by a representative of the tenpin industry. In addition to the 7,000 duckpin beds for which I speak, there are also two or three thousand additional beds that are unrecognized, one- or two-bed establishments in a club, in connection with a grocery store or school, or something like that. In the tenpin industry, I believe, they have 35,000 beds, approximately, so that the total number of beds involved is somewhere between 45,000 and 50,000—or a little more. That means that the total amount of taxes, based on this $15 use or privilege tax, would only be $700,000 or $750,000. We pay all the other taxes that any other businessman pays.

Senator TAFT. $750,000 or $7,500,000?

Mr. MCKEEVER. $750,000. I want to show you how small this is, taking every bed. We pay all the other taxes and when we realize that prices on all supplies and materials, such as pins, and so forth, have already advanced 40 percent since the close of last season, and to this cost is added the 10 percent tax, embodied in another section of this tax bill, which will add an average of well over $10 annual tax per alley bed in addition to the already existing taxes and this additional $15 per alley bed tax, which actually means double taxation, we find that we will be burdened with a total tax of $25 additional tax per alley bed; in all, about $70 a bed, which is a pretty big burden on a small alley.

Eighty percent of all the alleys in the duckpin industry are 4-, 6-, 8-, 10-alley establishments. In the States where the duckpin industry is operating, from Vermont to Florida, there are 616 bowling establishments accounting for 7,000 beds. Of this number, 78 larger establishments account for 2,100 beds while 538 small plants account for 4,900 beds, an average over the entire territory of 7 beds per establishment. There are two or three thousand additional alley beds in other States, and of substandard equipment, but among these the trend will be to an even lesser number of beds per establishment. In breaking down the alleys in one State, for example, Virginia was taken which has 950 beds in a total of 85 establishments, 220 of these beds are in 8 establishments while the other 730 beds are divided among 77 establishments.

All other States are in the same proportion with the exception of Connecticut and Florida and these States have a much greater

number of 4-, 6-, and 8-alley establishments. The majority of these places are located in the smaller cities, towns, and rural communities and by virtue of their size are restricted to a definite maximum as to the amount of business they can do. In all such localities the hours of business are confined to the evening, from approximately 7 to 11 p. m., and it is a well-established fact that in the rural communities people do not bowl or participate in sports until as late an hour as in the cities. It is also a seasonal business everywhere, but more particularly in these rural sections, from September 15 to May 15, a great majority of places closing down for the summer, even in the cities.

Granting that an establishment has capacity business every day in the week during these hours, for the full 8-month period of 39 weeks, allowing six games per alley per hour, which is the proven average over many years of operating, and at 15 cents per game, and many small operators are not able to get that much, it would give the operator of such plants a gross receipt of $800 to $835 annually per alley bed, and checking from many operators' statements that is a very fair average as many operators do not gross that much. Attached to the brief is a break-down of the cost of operation of the average eight-alley bed establishment.

In addition to this large numbers of people are leaving these communities and going to the industrial cities where defense work is located, taking that source of revenue away from the community entirely. Selectees leaving for camp leave a further gap in the available spending money in the community, due to that withdrawal from their families of the money they had previously been receiving.

The CHAIRMAN. You were taxed $10 per alley in the World War, I believe.

Mr. MCKEEVER. Well, it was right after that that a great many of our alleys found it necessary to close. I don't know that it was due to that reason many of our alleys folded up, had to go out of business, but that is the fact, they did. Now, we have gotten back on our feet to the extent that we are operating. We also invite attention to the fact that these alleys furnish employment for a certain type, particularly pin boys, and so forth, who can do little else and the average establishment uses 1 pin boy for each alley bed. This would mean an average of about 11 employees for each 8-alley plant, who would have have to find employment elsewhere if these establishments could not remain in operation. A very sizable number when taking the industry as a whole.

We respectfully invite attention to the fact that bowling is considered, by practically every physician, one of the best forms of physical exercise and during the past several years hundreds of high schools have recognized this and have put bowling on the regular curriculum in their physical-culture subjects, the students receiving regular credits just as in their other studies, and the entire bowling industry has been furnishing this bowling to these students at actual cost. It would be an undue hardship to require these thousands upon thousands of youngsters to pay the additional cost which must necessarily be obtained from them if the burden of operation is made too heavy. We also wish to point out that the physical upkeep and operation of a bowling establishment is far more expensive than the

average amusement establishment and that the popularity of the bowling game is primarily due to the fact that it costs the participant only the actual cost of the game, no expensive accessories to buy, such as golf clubs, tennis rackets, baseball uniforms, and so forth, or skates to rent, but if the price of the game is increased to any great extent, this appeal of a comparatively inexpensive exercise and recreation will be lost with the consequent rapidly declining business.

It is worthy of note that the class of men employed in this industry would probably be on relief if they were not so engaged. I refer to pin setters. It requires no education; it requires a strong back and a pretty tough head.

Senator RADCLIFFE. Are the majority of them minors?

Mr. MCKEEVER. No; in my own establishment I should think that the average age would be 40. You can't work minors except with a special work permit but you will find old pin boys doing that: They call them "boys" but they are boys of 55 or 60. I think I have one or two who are beyond the age on which you have to pay—what is it, old age or Social Security?

I am trying to give you a picture of the industry. Even in the large establishments, the total amount of business done would not be over $2,000 an alley bed, so if you take a 30-alley bed establishment, it would be $60,000 a year, and I think you would find the owner of that place would not be making very much. His tax would be $450 under this proposed bill, plus excises on his pins and other material. You are putting a special tax on him not being paid by any other businessman. That, we naturally feel, is unfair; but I am particularly and principally interested in the cases of the small establishments scattered throughout the country where they have 4, 6, 8, or 10 alleys; and I don't want to the committee to forget the example I gave you of the 8-alley establishment where the owner makes approximately $1,200 a year. If he only had four alleys, unless he did all the work himself, including the reconditioning of the alleys, he certainly wouldn't be making over $700 a year; and if you tax him $60 a year for special use tax for that privilege, it does look like it is soaking the little man. I have heard it said that these bowling alleys are gold mines. I have seen some of the Congressmen—I don't know whether any Members of the Senate have visited the bowling establishment operated by me—and they come in there and find it crowded. It is true we are crowded at certain times of the day, but all the rest of the day we are idle; and in the summer we operate and put air conditioning plants in our places of business. I operated at a loss last month of $1,000 in order to keep my establishment open and keep these employees. I figured it was better to operate at a loss such as that rather than to close. I just want to tell you what the situation is. I would be glad to answer any questions you may have to suggest, if there are any. I have this prepared statement.

The CHAIRMAN. You want this to go in the record?

Mr. MCKEEVER. Yes; I would like to have it in the record and there is attached to the back of that a sample of a balance sheet of receipts and expenditures of the average eight-alley bed establishment.

(The sheet referred to follows:)

A break-down of receipts and expenditures of the average 8-alley-bed establishment

Granting probable maximum receipts per single alley bed		$825
Pin boys at 0.03½ cents per game (in many places this cost is higher)	$200	
Present tax average per bed	70	
Pins used per bed per year (figured at an absolute minimum)	60	
Resurfacing bed annually (a universal price everywhere)	35	
Shellac, score sheets, and all other accessories	15	
Bowling balls (figured at present price of $44 per dozen—3 balls per alley and on the basis of one-third cost—usual life 3 years)	4	
		384
Net receipts per alley bed before rent, light, heat, and help		431
This would make a total for eight alleys		3,528
Additional necessary expenses:		
Rent figured at $50 per month for 12 months	$600	
Help for 8 months, covering actual full operating season, $25 per week for 39 weeks	975	
Porter for 39 weeks at $15 per week	585	
Light, $30 per month for only 8 months	240	
Heat, 6 months only at $15 per month	90	
		2,490
Net receipts for 8 months		1,038
Granting the operator will keep open 3 of the 4 remaining months, without help of any kind as he would have very little regular or so-called rush business, he may be able to net a total of $75 per month for these 3 months		250
Making a total net income (for a man with a family)		1,288

From this net income must now be taken the 10-percent tax on pins and balls as in the present bill which will amount to $7.90 per bed, a total of $63.20 for the eight alleys and if the $15 is also added, making another addition of $120 for eight alleys a total of $183.20 will have to be taken, in taxes, from the $1,288 which will leave a net income of $1,104.90, for a full year's business. And all this provided costs, labor, and so forth, do not advance above the present level.

NOTE.—Nothing is deducted in the above statement for depreciation nor is any allowance made for interest on the owner's investment. The cost of the average bowling alley bed being $1,250 per bed.

It should also be mentioned that rent figured in the above is very low and will vary greatly in the many towns and communities as will the item of help to a certain degree.

There is one last thing I would like to suggest to the committee: It is, if you could reduce that $15 proposed tax to $5, we would want to go along and pay that $5 per alley, but we do think it is a discriminatory tax and it is a little unfair that we should be required to pay any tax which the next-door merchant is not asked to pay.

STATEMENT OF CHARLES V. FALKENBERG, CHICAGO, ILL., LEGAL COUNSEL, BOWLING PROPRIETORS' ASSOCIATION OF AMERICA, INC.

Mr. FALKENBERG. I appear here on behalf of the Bowling Proprietors' Association of America, Inc., an association of 1,500 operators of tenpin bowling alleys. That is the alley using 16-pound balls and 3-pound 10-ounce pins.

In the United States at present there are, according to the figures of the American Bowling Congress, which I have asked permission of the chair to insert in the record, 5,005 establishments, sanctioned establishments operating. There are 35,550 bowling alleys or beds in these establishments; the average number of alleys in each establishment in the 48 States is 7.1 alleys per establishment.

We are affected by two provisions of the tax bill:

Section 555 relates to coin-operated amusement and gaming devices and amends the Internal Revenue Code and provides:

(a) Every person who maintains for use, or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device, shall pay a special tax of $25 per year in respect of such device, and shall pay an additional special tax of $25 per year for each additional such device so maintained or the use of which is so permitted.

and we are willing to pay that tax.

Senator TAFT. That is on what? Slot machines?

Mr. FALKENBERG. That is the amusement tax on games where you put in a nickel and try your luck at registering a high count or score but receive no prize or reward therefor.

If one such device is replaced by another, such other device shall not be considered an additional device.

(c) Applicability of administrative provisions.

An operator of a place of premises who maintains for use or permits the use of any coin-operated device shall be considered for the purposes of subchapter B to be engaged in a trade or business in respect of each such device.

To this tax we do not object.

Section 556 relates to bowling alleys and billiard and pool tables, and it is provided in paragraph (a) thereof as follows:

Rate.—Every person who operates a bowling alley, billiard room, or pool room shall pay a special tax of $15 per year for each bowling alley, billiard table, or pool table. Every building or place where balls are thrown or where games of billiards or pool are played, except in private homes, shall be regarded as a bowling alley, billiard room, or pool room, respectively.

A Summary of Bowling Alley Establishments in the United States, as compiled by the American Bowling Congress, Inc., in May 1939, and in January 1941, appears on page 3 of the A. B. C.'s official publication, Bowling, volume 7, No. 11, issued January 16, 1941, and is attached to this statement as exhibit A.

It shows that in January 1941 there were 5,005 tenpin bowling alley establishments in the United States, with a total of 35,550 certified alley beds or lanes, and with an average of 7.1 beds or lanes in these establishments.

The Bowling Proprietors' Association and the quoted summary of the A. B. C. are interested in and refer only to tenpin bowling alley establishments, as distinguished from duckpin establishments, who are represented before this committee by the National Duckpin Bowling Congress.

It is the studied opinion of the officers and directors of our association that at the present time the proposed tax of $15 for each alley and for each table is excessive and in many instances might prove confiscatory, and that for the reasons hereinafter set forth the tax should be reduced so that the operator would pay not more than $5 per alley and $5 per table.

An overwhelming majority of the members of our association have in their establishments billiard tables and pocket tables (which in the past were commonly known as pool tables), which they operate in conjunction with their tenpin bowling alleys. Practically all tables are 10, 15, or 20 years of age. They are rarely in use and are retained chiefly because the proprietory bought them years ago and owns them. The tax on tables would, in effect, be a use tax on nonremunerative personal property.

That the industry of tenpin bowling has enjoyed a phenomenal growth in recent years is evidenced from the summary found in the exhibit attached. From this summary it is seen that whereas 3,880 establishments, with 25,797 certified alley beds or lanes were in operation in May 1939, the number had increased 28 percent, to 5,005 establishments, by January of 1941, and had increased by 37.7 percent to 35,550 certified alley beds or lanes by that last date.

Twelve States have 81 percent of the establishments and an approximate like amount of alley beds or lanes, viz:

	Establishments			Establishments	
	1939	1941		1939	1941
California	95	179	New Jersey	379	475
Illinois	423	529	New York	743	875
Indiana	114	178	Ohio	340	404
Iowa	86	103	Pennsylvania	355	483
Michigan	255	335	Wisconsin	375	439
Minnesota	108	212			
Missouri	119	137	Total	3,422	4,349

Tenpin bowling has grown from a recreation in which a very small proportion of the public indulged, into one of the major recreations of the Nation.

Bowling is a "participant" sport, as distinguished from a "spectator" sport and is one of the very few recreations that offers physical exercise as well as mental relaxation to persons of both sexes and of all ages.

Tenpin bowling alley operators do not sell a "commodity" to the public; they sell a "service." A service, in the very nature of things, must be offered at a much lower unit cost to the public than a commodity, because after spending his money in bowling, the patron takes nothing with him of a tangible nature to his home, as he does when merchandise is purchased. For illustration—movies or talkies, amusement parks, roller coasters, dance halls, or roller and ice skating rinks in the average city cannot charge more than 10 cents or 25 cents for each unit of service without suffering a very sharp decline in business.

The public regards these diversions and recreations as something they should receive without too great a cost. These diversions and recreations, including tenpin bowling, are therefore dependent on a very large number of unit sales, if they are to realize any appreciable profit.

The average tenpin bowling establishment in the United States consists of 7.1 alley beds or lanes, and occupies about 6,000 to 8,000

square feet of floor space. Building costs or rental is therefore a large factor in computing the fixed overhead for each such establishment.

A representative financial picture for an average 10-lane establishment is somewhat as follows:

Income: 10,000 lines or games per month from Sept. 15 to May 15, or 80,000 lines or games per year, at 25 cents per game, yield a total gross revenue of	$20,000
(98 percent of the establishments are not open for business from May 10 to Sept. 10 of any year.)	
Expense: Because of the labor shortage, due to national-defense work, pin boys to spot the pins will receive during the coming season an average of 7½ cents per game or line. This amounts to 30 percent of the gross, which in the instant case would amount to $6,000 per year for only 1 group of employees, an unusual condition, we submit	6,000
Rental is normally figured at $25 per month per alley lane, or $250 per month, or a total yearly rental of	3,000
Porter hire amounts to (per year)	800
A counterman receives (per year)	800
An alley mechanic at (per year)	1,500
Total in wages, in addition to the $6,000 paid to pin boys	3,100
Light bills each year approximate	800
Heat for a year will cost	400
The price of supplies, such as tenpins, bowling balls, lacquer, etc., has increased 35 percent in the last 8 months, and during the coming year in a 10-alley establishment will cost	1,500
Advertising and business promotion for a year will average	500
State and municipal taxes vary in the several States, but in Michigan, for instance, the personal-property taxes on the equipment would amount to	330
In Chicago, tenpin alleys, 1 to 3 years of age, and tables 10 years of age (in addition to the city-license fee of $5 per alley and table) will pay a yearly personal tax of	310–400
In Michigan permits and licenses, per year, cost	25
Because of the lack of steady employment in bowling establishments, an unemployment-compensation tax of 4 percent on the total pay roll must be made to the State of Michigan, hence on the hypothetical total pay roll of $9,100, this latter tax each year amounts to	564
The Federal annuity tax of 1 percent under Social Security, title IX, for the year amounts to	91
The initial cost of the 10 bowling alleys with return chutes, etc., amounts to a minimum of	15,000
Tables, spectator's seats, scoreboards, benches, counters, showcases, lockers, etc., will cost an extra	7,500–12,500

From the foregoing we find a gross income of $20,000 against a total operating overhead of $16,000 to $18,000, or a net maximum profit of $4,000 on an investment of $22,500 to $27,500, not including as part of the investment the cost of the building. This profit includes the full-time services of the owner-operator to supervise the establishment.

This, we submit, is a bare living for the average bowling operator, and he can ill afford any additional tax or charge in his business.

In Chicago the operator is faced with the following taxes and fees:

Retail liquor license to the city, $100 per year for each bar.
Retail liquor license to the State, $50 per year for each bar.
Retail liquor tax, Federal, $25 per year.
Cigarette license to the city, $100.
Retail sales tax paid to the State, 2 percent of gross sales.

Sign inspection, elevator inspection, and fan inspection, city, $15 to $40 per year. Corporate franchise tax to the State, Federal corporate stock tax, unemployment-compensation tax, old-age insurance tax, personal property tax and city license fee per unit, personal income tax, corporate income tax—these charges vary with the capital structure and volume of business or income done by the individual establishment.

Comparable taxes are paid by each operator in all other metropolitan cities in the Unted States.

Tenpin bowling establishments might well be divided into two categories, viz:

1. Those in metropolitan centers like Chicago, New York, Detroit, St. Louis, and Los Angeles; and

2. Those in the rural sections.

Those in each section could again be divided into—

(*a*) Air-conditioned, soundproof, streamlined establishments located in the so-called single-purpose building, i. e., a building constructed for the express purpose of operating a tenpin bowling establishment therein, and unless completely rebuilt usable for no other purpose; and

(*b*) The non-sound-proof, non-air-conditioned, old-time establishment, generally located on the second floor of some building, or in a remodeled garage, or in the basement of some large building.

The great majority of these newer, up-to-date establishments, constructed in the past 3 or 4 years, experienced great difficulty in financing the construction of their single-purpose building and the procurement and installation of the bowling alley equipment. These number less than 5 percent of all tenpin establishments in the 48 States.

Classified by every lender of money as a single-purpose building, construction loans could not be obtained from the local bank, from the investment banker, from the private lender of money, from the insurance companies, from the R. F. C., from the F. H. A., or from any other private or public lending agency, and when the average loan was finally obtained, it was generally for a substantial commission, at a high rate of interest, and under exacting terms. Cost of an air-conditioned, sound-proof, one-story building with half or full basement, including plot of ground 135 by 125 feet will be a minimum of $120,000 to $225,000, exclusive of equipment; interest therefor is $7,200 to $13,500 per year without depreciation.

The equipping of the establishment was another financial problem. For practical purposes, 24 alleys or lanes on one floor, free from posts, are needed. Tournaments, sweepstakes, and championships require multiples of six alleys. The cost of equipping a 24-lane establishment would approximate $100,000, which could be financed only by paying 25 to 35 percent down and the balance in equal monthly installments over a period of 3 to 5 years. Interest alone on equipment is $6,000 per year, without depreciation. Repayments on loans or contract would be $13,000 to $22,000 per year.

Stock companies or syndicates of small operators had to be formed to provide adequate capital for these 24 alley ventures. In self-protection, having no alternative, except to go out of business, these operators, who, for 20 or 25 years had pioneered recreational bowling, had to band together so as to meet the ruinous competition presented by a half a dozen or more newcomers in the field of bowling, who saw an opportunity to capitalize quickly and profitably on the years

of constructive effort of the small bowling operator, he possessing an establishment of 4, 6, 8, or 10 alleys. Unfortunately, other newcomers entered into the competition and it soon became a small but vicious serious circle of action. These were practically all constructed or started prior to the present European-Asiatic conflict. Hence we have the completed building and the completed enterprise on our hands and are faced with the necessity of meeting interest charges and prepayments on principal, even though the business is closed.

In hearings before the then N. R. A. Administrator, Gen. Hugh Johnson, figures and facts were presented by this association indicating:

(*a*) That the then approximately 1,500 member tenpin bowling establishments in the United States charged an average of 20 cents per game or line for tenpin bowling.

(*b*) That the profit to the operator approximated three-quarters of a cent to 1½ cents per line or game.

(*c*) That tenpin boys were paid 4 cents per game for spotting pins.

(*d*) That not one billiard or pocket billiard table had for 5 years or more earned sufficient money to offset the rental charge for the space the table occupied in the establishment.

Today bowling is 20 cents per line each afternoon until 5 o'clock. Three games for 50 cents is the charge for high-school boys and girls Saturday and afternoons. Bowling is an accredited "subject" in Chicago's public high schools. Twenty-five cents per line is charged in most establishments after 5 p. m.

The bulk of bowling is done by members of leagues, under signed agreements, commencing the 1, 2, 3, or 4 days following Labor Day of each year, for 31 to 37 weeks.

The charge for league bowling is approximately 3 lines for 75 cents (some agreements provided 3 games for 67½ cents), out of which the operator now pays:

Six to eight cents per line to the pin boy for spotting pins (with an occasional guaranty of $2 or more per day if the boy is called to report for work and there is no work, or but an hour's work for him). Where 10 or more boys are involved (generally 1½ to 2 boys must be held for call for each alley), this guaranty, paid to tenpin boys who sit around and do no work, frequently wipes out the entire day's profit for the operator. Four dollars per day guaranty is threatened in half a dozen States to be demanded by pin boys.

Two dollars per year for each league sanction to the American Bowling Congress.

One dollar to one dollar and fifty cents each 2 hours to a foul line man for each eight teams bowling on eight alleys in league play. (This is $9 to $13.50 per night at a 24-alley establishment.)

As promotional expense, each proprietor must and does pay the entry fee of from 5 to 20 teams in each city tournament, each State tournament, each A. B. C. national tournament, and like tournaments for the Women's Bowling Association. All tournaments are held annually.

They must, in addition, buy lettered shirts for the different league bowlers to advertise the establishment, and must pay entry fees in the various types of bowling sweepstakes staged periodically in the year, and last, but not least, conduct bowling classics—leagues, individual championships, and team championships—in which the participants are the outstanding bowlers in each city.

These agreements signed by bowling leagues have in practically every instance already been signed for the coming season by the leagues and the operators, and in many instances for the next two seasons. The bowling operator finds it an utter impossibility to now change his agreement so that he might require the bowler to pay an increased charge, sufficient to permit the proprietor to absorb the proposed $15 tax or fee on each table or alley.

At the time of our appearance before General Johnson, it was, and at the present time it is, a rare occasion when a patron rented a table, either billiard or pocket, for an hour. The patron occasionally picks up a cue to casually knock the balls around the table for the 15 or 20 minutes that he must wait until his alley is free or until the arrival of the time his league commences to bowl. About half the tables never are used from year to year.

Other taxes which he must now pay and which have been added since the N. R. A., include: (1) Unemployment compensation; (2) old-age insurance.

Before we were aware of the proposed tax on alleys or tables, the Bowling Proprietors' Association in convention assembled at Louisville, Ky., on June 10 and 11, 1941, adopted a resolution binding upon all members that:

> During the period of the present emergency the price of bowling to all uniformed members of the armed forces of the United States will be 15 cents per game or line.

During the war of 1917–18, the several city or local associations contributed to the different cantonments completely equipped bowling alleys, without cost to the Government or any other cantonment agency.

Unsuccessful in their efforts to make like contributions this year, they adopted the alternative above set out, a reduction of 40 percent in the cost of bowling to the service man, and at the reduced price they assume a loss of 5 to 7 cents per game, as their contribution to the recreational activities of the service men on leave.

The old establishments in metropolitan centers are, like those in the rural districts, finding it daily more difficult to obtain tenpin spotters, for the reason that these boys can earn double the wages in factories or in defense industries than they can earn by spotting pins ($1.80 to $3 per league night, Monday through Friday, plus open play afternoons, Saturdays and Sundays).

The selective-service law has hit tenpin establishments a heavy financial blow, because a great many young men in the draft age, accompanied by their girl companions, were in the past regular bowlers. Now he is in the service and she remains at home.

Most of the 48 States have safety laws and health laws, reinforced by city ordinances, prohibiting the use of boys under 18 years of age,

or high-school boys, for spotting pins, and where an exception is permitted, the authorities limit their services to 11 o'clock at night.

All profit in the average establishment is in the "open play," that is, nonleague play in the afternoon and at night after the leagues have bowled; that is, after 11 o'clock at night, but unless pin boys are available, this open play cannot be obtained, and many nights they are unavailable and the customer is lost to the operator.

It is feared by many smaller operators that because of the attractiveness of the newer, air-conditioned establishments, a great percentage of the patrons of the smaller, older establishments will be attracted to the newer places, and that in self defense the older, smaller operator will be forced to cut his price to 15 cents per game in the afternoon and 20 cents per game in the evening, and this notwithstanding the fact that it actually costs him 20 or 22 cents per game to operate, without considering the tax under discussion, or any other taxes which the city or the State will undoubtedly levy and collect. This will be pure suicide, but he will have no alternative but to close his place of business. Our officers are now seeking another solution.

Unless the proprietor can retain his patrons and keep the price at its present level (because of their tremendous overhead the newer men cannot cut the price and survive), it is inevitable that a great number of these smaller operators, possibly a majority of them, will find it necessary to close their doors, just as they did in 1931, 1932, 1933, and 1934, during which period so many tenpin establishments went out of business and returned their unpaid-for equipment to the manufacturer, that all manufacturers' warehouses were loaded to capacity with section-cut tenpin alleys, and these manufacturers pleaded with the operator to retain the alleys in his establishment, even though he made no payments thereon for months or years, but only protected the alleys against unnecessary depreciation.

Tenpin alleys are, on a small scale, operated in scores of Y. M. C. A. and like enterprises. All profits are used for aiding underprivileged children. This tax would practically eliminate their entire profit, and the many boys and girls and activities heretofore aided by them would henceforth be cut off from such aid.

If, unfortunately, this occurs, the very purpose of House Resolution 5417, namely, to raise revenue, will thereby be frustrated.

Assuming that each alley of the 5,005 establishments, or 35,550 lanes, were to pay $15 per year each, the total revenue to the Federal Government would amount, at a maximum, to $533,250. There is grave danger that this additional Federal tax imposition might cause the closing of the businesses of so many of both the smaller and the newer operators that the losses to the Government in income tax, in various types of social security tax and other fees and charges would more than equal the amount of the revenue which might, as a maximum, be realized under this proposal.

As intimated above, each member of our organization is not opposed, if there is no other way for these expenses to be met, to being called upon to contribute something extra toward the heavy, current expense of government, but each believes that if they must pay an added excise tax, that the sum of $5 per alley or lane, and $5 per table for the first 2

years of the proposed legislation, would be the maximum that they should be called upon to pay. This price they could by further sacrifice meet without great danger of closing their doors.

In behalf of the members of the association, we very respectfully recommend that if the proposed tax cannot be eliminated entirely it be changed from $15 per alley and per table to $5 per alley and per table.

Sometime after the armistice in 1918 a Federal tax was levied on bowling alleys. This tax remained in effect but a very short time, because the operators convincingly demonstrated to the Members of the Congress that their business was so small that they could not possibly pay the tax, and it was quickly repealed.

We are deeply obligated to the committee for their courtesy in permitting us this opportunity to present to them the views of the operators of tenpin bowling alley establishments in the United States.

(Mr. Falkenberg submitted the following table, referred to in his statement as exhibit A.)

EXHIBIT A.—*Summary of bowling alley establishments and alley beds certified by the American Bowling Congress*

State	Establishments				Certified alley beds				Average beds per establishment	
	May 1939	Janu-1941	Increase		May 1939	Janu-1941	Increase		May 1939	Janu-1941
			Number	Percent			Number	Percent		
Alabama	5	10	5	100.0	37	89	52	140.5	7.4	8.9
Arizona	4	9	5	125.0	22	66	44	200.0	5.5	7.3
Arkansas	6	4	−2	−33.3	35	23	−12	−34.2	5.8	5.7
California	95	179	84	88.4	872	1,793	921	105 6	9.2	10.0
Colorado	17	26	9	52.9	127	186	59	46.4	7.5	7.1
Connecticut	8	8			46	46			5.7	5.7
Delaware	6	11	5	83.3	58	118	60	103.4	9.7	10.7
Florida	12	22	10	83.3	98	162	64	65.3	8.2	7.3
Georgia	1	4	3	300.0	12	28	16	133.3	12.0	7.0
Idaho	8	11	3	37.5	38	69	31	81.5	4.7	6.2
Illinois	423	529	106	25.0	3,308	4,327	1,019	30.8	7.8	8.1
Indiana	144	178	34	23.6	925	1,202	277	29.9	6.4	6.7
Iowa	86	103	17	19.7	466	568	102	21.8	5.4	5.5
Kansas	37	49	12	32.4	197	257	60	30.9	5.3	5.2
Kentucky	30	31	1	3.3	222	254	32	14.4	7.4	8.2
Louisiana	5	12	7	140.0	24	89	65	270.8	4.8	7.4
Maryland	2	3	1	50.0	22	28	6	27.2	11.0	9.3
Massachusetts	2	4	2	100.0	12	20	8	66.6	6.0	5.0
Michigan	255	335	80	31.3	2,223	3,092	869	39.0	8.7	9.2
Minnesota	108	212	104	96.2	595	1,244	649	107.3	5.5	5.8
Mississippi	2	3	1	50.0	16	22	6	37.5	8.0	7.3
Missouri	119	137	18	15.1	919	1,063	144	15.6	7.7	7.7
Montana	20	25	5	25.0	111	141	30	27.0	5.6	5.6
Nebraska	27	39	12	44.4	197	258	61	30.9	7.3	6.6
Nevada	1	5	4	400.0	12	27	15	12.5	12.0	5.4
New Jersey	379	475	96	25.3	2,123	2,817	694	32.6	5.6	5.9
New Mexico	3	9	6	200.0	20	49	29	145.0	6.7	5.4
New York	743	875	132	17.7	4,059	6,065	1,406	30.1	6.3	6.9
North Carolina	5	6	1	20.0	15	23	8	53.3	3.0	3.8
North Dakota	18	30	12	66.6	83	149	66	79.5	4.6	4.9
Ohio	340	404	64	18.8	2,504	3,469	965	38.5	7.4	8.5
Oklahoma	23	37	14	60.8	152	240	88	57.8	6.6	6.5
Oregon	20	28	8	40.0	140	190	50	35.7	7.0	6.8
Pennsylvania	355	483	128	36.0	2,073	2,876	803	38.7	5.8	5.9
South Carolina	1	1			2	6	4	200.0	2.0	6.0
South Dakota	13	23	10	76.9	71	131	60	84.5	5.5	5.7
Tennessee	12	17	5	41.6	80	138	58	72.5	6.7	8.1

EXHIBIT A.—*Summary of bowling alley establishments and alley beds certified by the American Bowling Congress*—Continued

State	Establishments				Certified alley beds				Average beds per establishment	
	May 1939	January 1941	Increase		May 1939	January 1941	Increase		May 1939	January 1941
			Number	Percent			Number	Percent		
Texas	40	61	21	52.5	314	472	158	50.3	7.9	7.7
Utah	8	11	3	37.5	75	113	38	50.6	9.4	10.2
Vermont	2	2	.....	.....	15	19	4	26.6	7.5	9.5
Virginia	1	2	1	100.0	12	16	4	33.3	12.0	8.0
Washington	31	47	16	51.6	187	312	125	66.8	6.0	6.6
West Virginia	23	29	6	26.0	135	187	52	38.5	5.9	6.4
Wisconsin	375	439	64	17.0	2,017	2,501	484	23.9	5.4	5.7
Wyoming	7	11	4	57.1	35	53	18	51.4	5.0	4.8
Alaska	2	2	.....	.....	5	5	.....	.....	2.5	2.5
Canada	47	49	2	4.2	442	446	4	.9	9.4	9.1
China	6	6	.....	.....	23	23	.....	.....	3.8	3.8
Hawaii	3	6	3	100.0	21	46	25	119.0	7.0	7.6
Mexico	.....	2	2	.....	.....	28	28	.....	.....	14.0
Washington, D. C.	.....	1	1	.....	.....	4	4	.....	.....	4.0
Total	3,880	5,005	1,125	28.9	25,797	35,550	9,753	37.7	6.6	7.1

(Whereupon, at 12:25 p. m., the hearing was recessed until 2 p. m.)

AFTERNOON SESSION

(Pursuant to the adjournment for the noon recess, the committee reconvened at 2 p. m., Senator Walter F. George (chairman) presiding.)

The CHAIRMAN. Dr. Compton, will you come around, please?

STATEMENT OF DR. WILSON COMPTON, WASHINGTON, D. C., REPRESENTING THE NATIONAL LUMBER MANUFACTURERS ASSOCIATION

The CHAIRMAN. You are representing the National Lumber Manufacturers Association?

Dr. COMPTON. That is right, Mr. Chairman.

The CHAIRMAN. And you have a brief, I presume?

Dr. COMPTON. I have a short statement here, which, if it is agreeable, I would like to base my few remarks upon. In fact, I might save you time, and my own, by just following this.

The CHAIRMAN. It is very much against our will, but in order to accommodate as many of the industries and taxpayers as possible, we had to put a limitation of 10 minutes on the time. From your brief, however, you will not consume more than that.

Dr. COMPTON. I will not occupy 10 minutes.

I noticed while I was sitting here, Senator, a table on page 578 of the hearings which you held, and I would like to have my remarks to be related to the table entitled "Table B—Sawmills and Planing Mills, per Income Returns," that appears on that page.

The CHAIRMAN. Very well, that will be so noted.

Dr. COMPTON. My name is Wilson Compton. I am the secretary and manager of the National Lumber Manufacturers Association and

vice president of American Forest Products Industries, Inc. I have sought an opportunity in behalf of the major lumber and timber products industries to ask your consideration of an important, somewhat paradoxical, and I think an undesired discrimination in the pending tax bill. It has been brought to your attention by spokesmen for the coal industry, the railroads, the timber industries of the West and others. I wish to put before you a summary of its unfair and discriminatory effects upon the lumber and timber products industries in all regions, South, North, and West.

This discrimination is in section 201 (a) of the bill. In subdivision (2) of that section is provided a "special rule in certain cases where invested capital credit is used" in the computation of excess-profits taxes. This provision would apply to all companies which, during the period 1936 to 1939 showed earnings less than 8 percent of invested capital. Especially will it apply in the natural resources industries with their comparatively large invested capital and their comparatively low earnings in recent years.

This proposed special rule is a penalty tax applicable in fact only to corporations with no earnings or small earnings during the base period, and applicable to them for no other reason than that during the base period they were unable to show substantial earnings. It would not even apply to a new corporation which was not in operation during that period. And to that point I would like to call especial attention.

The lumber industry during recent years has been notoriously unprofitable. Income-tax data published by the Bureau of Internal Revenue indicates a total net income for the base period for companies in lumber and timber products industries amounting to less than 1½ percent annually of their assets admissible in the computation of invested capital. At that point, could I refer to this table on page 578 of the hearings?

The CHAIRMAN. Yes.

Dr. COMPTON. To illustrate specifically the effect of this penalty tax on the lumber manufacturing industry may I cite three examples, and these are all drawn from the published reports of the Bureau of Internal Revenue. All I have to say is predicated upon the publication of the Bureau, and that is based, in turn, on the income returns filed with them.

First, 55 percent of the income-tax returns for corporations in this industry during the 4-year base period reported no net income. Data on assets is available for only 3 of the 4 years. But these no-net-income corporations in the 3 years for which data are available, had average assets totaling $448,000,000 after deducting items not considered as part of invested capital for the purposes of this law.

Eight percent of their admissible assets of $448,000,000 amounts to $35,824,000. This theoretically is their invested capital credit or exemption from the excess-profits tax. But on this credit the pending bill proposed a tax of 10 percent. These corporations would, therefore, be taxed $3,582,000 on their exemption.

Second, the remainder of the lumber companies, accounting for approximately 45 percent of the returns reported a net profit in the base period. Their average invested capital, computed from the available data published by the Bureau is $598,000,000. Most of these

are companies of comparatively small or moderate size. Most would be entitled, under the standards contained in the pending bill, to an 8 percent excess-profits tax credit on an aggregate of $47,845,000. During the base period these companies had a net income before income taxes equivalent to 6.39 percent of their admissible invested capital or an aggregate of $37,512,000. The difference between the invested capital credit and the earnings credit thus computed is $10,333,000. This, too, by the terms of the proposed special provision would be subject to a penalty tax of 10 percent or $1,033,376.

Third, the lumber manufacturing corporations making Federal income tax returns total about 3,000. Their combined admissible invested capital is about $1,046,000,000. Their average yearly net income during the 4-year base period, without subtracting the $12,500,000 deficit in 1938 was less than $17,800,000, less than 1¾ percent of the invested capital. Assuming that these companies will use the invested capital credit option, that credit in the national industry aggregate would be about $83,600,000. Subtracting from that amount—if perchance such an amount were earned in 1941—the average earnings of $17,800,000 would leave $65,800,000, subject, therefore, to a 10 percent penalty tax or a tax of $6,580,000.

These examples, of course, are not totally accurate. The available data are not complete. The specific exemptions would somewhat reduce the tax but would not substantially modify the extent of the discrimination resulting from this special tax.

Nor does this discrimination exist merely in national industry averages. For example in Wisconsin in 1936, the only year of the 4-year base period for which this information is now available, 49 companies earned an average of 4.3 percent of invested capital; 55 others had a deficit of 6 percent. In North Carolina during the same year 74 companies earned an average of 6.4 percent and 50 had a deficit of 11.8 percent. In Oregon 65 companies earned 5.4 percent; and 114 companies lost 4.3 percent. In Texas, 40 companies with admissible invested capital of $10,200,000 had a profit of 12.2 percent and 33 others with an invested capital of $24,200,000 had a deficit of 2.9 percent. In Virginia 54 companies, including those which operated at a profit and those which operated at a loss, earned 3.9 percent; in Georgia 94 companies earned 4.2 percent; in Washington 246 companies earned 3.3 percent. These companies if they use the invested capital credit option, as most of them will, will be subject, under this special provision, to a penalty tax on the difference between these amounts and 8 percent (or 7 percent as the case may be) on their invested capital. To many of these companies which have been financially impoverished during most of the past 10 years, these are very considerable amounts. Most of them will have enough difficulty in paying their share of the fair taxes imposed on them. They should not in addition be asked to pay unfair taxes which penalize them for no reason except that in recent years they have been unable to show a more impressive earnings record.

We are not objecting to the tax rates. We know that the bills must be paid and that to do this the taxes must be high. But we are objecting to inequality of taxation and to discriminatory penalty taxes on companies with large investments merely because their operations during the recent so-called base period have been generally unprofitable. We hope that this inequitable provision of the pending

bill will have your earnest consideration, and that it may be eliminated before the revenue bill is reported to the Senate.

The CHAIRMAN. Are there any questions by any members of the committee of Dr. Compton? If not, Doctor, thank you very much for your appearance.

Dr. COMPTON. Thank you.

The CHAIRMAN. Mr. Thomas Young, of Salt Lake City.

STATEMENT OF THOMAS YOUNG, SALT LAKE CITY, UTAH, REPRESENTING THE NATIONAL SIGN ASSOCIATION, INC.

The CHAIRMAN. You appear on the tax on the electric signs?

Mr. YOUNG. Yes, sir.

The CHAIRMAN. I believe your appearance is for the National Sign Association, Inc., is that correct?

Mr. YOUNG. That is right.

The CHAIRMAN. All right, sir, Mr. Young.

Mr. YOUNG. Mr. Chairman and gentlemen, I am president and manager of the Young Electric Sign Co., in Salt Lake, and also president of the National Sign Association.

As president of the National Sign Association, I speak in behalf of an industry comprised of some 3,500 small manufacturers, who are performing a service primarily adapted to the needs of the local merchant and businessman.

We are opposed to the imposition of an excise tax on advertising in any form, since such a tax will place a handicap on the expansion of business necessary to produce the means required to meet the defense program. The reasons why this tax should not be imposed on neon and electric signs, however, are of a special and important nature.

First, I wish to state our industry realizes, as do all others, that a state of emergency exists and that taxes must be levied in order to carry out the defense program. We are not opposed to paying our full share of any equitable tax, even to the full extent of our profits, if necessary, but we are opposed to the suggested tax under consideration, which will inflict an unjust burden on the development and proper use of our medium and inhibit the effort of the small businessman in adjusting himself to conditions he is now facing.

For a large percentage of small businessmen, our medium is the chief form of advertising used, and for many the only form used. Please remember that most neon and electric signs are installed on the merchant's place of business, and are the means by which the merchant can best identify his place of business, and thereby sell his merchandise. For the great majority, the neon and electric sign represents the only means of forming a contact between prospect and himself—the only means of securing business. Usually his trade is drawn from a relatively small area, and in more cases than may be realized, the sign is the first and only contact available to those passing in his vicinity. For this reason no other medium of advertising is available for his use. All other media of wider circulation would represent an economic waste, which makes their use not only impractical but impossible. Handicap the small businessman (and by this the large majority of all business establishments) with this tax, and you make it difficult to

readily readjust his business to the present program, and may even cause conditions that will force him out of the enterprise in which he is engaged.

Not less severe is the effect on our own industry, which gives employment to more than 50,000 persons, most of whom are highly skilled in their specific trades, and so specialized as to make them unsuited to any demands of the defense industry. In the present trade their wages and working conditions are above the average for industry. Signs are custom-built and, therefore, require a much higher percentage of labor to the finished product than those products produced by quantity methods. Our plants do not have the type of equipment or machinery required for defense products. Our margin of profit is small, and any appreciable diminution of business will result in loss of employment, elimination of profits, and consequent loss of expected revenue.

It is our belief that the total amount of revenue which could be collected would be small, and that the cost of its collection from so many firms would net a very much smaller net income to the Government. There is, perhaps, a smaller volume of business in new signs produced than might be expected. Because signs are, by their very nature and purpose, placed in positions of visible recognition, the amount and quantity is always overestimated by the general observer. The total revenue of the sign industry in all its ramifications reaches a figure much less than that of an oil company in one of our States. The work being custom-built, is distributed between an estimated 3,500 firms, the greatest majority of which employ few individuals. The companies reaching a volume of $100,000 in a year or over, will not exceed more than 40 to 50 in number, and according to a Government census report, only 1,386 even enjoy a business of over $5.000 a year.

Because this tax would impose a hardship on thousands of small businessmen, would throw many specialized men out of employment, and would not net an important gross revenue, we register our earnest opposition. These objections are in addition to the fact that the very theory of an excise tax on advertising will be a tax on business development.

Senator CONNALLY. Do you know of any tax that is not?

Mr. YOUNG. How is that?

Senator CONNALLY. You say it is a tax on business development. Do you know any tax that is not a burden on business in some way?

Mr. YOUNG. I do not, Senator.

Senator CLARK. No tax really encourages the development of business.

Mr. YOUNG. Let me say at this moment, however, that while I am speaking of a struggling business, I am practically speaking with 25 years or so behind my record. As I appear here before you gentlemen my mind goes back to the struggling existence of this industry in the days when we were manufacturing what was known as bulb-type signs, and how difficult it was for the industry to get its product on the market by reason of the high cost of operation, and then, after the war days, the last war days, the inception of gaseous-tube signs came into being, and the general acceptance of the public was somewhat retarded by reason of engineering

and by reason of its being of a highly specialized nature, and it too some time before this medium was generally accepted.

The neon sign, as my report indicated, is a beautiful thing to look at. Many people take the position that in looking at a neon sign, because of its beauty and enhancement of color, every time it holds the eye there is a profit made.

Since the adoption of the neon tube and the neon sign into the life of the American business many developments have been made in the use of fluorescence. It is an accepted thing. Our people in business want it. It is inexpensive to operate and it has done considerable to enhance the communities and cities and highways where these signs are erected, and for that reason it is a spectacular business and is something that should be considered as being of importance in all its ramifications.

Senator TAFT. You do not think it differs from all the rest of the outdoor advertising, do you? I mean, you cannot distinguish between the different kinds of outdoor advertising?

Mr. YOUNG. Outdoor advertising, in a measure, is relatively connected with this business. Neon tubes are used in connection with outdoor advertising on signboards.

Senator TAFT. Are you objecting to a tax on any electric signs?

Mr. YOUNG. I am objecting to a tax on any electric signs.

The CHAIRMAN. The manufacturers' sales tax?

Mr. YOUNG. Or a manufacturers' sales tax. The fact that it is a highly specialized product in labor, and the increasing demands of labor from time to time, by reason of increased cost of living, warrant the consideration of this matter.

In addition to that, we are confronted throughout the United States with the everrising taxes of cities. Communities and municipalities are constantly raising taxes on the electric sign, and in order to climax my remarks, I would like to make this impression, that if the statistics are followed, you will find that the small manufacturers, the neon sign manufacturer, is not in the position to even own his own buildings. Many are compelled to lease their property and rent from month to month.

Are there any questions that I could answer?

The CHAIRMAN. Are there any questions from any member of the committee? If not, thank you very much.

We were not able to reach some of the witnesses on Friday. One was Mr. Edward O'Neal, president of the American Farm Bureau Federation. Mr. O'Neal, will you come around, please, sir?

We have not finished today's list but then, since you were on the list on Friday, and were not reached, I understand you are free this afternoon to go ahead.

STATEMENT OF EDWARD A. O'NEAL, CHICAGO, ILL., PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. O'NEAL. Thank you, Senator. I am sorry that I had to lose my place Friday afternoon, but I am afraid I was too frank. I thought it would take 35 minutes.

The CHAIRMAN. You were too honest.

Mr. O'NEAL. Too honest at one time, and honesty does not pay.

Senator BARKLEY. Is that a habit of yours, or just a casual occurrence?

Mr. O'NEAL. It is casual, I assure you. I would very much like to have the time, but if you will buckle me down to 10 minutes, I will not have the time to go through this brief here. It will take me about 35 minutes.

The CHAIRMAN. Of course, you can put your brief in the record. If you cannot confine yourself to a briefer period in your statement, we will not count it against you if any questions are asked, because you were to go on on Friday.

Mr. O'NEAL. Thank you, Senator George. I appreciate this opportunity, because my organization is very, very vitally interested in taxes.

Farmers pay the heaviest percentage of taxes of any group in the United States, and it is of vital importance to us all. If you want to cut me off now, and confine me to 10 minutes, I would like to pick out a couple of points. I have four recommendations that I want you gentlemen to consider.

The CHAIRMAN. Mr. O'Neal, in the interest of these other gentlemen here, your whole brief will go in the record. Now you may discuss such parts as you can in the 10 or 15 minutes that have been allotted.

Senator HERRING. I suggest we give Mr. O'Neal some of Mr. Alvord's time that was not used last Friday.

Mr. O'NEAL. The Chamber of Commerce had 3 hours, and I hope we may have a little time to cover our subject.

The CHAIRMAN. We will not be very rigid with you.

Mr. O'NEAL. The farm people, who constitute one-fourth of the Nation's population, have a vital concern in the Nation's tax policies. Agriculture is a $38,000,000,000 industry. A farm purchase by an operator is the investment of a life-time's earnings; all he has earned to date and hopes to earn in the future. No other large group with comparable incomes has as high long-term investments as farmers. We have sought consistently to view national tax policies from the broad standpoint of the public welfare and not from a narrow, class, selfish point of view.

The general policy of the American Farm Bureau Federation on Federal taxes is set forth in the following resolution adopted at our twenty-second annual convention, held in Baltimore, in December 1940:

> The national defense program is placing new and greatly increased burdens upon the Federal Budget. In affirmation of the policies set forward by the board of directors, we support higher taxes to meet a proper share of this added expenditure. We will oppose efforts to raise this revenue from excise or consumption taxes. The corporate and personal income tax must be the main source of revenue and the excess-profits tax should be tightened and maximum rates of profit established above which all revenues will be considered as excess profits and be taxable as such. Only by such tax policies can profiteering be forestalled and the defense program financed on the basis of ability to pay.

At a meeting of the three largest national farm organizations, the National Grange, the American Farm Bureau Federation, and the National Council of Farmer Cooperatives, in Chicago on June 5 last, called to discuss the problems facing the farmers, organized agricul-

ture was united in adopting the following statement of policy with respect to national defense and taxation:

> In order to prevent dangerous inflation and an undue accumulation of debts as a result of the enormous expenditures for national defense, we urge that, insofar as practicable, the costs of the defense program be paid from current income. This requires a tax program with a broad base, in which everyone will take part in accordance with ability to pay. In this emergency all unwarranted profits of industry, labor, and agriculture should be recaptured by appropriate taxation to help pay the cost of the defense program.

The proposed revenue bill of 1941, as passed by the House, fails to meet adequately our present fiscal requirements to finance the national defense program and to check runaway inflation. In order to meet this need, the American Farm Bureau Federation proposes the following recommendations:

1. The proposed bill should provide more revenue, in order to pay as we go a larger proportion of the cost of the defense program while the Nation is able to pay.
2. The proposed bill should be amended so as to require everyone to contribute to national defense according to his or her ability to pay.
3. Stop profiteering at the expense of national defense and security.
4. Use tax powers to check inflation. This is the most effective way to prevent disastrous inflation.
5. We are strongly opposed to increased excise taxes, a general sales tax, or a manufacturers' tax; at least until other tax sources have been more nearly exhausted; and favor, instead, increased taxes based upon ability to pay.

I wish, Mr. Chairman and gentlemen, to discuss briefly these five recommendations.

1. The proposed bill should provide more revenue. This measure does not raise enough money either to cope adequately with the fiscal requirements for financing the national defense program or to provide an effective check against excessive inflation.

The estimated national debt now is approximately $50,000,000,000. Already we have either expended or obligated approximately $50,000,000,000 for the national defense program.

If the war continues, it is not unlikely that the total cost of our national-defense program may amount to $100,000,000,000. We certainly ought to pay at least two-thirds of this cost as we go. According to Treasury Department estimates, the total Federal expenditures during the fiscal year ending June 30, 1942, will amount to $22,169,000,000; and total receipts without this bill will amount to $9,402,000,000, leaving an estimated deficit of $12,767,000,000.

It is estimated that this bill will provide $3,236,700,000 of additional revenue on a full year's basis. Even if this were raised to 3½ billion dollars, the total estimated Federal deficit for the current fiscal year would amount to $9,267,000,000. If our national expenditures are going to continue at these levels, it is vitally important—both from the standpoint of a sound fiscal policy and from the standpoint of preventing an orgy of inflation, with the inevitable disastrous consequences of deflation that will follow—to recapture a larger percentage of increased profits and earnings that result from the enormous defense expenditures. We ought to pay a larger share of the cost of the defense program out of those increased profits and earnings instead of depending so heavily upon borrowing.

It is estimated that the national income for 1941 is at a level of about $88,000,000,000, about $12,000,000,000 above last year. If additional taxes are equitably distributed and levied, we should be able to recapture a larger percentage of these increased profits and earnings than the 3½ billion dollars proposed.

The Nation is better able to pay a larger share of the cost of the defense program now, when profits and earnings are greatly increased, than it will be in the difficult years of post-war readjustment. Too much borrowing, resulting in inflation, will certainly get the whole economic machine out of gear as it did in the first World War. All of these expenditures have got to be paid for some time. It is better to pay for them now as far as we can out of increased incomes, than to postpone payment until a later period when the national income may be much lower than it is now.

2. The proposed bill should be amended so as to require everyone to contribute to national defense according to his or her ability to pay.

I agree with the statement made by Secretary Morgenthau to this committee that we need an "all-out tax program" on the basis of ability to pay; that our tax program has not kept pace with the defense program; and that the people of this country have never been more ready to make sacrifices for the common good.

The proposed bill does not meet this objection of an all-out tax program based on ability to pay. According to the estimates of the Treasury Department, the present bill proposes to obtain from individual income taxes $864,800,000, or 26.7 percent of the total yield; from corporation taxes $1,345,200,000, or 41.6 percent; from estate and gift taxes $151,900,000, or 4.7 percent; and from increased taxes $874,800,000, or 27.0 percent.

The time has come when we must face the fiscal situation frankly and courageously, and provide a system of taxation that will properly finance our defense program on a fair basis to all. Let's stop straining at gnats by hunting up all kinds of little vexatious excise taxes that raise comparatively little revenue but cause a lot of irritation and tend to discredit our national fiscal policy. Let us give the American people a chance to do their part for national defense and national security. I believe the great masses of the American people are ready to do their part and to help pay for the defense program provided it is put on the basis of ability to pay.

A Gallup poll taken last May indicates that the American people are willing to pay, each his individual share, of the defense costs. Fifty-eight percent of the people interviewed were in favor of every family with an income of $1,000 paying at least $10 a year, and larger amounts for families with larger incomes. Fifty-nine percent said they would be willing to pay the equivalent of 2 weeks' salary in addition to taxes they were then paying. Seventy percent said they thought defense costs should be met chiefly by taxation, rather than by borrowing.

A later Gallup poll, reported in this morning's Washington Post, indicates that the general public's views are:

1. To make families now exempt pay at least something.
2. To levy a higher tax than at present on incomes between $3,000 and $10,000, and
3. To lower the tax on families earning over $10,000.

The general public favored an income tax of $6 on a net family income of $1,000; $17 on an income of $1,500; and $55 on an income of $2,000—all of which would be exempt from income taxes under the present bill.

A Gallup poll taken of Who's Who showed a vote of 53 percent for and 37 percent against a proposal that every family not on relief should be required to pay a Federal income tax. It looks like every group, from top to bottom, of our income strata believes in this objective.

In the past several months I have talked to a great many people on the farm and off the farm—farmers, businessmen, taxi drivers, workers, and others—and universally I find a willingness to pay their fair share of the defense program. Our boys are making their contribution to the national security by leaving their jobs and giving at least a year of active military training—and it may be several years. They are risking their lives as well as making sacrifices of income. It is the patriotic duty of other citizens engaged in civilian occupations to be prepared to do their part in supporting the national-defense program. Let us give the American people a chance to demonstrate their patriotism by providing a simple income tax, graduated on the basis of ability to pay, so that they can all help finance the defense program in accordance with their means. This tax—particularly in the lower brackets—should be made simple so that the taxpayer can compute his taxes readily.

Such a tax would give every citizen a chance to participate in the responsibilities of government, which is fundamental to the preservation and successful functioning of a democracy.

The proposed bill exempts entirely the great bulk of wage earners and other income earners from income taxes. Under its terms a single person with a net income of $800 and with no dependents would pay no tax; a married person with a net income of $2,800 and with two dependent children is exempt from all income taxes; and if he has four dependent children, he would pay no tax even though his income is $3,600.

There are 45,000,000 to 50,000,000 persons gainfully employed or receiving substantial incomes in the United States; yet it is estimated that this bill will collect income taxes from only 10,925,000 persons, or about one-fifth of the total number of persons earning wages or incomes. And it is estimated that out of 17,100,000 who will file returns, more than 6,000,000 will pay no tax.

Our tax base is too narrow. When the national income is $90,000,000,000, the income-tax base under 1940 exemption would be about $13,000,000,000. Seventy-seven billion dollars is outside the income-tax base. One of the most effective ways to increase the base is to lower exemptions.

According to the studies made by the Iowa State College, lowering the exemptions by half would add a total of $11,000,000,000 to the tax base, of which $9,800,000,000 is between the income levels of $2,000 and $10,000, and the remainder would be added from incomes above $10,000. Their studies show that low-income families would be better off under an income tax without any exemptions at all than under a sales tax, because low-income families spent so much on items subject to sales tax. Their studies further show that an adequate tax

base can be obtained by cutting present exemptions by half. This would still leave much of the population nontaxable.

If we are going to obtain the large amount of increased revenue needed to properly finance the national-defense program, the most equitable way to accomplish this is to broaden the income-tax base by reducing the exemptions. The only other way we can raise this much additional revenue is through a general sales tax. The studies of the Iowa State College show that the sales-tax route would be much more burdensome to the lowest income groups than the proposal to cut exemptions one-half. (Pt. XIII, report prepared for the American Farm Bureau Federation, March 29, 1941, by members of the economics staff, Iowa State College, Ames, Iowa.)

We therefore wish to respectfully recommend that the present exemptions of $800 for single persons, $2,000 for married persons and $400 for each dependent be reduced at least to half of these levels. I believe the American people would support a readjustment of the income-tax rates and exemptions so that every gainfully employed person would pay some tax for defense and would know that he is paying such tax.

If the use of the taxing powers is to be effective in checking inflation, it is essential to tax the excess earnings wherever they are. According to a study made by the Brookings Institution (America's Capacity to Consume, 1934) 42 percent of all families in the United States received incomes less than $1,500, and more than 70 percent had incomes less than $2,500. That is why it is essential to lower exemptions and require all to contribute in accordance with their ability to pay. The great mass of buying power which will create the greatest inflationary pressure, is contained in the income groups below $2.500.

According to a study by the National Resources Board, nearly two-thirds of the total consumer income went to persons receiving incomes under $2,600, who made up nine-tenths of all consumers and 63 percent of the total consumer expenditures went for food, clothing, and housing. (Structure of the American Economy, National Resources Board, pp. 9–11, June 1939.)

3. Stop profiteering at the expense of national defense and security. The present so-called excess-profits tax on corporate income is inadequate. Under the average-earnings option, a corporation is exempted from all excess-profits taxes whatsoever no matter how high its earnings may be, so long as its earnings do not exceed the average earnings during the base period, 1936-39. In addition, corporations are permitted, under the amortization provisions, to write off their entire extra investment due to defense at the rate of 20 percent a year so that, at the end of 5 years (or less, if the emergency ends sooner) they will have paid the entire cost of the additional plant expansion, out of the profits of Government contracts. In the case of profits in excess of the average earnings, the Government recaptures at the maximum 60 percent of the excess, under the proposed bill.

Merely because a corporation enjoyed an exceptionally favorable position during the period 1936–39, is no justification to give such corporation preferential treatment. It is unfair to the rest of the taxpayers to permit these favored corporations to enjoy their average earnings without limit, and escape any excess-profits tax on these profits.

We respectfully urge that the rates on corporate income be graduated upward to recapture a larger percentage of excess profits; and that the average earnings option be modified to provide that all profits above a reasonable maximum return on investment be considered as excess profits and subjected to the same schedule of rates as applied to all other corporations.

It is also essential that we prevent profiteering in wages and salaries. Millions of persons are receiving very substantially increased incomes as a result of the enormous expenditures for defense. All should contribute their equitable share toward helping to finance this program. American agriculture does not ask any special preferred positions; farmers are ready to do their part. We are against profiteering at the expense of national defense—whether it be in agriculture, industry, or labor. American farmers will match dollar for dollar on the basis of ability to pay and sacrifice for sacrifice with labor and industry to help finance the national-defense program.

We recommend that the committee give consideration to a greater graduation in the corporate income-tax schedule. The proposed bill provides for an increase of 5 percent on the first $25,000 of surtax net income, and 6 percent on the balance. A larger upward graduation would appear desirable in keeping with the principle of ability to pay and the further objective of preventing the growth of monopolies and the undue concentration of control of our economic resources. Statistics of corporate income issued by the Treasury Department show that most of the corporate income is earned by a comparatively small number of large corporations. For example, in 1937—out of 192,000 corporations making tax returns—169,623 had incomes less than $25,000 and that 22,399 corporations which earned more than $25,000, each earned 93.39 percent of the income of all corporations making returns. A total of 1,294 corporations earning $1,000,000 and over, received 61.89 percent of all the corporate income of corporations making returns. In addition, there were 285,840 corporations which had no net taxable income.

Furthermore, the present policy of concentrating defense contracts among a few large firms tends to increase costs, to cause undue concentration of population with serious housing and transportation problems, and to build up monopolies and further concentrate control of our economic system into the hands of a few great corporate enterprises. With one arm of the Government we are trying to break up monopolies and monopolistic practices, while we are building up monopolies in the defense program.

According to an announcement issued by the O. P. M. on July 26, 1941, 6 large corporations had 31.3 percent of all defense supply orders and 56 corporations had almost three-fourths of the total dollar volume of all War and Navy Department defense supply contracts.

It is imperative for the success of our all-out defense program and to the preservation of independent enterprise in America, that the defense program be decentralized. Thousands of small factories and firms are ready and anxious to help with this program, if they are given an opportunity. Decentralization of defense contracts among industry throughout the Nation would not only greatly strengthen our defense but would greatly stabilize our whole economy, and render less difficult the post-war readjustments.

There is a provision in existing law for a special national-defense tax equal to 10 percent of the total amount of other taxes to be paid. In the proposed bill these defense taxes which were imposed for a 5-year period by the Revenue Act of 1940 would be made permanent. I do not believe that it is desirable to add this special tax permanently to the tax structure, as it unnecessarily complicates the computation of taxes and it ceases to have much of its inherent value as a special emergency defense tax. I believe it would be much more desirable to continue the defense tax as a special temporary tax, but increase it sufficiently, when coupled with the graduated income taxes, so as to effectively recapture excess income.

4. Use tax powers to check inflation. We cannot stop inflation by merely putting ceilings on a few commodities, or even on all commodities. We must control the run-away wages as well as the run-away prices. It is essential that we use the tax powers to recapture excess earnings due to defense if we are to prevent inflation.

I hope you will turn and look at exhibit 4, which shows wages and salaries constitute 64 percent of the national income.

Unless we have the courage to act now to drain off a substantial part of the twelve to fifteen billion dollars increased national income, either into enforced savings or taxes, this greatly expanded consumers' purchasing power will compete for a greatly reduced volume of civilian goods, and it will be difficult—if not impossible—to prevent this competitive pressure from pushing up prices and wages.

In this connection, I wish to quote from the August 8 statement issued by the Office of Government Reports, as follows:

> The Federal Reserve Board issued a report predicting that unless an unusually large part of consumer income is saved or paid out in taxes, price inflation will grow. The Board said: National income payments by June jumped to a rate of about $88,000,000,000 a year—a $14,000,000,000 or 19 percent rise over the rate for May 1940; wage and salary payments rose 25 percent since May 1940, due to increase of numbers employed and hours worked; profits of large industrial corporations rose 25 percent since the first half of 1940 and dividend disbursements of all corporations increased 15 percent notwithstanding increases in taxes or other costs; commodity prices as a group were 25 percent higher in late July than early March and 50 percent above pre-war levels.

The Secretary of Labor reported on July 16 that hourly and weekly earnings in manufacturing industries in May registered a sharp advance. I quote from this statement:

> The rise in earnings to new high levels in May resulted from widespread wage increases and extension of overtime operations in many industries. During the past 2 months general wage-rate increases affecting nearly 1,500,000 workers have been reported to the Bureau of Labor Statistics.
>
> Wage-rate increases from April 15 to May 15 averaging 8.9 percent for more than 700,000 wage earners were reported by 1,026 manufacturing plants out of a reporting sample of 33,791 plants employing 7,105,000 wage earners.

Despite increases in prices of farm products in recent months, retail food costs still are low relative to the earnings of nonfarm workers compared with 1929, due to increased earnings of workers in recent months. With their earnings well above the 1929 level, factory workers in mid-1941 could buy 58 foods at retail for about one-fifth less than in 1929. I quote the following extract from the statement issued on August 14, by the United States Department of Agriculture:

> The average factory worker in 1929 had to spend about a third of his wages on a standard food budget (58 items); so far this year he has had to spend about a fourth, according to Department of Agriculture Economist Louis H.

Bean. This means, Mr. Bean points out, that the average factory worker, after taking care of his food budget, has almost a fifth more to spend on commodities other than food than he had in 1929. The gain in purchasing power has been even greater than the gain in dollars since most nonfood items cost less now. So far this year, the average employed factory worker has been able to buy 35 percent more in the way of goods other than food than in 1929. For other wage-earning groups, however, the gain in purchasing power has been smaller.

Farmers know the evils of inflation and deflation because they have suffered more than any other single economic group from the disastrous consequences of the deflation which inevitably follows inflation. It has taken American agriculture 20 years to recover from the staggering blows it received as a result of the deflation which followed the World War. In fact, we are not yet fully recovered. If you will look at exhibits 2 and 3, you will see how far we have gotten in our recovery. We are willing to support effective controls and effective tax measures to prevent inflation, provided these controls are applied all the way across the board to all economic groups, including both industry and labor as well as agriculture, and provided taxes are equitably distributed on the basis of ability to pay.

5. We are strongly opposed to increased excise taxes, a general sales tax, or a manufacturers' tax; at least until other tax sources have been more nearly exhausted; and favor, instead, increased taxes based upon ability to pay.

One weakness in our present tax structure is that we have complicated it and have unfairly distributed the tax burdens by resorting to all kinds of taxes which are calculated to delude the citizens into believing they are not paying any taxes. I believe the average citizen would rather pay his share of the taxes based upon his income, and know that he is paying it than to pay a lot of indirect taxes which, though hidden, in many cases impose burdens out of all proportion to ability to pay. For that reason, we are strongly opposed to increasing the excise taxes at this time, as proposed in this bill; and respectfully urge that the increased income be sought out of individual income taxes, corporate income taxes, excess-profits taxes, and the like.

For similar reasons we are strongly opposed to a general sales tax or a manufacturers' excise tax at this time. They tend to raise prices and the cost of living and to encourage pyramiding of prices. They also impose burdens out of all proportion to ability to pay. We do not need to resort to such tax devices at this time, when the country as a whole is enjoying very large increases in income. We are also strongly opposed to making present excise taxes permanent, as proposed in this bill.

Most of the existing taxes will expire in 1945, under the present law. Because these taxes are not based upon ability to pay and because no one can foresee what our fiscal requirements are going to be several years hence, we believe it is unwise to establish these taxes now as a permanent part of our Federal tax structure.

Senator TAFT. Mr. O'Neal, your idea of reaching the increased wages is simply through lowering the exemption, is that the suggestion?

Mr. O'NEAL. Yes, Senator Taft.

Senator TAFT. It does not produce any money to speak of, according to the general report.

Mr. O'NEAL. As I understand it, we asked the Iowa State College to make an economic study of taxes and, as I understand it, it does. It raises a considerable amount of money.

Senator TAFT. You do not state that.

Mr. O'NEAL. In other words, if you lower the exemption, as I suggested there, showed by the Gallup poll, indicating there that the American people were perfectly willing to pay the taxes, if they knew they were going for defense purposes, I do not think there is any question about it.

Senator CLARK. Mr. O'Neal, when you lower the exemption the Treasury not only profits by the amount which is brought in by the new taxpayers, but by reducing the exemption you lower the surtax base of the other taxpayers who pay at the higher rate bracket. So that is where the money comes from, rather than the relatively small amount of money that comes from the new class of taxpayers that are brought in. You also increase automatically the surtax on every other taxpayer.

Mr. O'NEAL. That is true as to the bracket from $2,500 and $5,000 on up.

I really think, gentlemen, we need in this democracy a tax consciousness. I think we should have it. I am very frank and honest. I think the Gallup poll is 100 percent right. I do not think I have seen a single person—and I run across some isolationists now and then—that do not believe in the defense program, so to speak, and they all say, in fact, I never had one not to say, "Well, I would contribute," even the bootblack, "I would be glad to contribute my part to a defense program."

Senator VANDENBERG. I think you are right, Mr. O'Neal. Everybody that appeared before the committee was in favor of taxes, excepting the particular ones applying to him.

Mr. O'NEAL. Senator Vandenberg, I will plead guilty. I will say for the farmer—let me repeat, I am the exception now to the whole rule—the farmer pays more taxes than any group in the United States, and speaking for my crowd—and we are people in the lower income group, Senator Vandenberg—we are willing to pay our fair share. It will hit us more than any group in this country.

Senator CLARK. Unfortunately, Mr. O'Neal, the farmer does feel the effects of inflation last, that is, any benefits that come out of inflation, and the deteriorating influence of deflation first. That was proved at the last war.

Mr. O'NEAL. Yes. Sam Houston used to talk about the tax board and William "Poison Gas" Harding, you remember that. As the chart shows you, we went way up there. When food and fiber get too high, it is just as certain as the laws of the Medes and Persians, just as sure as death and taxes, as to what will happen to us. It hits us. The labor stayed up there, industry stayed up there—the record is here—but it hit us. We are deathly afraid of what may happen at this time.

I remember on several occasions I went down to see President Coolidge. I pleaded with him after the aftermath of the other World War. Immediately after the other World War, I pleaded with him to lead the procession begging Congress to let us pay the taxes while everybody had the money. I forget who on this committee were here at that time. Senator La Follette, you and Senator

George probably remember, and Senator Barkley. They had 2,000 millionaires as the result of the last World War—I forget what it was, but there was great wealth made, and we all said, "Let us go and pay the public debt now and get rid of it, while you have got the money to pay it with."

Senator BARKLEY. There are about 6,000,000 farmers in this country, are there not?

Mr. O'NEAL. About six and a quarter million.

Senator BARKLEY. Six and a quarter million. Of course, the large majority of them are heads of families, they are married.

Mr. O'NEAL. That is right.

Senator BARKLEY. Do you know what proportion of them are there who are married and have dependents?

Mr. O'NEAL. No; I really do not.

Senator BARKLEY. Assuming that the committee should recommend a reduction of 50 percent in the exemptions, bringing the head of the house down to $1,000, how many farmers, heads of families, would be affected and required to pay an income tax?

Mr. O'NEAL. It would hit a good many of them, since you and the Congress have been so good in giving us these parities, the parity laws, and if you see that the administration carries out the laws the farmer is better able to pay, and his income has been increased by so much.

Senator BARKLEY. I am trying to get, if you have any figures on it, out of the 6,000,000 farmers, how many would be affected.

Mr. O'NEAL. I really do not know, Senator Barkley. A good many. You see, Senator Barkley, in 1940 the per capita income of the farmers was $183.

Senator BARKLEY. Per year?

Mr. O'NEAL. Per capita; yes. You multiply it by 4 up here; in Alabama you may multiply it by 6 or 8, and in Georgia, and there is $732. That would be about the average. The average farm family, I think, is about 4¼, so you just multiply the $183 by 4¼, and that would run to $732.

Senator BARKLEY. What I am trying to get at is what seems to me to be obvious, that out of the 6,000,000 farmers there would be a small proportion of them whose net income, after all deductions, would be more than $1,000.

Mr. O'NEAL. Well, I think under this parity concept that we are working under now—I call it the $2,000,000,000 Bankhead bill that you passed—you are going to find that the income of agriculture will run about ten and one-half or eleven billion dollars this year, maybe a little higher, and it is going to raise the income of agriculture very effectively.

Senator BARKLEY. Well, I hope you are right. I am for that, as you know.

Mr. O'NEAL. Yes. Of course, what hits the farmer so terrifically is the ad valorem tax of the State, which takes everything that the farmer owns except the smoke that runs out of his chimney.

Senator BARKLEY. Due to the Bankhead program there will not be very much smoke coming out of the chimney.

Mr. O'NEAL. That is right, but they still use the smoke in the smokehouse for smoking meat in your State, Senator.

Senator BARKLEY. The best meat in the world, too.

Mr. O'NEAL. It sure is.

Senator VANDENBERG. On page 6, in stating your objection to the general manufacturers' sales tax, you say that it is because the low-income families spend so much on items subject to sales taxes.

Mr. O'NEAL. That is right.

Senator VANDENBERG. Well, on page 7 you say nine-tenths of all consumers and 63 percent of the total consumer expenditures went for food, clothing, and housing,

Mr. O NEAL. Yes.

Senator VANDENBERG. If we had a general manufacturers' sales tax which exempted food, clothing, and medicine, the exempted items, including some others that fall into no tax anyway, would be about 80 percent. That would leave about 20 percent taxable. Would that be particularly burdensome and unfair, in view of your general approval of passing this burden around?

Mr. O'NEAL. I think this, Senator Vandenberg: I watched the sales tax working in the States, and I have helped the legislatures sometimes, where we had no income and you know the States have gone to sales taxes, many of them.

Senator VANDENBERG. Yes.

Mr. O'NEAL. I, as a farmer and representative of farmers' organizations, said: "Do not exempt food. Do not exempt it. Whenever you start a tax and begin putting exemptions in there, your tax is going to fail to carry out its purpose." I doubt if the manufacturers sales tax would raise anything much, if you begin to exempt these various things.

Senator VANDENBERG. By substituting the 5-percent manufacturers sales tax, with those exemptions, as an alternative for all of these new nuisance taxes against which you complain, we would get a billion and a quarter dollars out of that.

Mr. O'NEAL. Yes.

Senator VANDENBERG. What I am inquiring is, Would you rather sustain a challenge to the equity of that sort of a tax on the basis of its being prejudicial to low-income families when your own figures show 75 or 80 percent of low incomes would not be touched by it at all? Do not you think under those circumstances that the challenge would scarcely lie against that sort of program?

Mr. O'NEAL. I think the principle is wrong.

Senator VANDENBERG. We are talking about the mathematics.

Mr. O'NEAL. The mathematics? You know they are using logarithms now and various things in the mathematics to work these various things up.

Senator VANDENBERG. I want to find out how you would work it yourself.

Mr. O'NEAL. I want to work it so that every fellow out here who pays the tax knows that he is paying it. I want to say to you, Senator, you will find in your great State of Michigan that the people themselves like that sort of tax. They hate the sneaking tax that goes underneath. Some fellow will give you a ticket when you buy a quart of liquor, and then the other fellow will put it in the price

of the quart. You are not any worse off. Of course, you do not know after you drink the liquor as to what happens, but the point is, I fundamentally believe the American people want to pay this tax. They want total defense. They want to know that they pay for it, and they want it in a direct way.

Senator VANDENBERG. I think you are going to get your wish on their knowing that they are going to pay it.

Mr. O'NEAL. I hope so. I think they are able to do it. I think the American people are patriotic. They believe in total defense, and they question sometimes why they are not getting it any faster than they are.

Senator SMATHERS. Mr. O'Neal, if we lower the income tax to $500 on a single individual, that is, the exemption, what do you think he ought to pay on that $500? How much money do you think he ought to pay?

Mr. O'NEAL. I rather approve of the Gallup poll. What to do, they say? I think it is about $8 or $4. I believe they would pay that much, gladly pay that much, or more. I really think so.

Senator TAFT. Mr. O'Neal, what bothers me is this: You do not want the excise tax from which we get eight or nine hundred million dollars, you want to lower the exemptions. I question very much whether by lowering the exemptions you would make up what you lose in excise taxes, and yet you want to raise more money than this bill is raising. I think, to be fair with us, you ought to state what can be raised by these exemptions, because I do not think it meets the requirements that you yourself laid out.

Mr. O'NEAL. I do not want to take the time of the committee, but I refer there to the study at Ames College. If you will let me put it in the record, I will be glad to do it.

Senator TAFT. That is what I am suggesting. If you do that, I would appreciate it.

Mr. O'NEAL. Showing how you broaden the base and raise the money.

The CHAIRMAN. Yes.

Mr. O'NEAL. Halving the exemptions would add about $537,000,000 to tax revenue at existing rates; about $1,042,000,000 at proposed rates.

Senator TAFT. Would you tax at higher rates? This bill would start at 9 percent, about, from the present exemptions. Would you tax those people more? Would you raise those rates besides lowering the exemptions?

Mr. O'NEAL. Yes, sir; it is going to hit you and I, it is going to hit us all as we go along.

Senator TAFT. In other words, you think the rates in this bill are not high enough as well as the exemptions being too high?

Mr. O'NEAL. That is right.

The CHAIRMAN. Mr. O'Neal, thank you.

Mr. O'NEAL. Thank you, Senator George. I appreciate very much the opportunity of appearing before you.

(Mr. O'Neal submitted the following figures and exhibits:)

TABLE J-3.—*Percentage of incomes of each income class taken by present taxes and by various hypothetical taxes each adding $4,000,000,000 to revenue*

Income class	Percent of income taken by present taxes [1] (1)	Percent of income taken by sales tax A [2] (2)	Total of columns (1)+(2) (3)	Percent of income taken by sales tax B [3] (4)	Total of columns (1)+(4) (5)	Percent of income taken by income tax A [4] (6)	Total of columns (1)+(6) (7)	Percent of income taken by income tax B [5] (8)	Total of columns (1)+(8) (9)
Under $500	22.5	8.0	30.5	6.4	28.9	0	22.5	0	22.5
$500 to $1,000	18.7	6.0	24.7	5.1	23.8	0	18.7	.9	19.6
$1,000 to $1,500	18.1	5.7	23.8	5.2	23.3	.9	19.0	1.4	19.5
$1,500 to $2,000	18.7	5.5	24.2	5.3	24.0	1.5	20.2	1.5	20.2
$2,000 to $3,000	18.5	5.2	23.7	5.3	23.8	2.0	20.5	3.4	21.9
$3,000 to $5,000	19.0	4.6	23.6	5.1	24.1	2.5	21.5	5.8	24.8
$5,000 to $10,000	19.3	3.9	23.2	4.5	23.8	8.4	27.7	8.0	27.3
$10,000 to $15,000	28.3	3.2	31.5	3.8	32.1	10.1	38.4	8.3	36.6
$15,000 to $20,000	35.7	3.1	38.8	3.8	39.5	11.5	47.2	8.7	44.4
$20,000 and over	43.2	2.1	45.3	2.7	45.9	15.7	58.9	9.2	52.4

[1] G. Colm and H. Tarasov, Who Pays the Taxes? These estimates include the defense taxes of 1940.
[2] 8.9-percent tax on all sales except housing, medical care, and education.
[3] 15.4-percent tax on all sales except food, housing, medical care, and education.
[4] 25.5-percent increase in normal tax on personal incomes and minor adjustments in surtax rates at higher levels, new normal rate being 29.5 percent.
[5] 14.3-percent increase in normal tax rate accompanied by lowered exemptions, these being $1,000 for a married couple, $500 for a single person, and $200 for each dependent. The new normal rate would be 18.3 percent.

TABLE J-4.—*Total amount paid by consumer units in each income class under alternative taxes*

Income class	Number of consumer units [1] (in millions)	Amount paid under sales tax A [2] (millions of dollars)	Amount paid under sales tax B [3] (millions of dollars)	Amount paid under income tax A [4] (millions of dollars)	Amount paid under income tax B [5] (millions of dollars)
Under $500	4.0	97	75	.....	.....
$500 to $1,000	9.0	428	353	.....	66
$1,000 to $5,000	8.3	575	514	93	146
$1,500 to $2,000	6.3	594	567	165	162
$2,000 to $3,000	7.2	891	895	352	599
$3,000 to $5,000	4.3	729	785	399	935
$5,000 to $10,000	1.2	312	353	684	650
$10,000 to $15,000	.2	75	89	246	201
$15,000 to $20,000	.1	55	65	206	155
$20,000 and over	.2	244	310	1,855	1,086
Total	40.8	4,000	4,000	4,000	4,000

[1] Consumer units include all families and all single individuals not living in a family group.
[2] 8.9 percent tax on all sales except housing, medical care, and education.
[3] 15.4 percent tax on all sales except food, housing, medical care, and education.
[4] 25.5 percent increase in normal tax on personal incomes and minor adjustments in surtax rates at higher levels, new normal rate being 29.5 percent.
[5] 14.3 percent increase in normal tax rate accompanied by lowered exemptions, these being $1,000 for a married couple, $500 for a single person, and $200 for each dependent. The new normal rate would be 18.3 percent.

TABLE J-5.—*Average amounts taken from consumer units in each income group by present taxes [1] and by alternative additional taxes*

Income class	Average income per consumer unit [2]	Average amount taken by present taxes	Average sum left after payment of present taxes	Average additional tax under sales tax A [3]	Average additional tax under sales tax B [4]	Average additional tax under income tax A [5]	Average additional tax under income tax B [6]
Under $500	$302	$68	$234	$24.20	$19.30	0	0
$500 to $1,000	796	149	647	47.80	40.60	0	$7.30
$1,500 to $1,500	1,227	222	1,005	69.90	63.80	$11.20	17.60
$1,500 to $2,000	1,734	324	1,410	95.40	91.90	26.10	25.80
$2,000 to $3,000	2,415	447	1,968	125.60	128.00	48.80	83.20
$3,000 to $5,000	3,735	710	3,025	171.80	190.50	93.50	218.30
$5,000 to $10,000	6,842	1,321	5,521	266.80	307.90	574.40	515.80
$10,000 to $15,000	11,510	3,257	8,253	368.30	437.40	1,164.00	951.20
$15,000 to $20,000	17,010	6,073	10,937	527.30	646.40	1,961.90	1,471.40
$20,000 and over	60,654	26,203	34,451	1,273.70	1,637.70	9,525 60	5,575.90
All groups [7]	2,134	469	1,665	[8] 98.10	[8] 98.10	[8] 98.10	[8] 98.10

[1] Includes Federal, State, and local taxes.

[2] A consumer unit is a spending unit, that is—either a family, or a single individual who is not a member of any family group.

[3] 8.9 percent tax on all sales except housing, medical care, and education.

[4] 15.4 percent tax on all sales except food, housing, medical care, and education.

[5] 25.5 percent increase in normal tax on personal incomes and minor adjustments in surtax rates at higher levels, new normal rate being 29.5 percent.

[6] 14.3 percent increase in normal tax rate accompanied by lowered exemptions, these being $1,000 for a married couple, $500 for a single person, and $200 for each dependent. The new normal rate would be 18.3 percent.

[7] These, including other figures in the tables, are estimates based on the assumption of a national income of $88,000,000,000.

[8] These must be the same since sales tax A, sales tax B, income tax A, and income tax B were all designed to add $4,000,000,000 to tax revenue.

EXHIBIT I

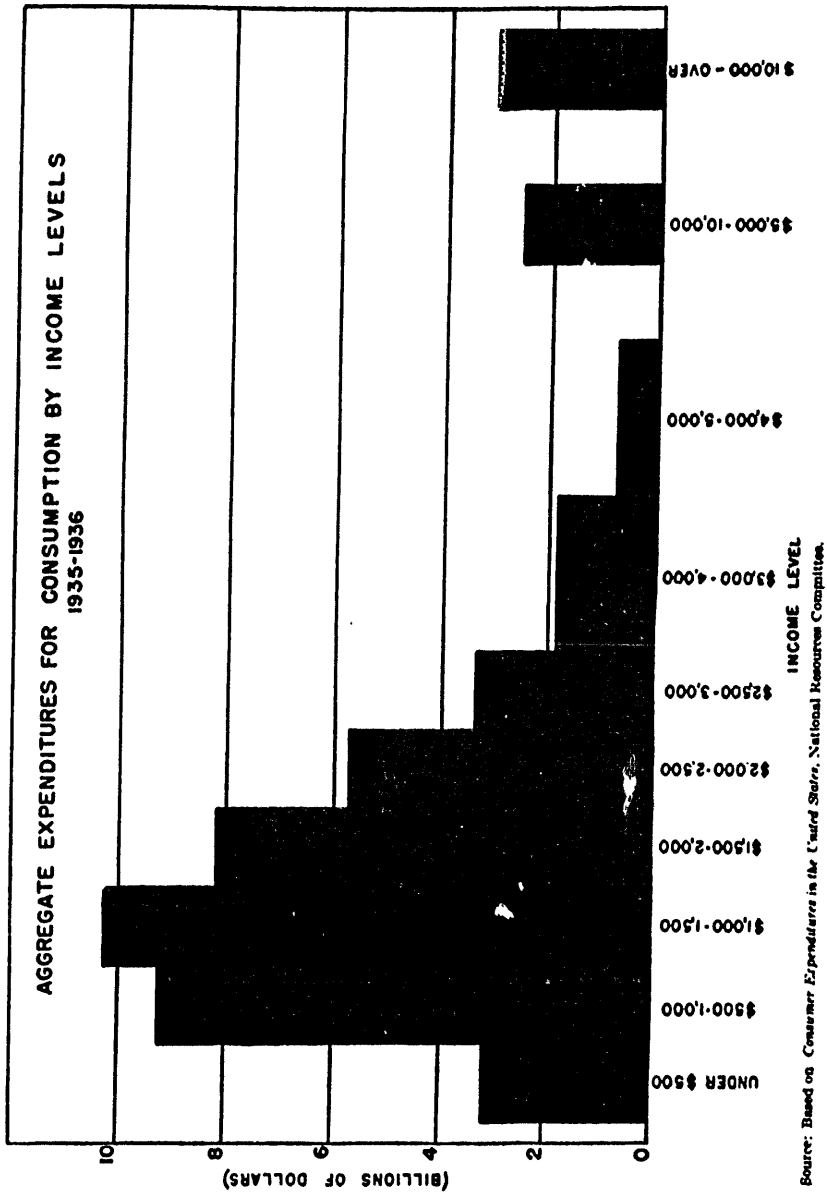
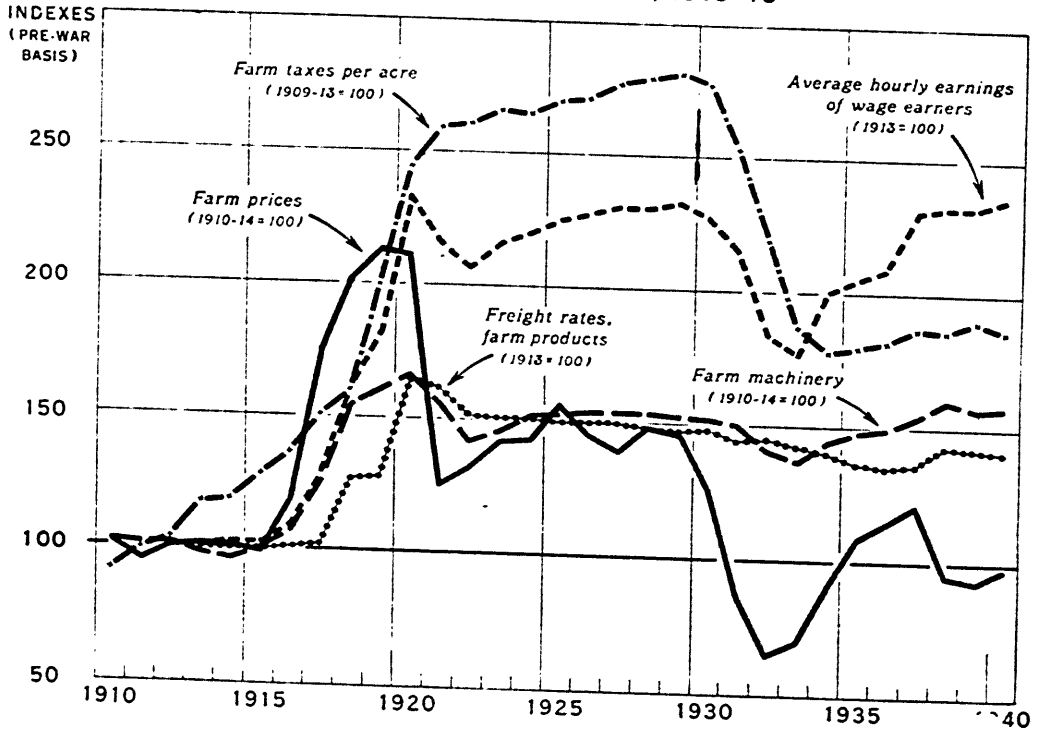

AGGREGATE EXPENDITURES FOR CONSUMPTION BY INCOME LEVELS
1935-1936
(BILLIONS OF DOLLARS)
0
2
4
6
8
10
UNDER $500
$500-1,000
$1,000-1,500
$1,500-2,000
$2,000-2,500
$2,500-3,000
$3,000-4,000
$4,000-5,000
$5,000-10,000
$10,000 - OVER
INCOME LEVEL
Source: Based on Consumer Expenditures in the United States, National Resources Committee.

EXHIBIT 11

FIGURE 9.—EFFECTS OF INFLATION AND DEFLATION ON COST FACTORS, ANNUALLY, 1910-40

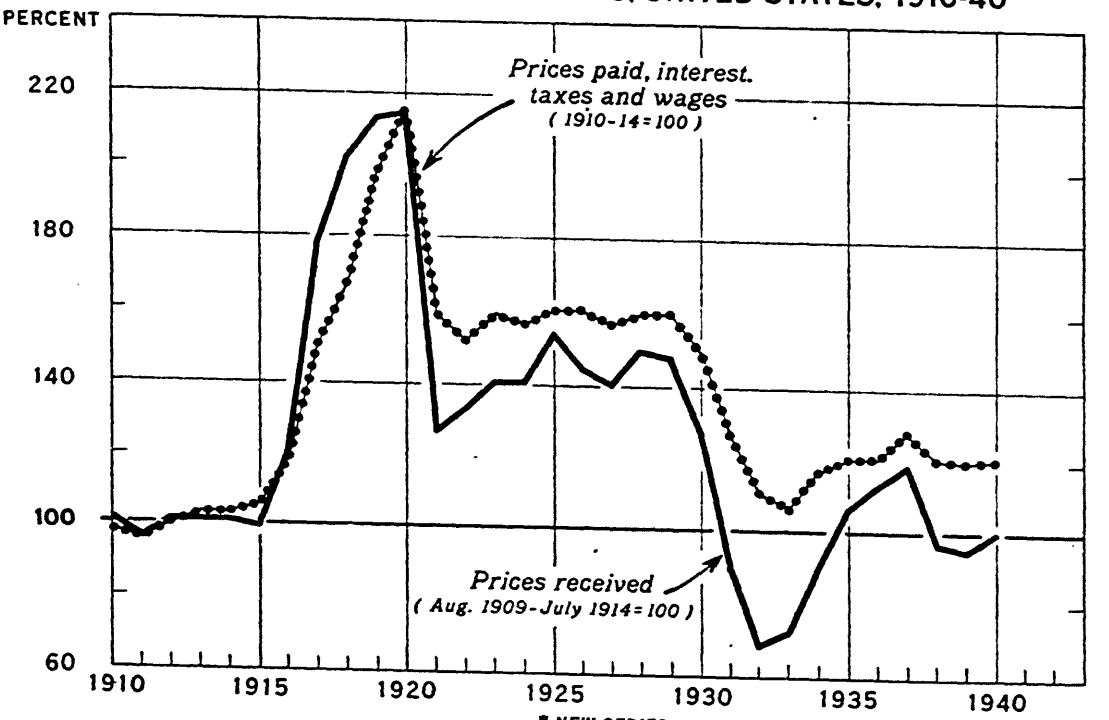


U. S. DEPARTMENT OF AGRICULTURE

NEG. 39315 BUREAU OF AGRICULTURAL ECONOMICS

EXHIBIT III

PRICES RECEIVED BY FARMERS, AND PRICES PAID INCLUDING INTEREST, TAXES, AND WAGES, INDEX NUMBERS, UNITED STATES, 1910-40*



U. S. DEPARTMENT OF AGRICULTURE

NEG. 39383 BUREAU OF AGRICULTURAL ECONOMICS

EXHIBIT IV.—*Comparative size of distributive shares transferred by enterprises in selected years*

[From: Survey of Current Business June 1941, p. 15]

Type of share	1929	1932	1938	1939	1940
Total national income	83,365	39,991	64,418	70,674	76,035
Business savings [1]	1,406	−8,232	−1,695	67	750
Total shares transferred by enterprises	81,869	48,223	66,113	70,607	75,285
	Percent of total transferred, by enterprise				
Total shares transferred by enterprises	100.0	100.0	100.0	100.0	100.0
Total compensation of employees	64.3	65.3	68.0	68.2	68.8
Salaries and wages	63.8	64.1	62.1	62.8	64.0
Supplements to salaries and wages	.5	1.2	5.9	5.4	4.8
Work-relief wages [2]	.....	.3	3.2	2.6	2.1
Social Security contributions of employers	.....	.....	1.8	1.8	1.8
Other employee income [2]	.5	.9	.9	.9	.9
Entrepreneurial (owners') withdrawals from enterprises other than agricultural [3]	10.2	11.4	10.3	10.0	9.8
Net income of unincorporated agricultural enterprises [3]	6.9	3.4	6.7	6.8	6.6
Total dividends, interest, and net rents and royalties	18.6	19.9	15.0	15.1	14.8
Dividends	7.3	5.7	4.8	5.3	5.5
Interest (net)	7.2	11.6	7.5	7.0	6.6
Net rents and royalties	4.1	2.6	2.9	2.8	2.7

[1] Business savings in incorporated and unincorporated enterprises other than agricultural.
[2] See footnote on corresponding item table 2.
[3] Includes returns for personal services of owners.

EXHIBIT V.—*Consumer expenditures for automobiles*

Income	Total expenditures	Percentage of total expenditures [1]
		Percent
Under $500	$63,000,000	.....
$500 to $750	118,000,000	2.6
$750 to $1,000	218,000,000	7.3
Total, $1,000 and under	399,000,000	9.9
$1,000 to $1,250	316,000,000	9.9
$1,250 to $1,500	315,000,000	11.5
$1,500 to $1,750	327,000,000	9.4
$1,750 to $2,000	327,000,000	8.5
$2,000 to $2,500	549,000,000	13.1
Total $1,000 to $2,500	1,834,000,000	52.4
Total $2,500 and under	2,233,000,000	62.3
Total for all income groups	3,781,000,000	100.0

[1] Less than 0.05 percent.

Source: Consumer Expenditures in the United States, National Resources Committee, table 30A, p. 89.
NOTE.—Consumers with incomes of $2,000 to $2,500 expend 13.1 percent of the aggregate expenditures for automobiles. This is the largest percentage of any single income group.

The CHAIRMAN. Mr. Charles W. Green.

STATEMENT OF CHARLES W. GREEN, SEDALIA, MO., PRESIDENT, INTERNATIONAL ASSOCIATION OF FAIRS AND EXPOSITIONS

The CHAIRMAN. Mr. Green, will you give your address and for whom you appear, and in what interest you appear?

Mr. GREEN. I am president of the International Association of Fairs and Expositions. I live at Sedalia, Mo.

The CHAIRMAN. You are addressing your statement before the committee to what particular thing, Mr. Green?

Mr. GREEN. Mr. Chairman, and gentlemen, we earnestly urge that you reinstate in this section 1701 of the Internal Revenue Code subsection (b) as concerns the agricultural fairs. We in the fair business are not asking for anything individually. We in the fair world are community builders. The county fair, the community fair, the State fair, and regional fair are for the good of the various communities in which we live.

All of you know, most of you I am sure know, about the State or county fairs, and you know that they have a tough time existing, and if you put this admission tax on us now you are going to put an added burden on us in the operation of these fairs that we are trying to do good with in our various communities.

Senator Vandenberg, in your State there are something like 90 county fairs.

Senator VANDENBERG. I am very well aware of that. I have attended each one of them.

Mr. GREEN. In Senator Taft's State there more county fairs than in any State in the Union. In our State of Missouri, where Senator Clark and I live, we only have 20 left. I used to go to Bowling Green, to the county fair, and it died because they did not have money to operate with.

Most of the people in the county fairs give their time and their energy and their money to build these fairs for the community good. The agricultural fair evidently does a definite good in our country, because they have existed as long as the human race.

Senator VANDENBERG. What is the average admission price?

Mr. GREEN. 25 cents, I would say.

Senator VANDENBERG. What would the tax be on this?

Mr. GREEN. It would be 3 cents, making a total of 28 cents. If you put this tax on, you might say that we could pass it on. If we pass it on to the patron it is going to come back to us. Those of us who operate the fair know that. It is for this reason, that it will come back to us in operation costs. We just simply cannot pass it on.

A million boys and girls in this United States today are in the 4-H club work that was started by the United States Department of Agriculture, and contrary to what many people might believe, most of those boys and girls come from families of very meager circumstances. It is the greatest movement for the youth that we have, and they come to us, and they have a tough time getting along, and we have a tough time getting along, we in the county fairs and even in the State fairs. Down in Senator Barkley's State, I happened to have been to his fair a lot of times, they get a small appropriation.

We operate on an appropriation, the State fairs do. I happen to manage a State fair. We operate on an appropriation, plus our earnings.

The fair business is a seasonal business, it is a business where all of the activities are focused on 1 week in the year absolutely. We have to make long-time contracts in spite of the weather. We set a date in December or August, and we just hope it will be good. There are 51 weeks in between the fairs, and we pick one out to make the fifty-second week. We just cannot change the contracts.

This is going to put an added burden on our fairs that we are trying to do a definite good with in our various communities.

Senator VANDENBERG. I do not think you made it quite clear as to why you cannot pass the tax on to the patron.

Mr. GREEN. I will tell you why, Senator Vandenberg, because of the various things about this tax it is just bound to come back, and it is in this way, that it will cut down our attendance. We might build the best fair in the world for a great educational and instructive program, and without attendance it all goes to naught.

Senator VANDENBERG. You mean people at this particular moment would go to a fair for 25 cents that would not go to a fair for 28 cents when the other 3 cents was in support of national defense?

Mr. GREEN. Every single individual fair officer—I believe I have talked with all of them individually—and the rest of us are in favor of the defense program, but we, as a body of people, may I say, are community builders, and you are spreading that out. So many of these people just simply will not come. We have to absorb it in a lot of ways, and it adds to the administrative cost of our own fairs that we now operate, and we are just up to the limit now. Eighty-five percent of the county fairs of the State of Pennsylvania are in the red now. We have only 22 county fairs left in my State, and I think that is true in most of the States.

Up in Senator La Follette's State, I am not so sure what your county fairs are doing up there, but if they tried to pass this on its cuts them down in their attendance.

Senator VANDENBERG. Then your answer to my question is people will not go to a fair for 28 cents when they will for 25 cents, even though the other 3 cents is for national defense?

Mr. GREEN. Not exactly, Senator. You just do not have any idea at all how tough it is to get them to come even at 25 cents.

Senator CONNALLY. Why do not you get a football game to attract attendance?

Mr. GREEN. Senator, I have been to a football game at your State fair, in the Cotton Bowl at Dallas. It is a great thing.

Senator CONNALLY. Plenty of them come.

Mr. GREEN. Yes; they do, but you know fairs were built primarily for agriculture and livestock. There are just two basic principles for the fairs, the agricultural and livestock, and then the recreational and entertainment is the other one, and that is only to draw the attendance, not to help us to pay these premiums. If we pass the tax on, we are going to have to cut down. We are very liable to have to cut down on the premium money that we set up for these people.

Senator VANDENBERG. If you pass it on, why do you have to cut down on premiums?

Mr. GREEN. They just simply will not pay it. We have tried it in various different ways. We tried to raise the admission fee from 25 cents to 30 cents, and every time we do that we decrease our attendance at the fair.

Senator VANDENBERG. You do not have the patriotic appeal then if you have a great mass unwillingness to pay.

Mr. GREEN. Individually, we will still pay it, Senator. Individually, we want to do that. We have got 30 or 40 people putting up the money for the fair, their money has gone into it. That is true of most of the county fairs and a good many of the State fairs. Senator Connally's State fair is owned by representative businessmen of Dallas, Tex., it is called the State Fair of Texas, but it is not owned by the State.

Senator CONNALLY. The ground is owned by the city of Dallas.

Mr. GREEN. They call it the State Fair of Texas, and it is known as the largest State fair in the United States.

Senator BARKLEY. Where would you draw a line between admissions that ought to be taxed and admission that ought not to be taxed?

Mr. GREEN. We are already contributing some money, Senator, for tax in commodity sales, and in midways and carnivals that we have in our fair grounds, but we are just struggling to keep living, to keep going.

Senator BARKLEY. You probably did not understand my question. We have a great many admission taxes on moving-picture theaters and all sorts of entertainment, fairs of various kinds. Where would you draw the line by saying "These shall be taxed and these others shall not be taxed"?

Mr. GREEN. Senator, the moving-picture man is operating a business for his own private gain.

Senator BARKLEY. You would tax him?

Mr. GREEN. We in the fair business are not trying to make money we are not operating for money.

Senator BARKLEY. You think a tax on the theater is justified?

Mr. GREEN. I think a tax on any business is justified, but this business is a community business. Each of us in the various sections around there, we give our time, our money, and our energy to keep the fairs going.

Senator BARKLEY. Would you think the average man or woman would rather pay this 3 cents, or whatever it is, for admission or have his or her exemptions reduced by 50 percent?

Mr. GREEN. I would not say anything about that, Senator Barkley, but I am only thinking from the standpoint of the fair business, and trying to keep them going and keep them from folding up, in other words.

The CHAIRMAN. You merely want this provision put back in the law which was stricken out by the House bill:

Any admission to agricultural fairs, if no part of the net earnings thereof inures to the benefit of any stockholders or members of the association conducting the same, or admissions to any exhibit, entertainment, or other pay feature conducted by such association as part of any such fair, if the proceeds therefrom are used exclusively for the improvement, maintenance, and operation of such agricultural fairs.

That is all you ask?

Mr. GREEN. That is right.

Senator BARKLEY. Does that apply to midways and sideshows within the fairgrounds or just the gate admission?

Mr. GREEN. What we are talking about is just the outside gate admissions and any grandstand admissions we might have.

Senator BARKLEY. It does not apply, then, to any concessions?

Mr. GREEN. No, sir; not to any concessions; not at all. We are simply trying to keep our American fairs living, to keep them from folding up.

Senator CONNALLY. Is not your chief difficulty not from the price of admission as much as it is from competition from other forms of amusement, the automobile, for instance?

Mr. GREEN. We are competing with the radio entertainment, yes, and the screen entertainment. Absolutely we are.

Senator BARKLEY. You do not compete except for 1 week, though, out of the 52 weeks?

Mr. GREEN. That is right. We are the biggest gamblers in the world.

Senator CONNALLY. Would a tax of 3 cents cause you to fold up?

Mr. GREEN. We have tried to build our plant up. A man goes to our fair and he sees a bull or a cow, or chickens, or a pig, or something that his neighbor has—we live by comparison anyway—he sees a better one here and that will stimulate that man to be a better farmer, to grow better corn, to have better stock. You know President McKinley, I believe, said the fairs were the show window of agriculture. Our fairs were founded on agriculture, and we have had to add to these fairs some sort of amusement, some sort of entertainment, which only helps us to draw in a gate that will help pay these premiums, that we think are doing so much good.

The CHAIRMAN. Sometimes political speeches are made inside the fairs.

Mr. GREEN. Senator La Follette's fair is going on right this week, and so is our fair. The Governor will be down there, he will be telling about a lot of grand things that we are going to do, and we are going to listen to him, we are going to "hurrah," and then we are going to the next fair. We want them and we need them.

Gentlemen, the fairs are helping the defense program pretty much and the O. P. M. has recently approved fairs very much. Over at the Eastern States Exposition right now the Governor has sent in a big exhibit there, a tremendous exhibit. I tried to get one at Sedalia, but I did not get along very well with it. I think every fair in the United States wants to help in the defense program. We have an Army recruiting station in my fair grounds right now. My fair started yesterday.

Senator CLARK. This bill will not catch us this year.

Mr. GREEN. Senator, we do not want it to catch us any time. We want to keep these fairs going. You know they have been going a long time. They must be pretty good, because you go back to Genesis and you read about the fairs at Tarshish.

Senator CONNALLY. Those fairs that you talk about charged 15-cent admissions.

Mr. GREEN. They did not have any then, Senator.

Senator CONNALLY. I know they did not.

Mr. GREEN. I mean way back there. I am going back in history. They were simply trade fairs, industrial fairs, things like that then. They just moved about the country. Now we have them in permanent places. Most of the fairs in the United States look like a widow woman's place.

Senator CLARK. I have got four shares of stock that I will give you.

Mr. GREEN. I know you would not ask me much for them.

Thank you very much, gentlemen. We would like the privilege of submitting a brief, more in detail in support of our earnest wish, and hope that you will help us in the fair world to keep these fairs going.

The CHAIRMAN. Yes, sir; get it in this week.

Mr. GREEN. Thank you very much.

The CHAIRMAN. Mr. Courtland Jones, of Denver, Colo.

Senator JOHNSON. Mr. Chairman, Mr. Cortland Jones is in the room, but in order to conserve the time of the committee he simply wishes to say he concurs in the testimony offered by Mr. Green, that he does not care to urge the matter further. The subject has been well covered by Mr. Green.

The CHAIRMAN. I thank you very much, Senator. If Mr. Jones should desire to, he may file a memorandum.

(The following letter was submitted for the record:)

INTERNATIONAL ASSOCIATION OF FAIRS AND EXPOSITIONS,
Richmond, Va., August 22, 1941.

SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

GENTLEMEN: This brief supports the verbal testimony made by Mr. Charles W. Green before your committee on Monday, August 18, 1941.

This association wishes to be placed on record as opposed to that part of the revenue bill of 1941 which takes away the present exemption on the payment of admission taxes now enjoyed by agricultural fairs. Specifically, we would like restored to the revenue bill of 1941 section 1701 of the Internal Revenue Code, subsection B, agricultural fairs.

In order to tell you how the present revenue bill would affect all fairs, if enacted, permit us first to outline briefly what our purposes and accomplishments are.

What are our purposes?

Our basic function is to provide a medium for mass education through observation, comparison, and study.

To accomplish this—

1. We must have an adequate physical plant and facilities. In a great many States, the State itself has erected a substantial plant, using State funds. In many other States, counties, municipalities, and individuals have erected plants. Many of these large plants are actually owned by either the State, county, or city.

2. We must have sufficient income to accomplish these objects. For a long period of years States, counties, and cities have substantially appropriated funds to carry out this work. The remaining revenue needs must practically all come from the sale of admission tickets.

What do fairs accomplish?

1. They furnish the major medium for 4-H Club members to present their results and accomplishments annually. Started by the United States Department of Agriculture, the 4-H Clubs now have over 1,000,000 members.

2. They offer their facilities and prize money as encouragement to other boys' and girls' movements, such as the Future Farmers of America, vocational agricultural schools, and public-school students both rural and urban.

3. Because of substantial cash prizes livestock exhibitors compete and from this, improved breeding methods and livestock methods are attained. At no other place can a farmer see so many kinds of livestock and talk to many exhibitors who are showing the actual product as at a fair. Livestock is still considered the basic element of agriculture.

4. Agricultural products on display promote improved agriculture both in methods and production. Within the last month Secretary of Agriculture Claude Wickard said "Food will win the war."

5. Fairs provide the vehicle for the display and study of modern methods in home economics, home management, and home making.

6. Fairs furnish an important medium for Federal, State, and county agencies to reach the public directly, an invaluable method of contact for disseminating factual and educational material.

The United States Department of Agriculture Office of Exhibits, State agricultural colleges, county agents, and other governmental bureaus in every State use the fairs as a means of reaching people.

What our Government thought of fairs in 1917

In 1917 the fairs offered their services to the Federal Government. The President of the United States, the Federal Food Administrator, the Secretary of War, and the Federal Railroad Administrator, all urged the fairs to continue operation as a means of--

1. Encouraging food production.
2. Maintaining national morale.

What the fairs can do in the present crisis

1. Keep up the morale of our citizens by providing wholesome diversion, clean recreation, and public interest.

2. Furnish a medium for the Federal and State governments to popularize the defense program. As one example, the President, Secretaries Knox and Stimson have approved the huge 6-acre defense exhibit at the Eastern States Exposition and for some time have had a staff of Army officers planning this exhibit.

3. All fairs have offered their facilities to Government agencies in furthering and promoting defense activities.

What would be the effect of a tax?

1. It would reduce the attendance.

(*a*) Actual experience of many of our large State fairs show that people do compare entertainment offered at a theater, for instance, with air conditioning and other conveniences in comparison to an outdoor fair with weather which may be too hot or too cold, or rainy, pushing crowds, and traffic problems in getting to the fair.

(*b*) If the proposed gasoline rationing does go into effect on the eastern seaboard it will definitely hurt the Sunday attendance at many fairs and in some cases will result in a financial loss because Sunday is a big day.

(*c*) Because of the things mentioned above a substantial number of State fairs have reduced their outside gate admission to 25 cents. It has made a difference between a profit and a loss to many fairs.

2. It would reduce revenue of a fair.

This would mean fewer patrons which would mean—

(*a*) Fairs would be forced to reduce prize money. It can be proven statistically a thousand times over that the volume of exhibitors in every department, including the boys and girls departments, are definitely influenced by the amount of prize money offered.

(*b*) A reduced number of patrons would lessen the values of a fair to everyone, not only the patrons but to exhibitors, which would include many Federal and State departments.

(*c*) The reduced values to everyone concerned would mean the closing of many fairs, especially the smaller fairs of which there are over 1,500.

(*d*) We have written statements from a large number of fairs stating that they could not pass the tax along to their patrons, they could not absorb it and they definitely would not hold a fair if required to pay a tax.

(*e*) The tax would penalize an institution which for every reason should be encouraged.

3. Present hazards of fair operation are almost insurmountable.

(*a*) No fair is organized to make money, and very few actually make money. The best men in every community are its directors because it is considered a community builder.

(*b*) A large number of our State fairs are financed by the State because they are considered educational.

(*c*) Fairs operate for 1 week out of 52.

(1) A date once set cannot be changed.

(2) Long-term contracts must be made in order to have certain departments.

(3) Premium offerings must be announced early in the year so that farmers and others can grow the crops to be exhibited.

(4) Because of these commitments, quick adjustments by a fair are absolutely impossible.

(5) Every year many fairs show a financial loss solely because of the weather. There is nothing a fair can do to protect itself. When this occurs either the taxpayers' money is taken out of the State treasury to pay the loss or private individuals do the same.

To summarize

1. All fairs are operated as educational institutions.

(*a*) Without this background States, counties, and cities would not continue to finance their operations, and their losses.

(*b*) Without this background the Federal and State governments, State colleges, and others would take no part in them. Neither would every type of youth-work organizations.

2. The first and major step will be the reduction of premiums offered. This will affect the exhibits, will in turn affect the interest of the patrons, and will definitely reduce the attendance. By the time the cycle is completed there is no question but that many fairs will be closed.

3. Up to this date and after repeated Federal hearings over a period of years, the Federal Government has recognized the values of a fair and have not imposed an admission tax. Without a fair's inherent soundness a tax would have been imposed years ago.

4. If a tax is finally imposed it will do the following:

(*a*) A substantial number of small fairs will go out of business rather than try to operate. A number of them have gone on record stating that this will be their decision. All of the State and regional fairs will try to rearrange their budgets so as to try to live.

Experienced fair men have found that fair operation is different in many respects than the operation of other lines of business. We have found that a difference in the amount of prize money offered can quickly and definitely and completely change the appearance and enthusiasm for a fair. We have found that the admission price does affect the volume of patronage. Unlike a theater where people are buying entertainment only, a fair must have a popular price and it must be low. Approximately half of the State fairs now have a 25-cent gate. They have been forced to drop from $1 to 25 cents. The admission charges at our grandstands have gone through the same evolution. Every time the revenue is decreased the services we offer must necessarily be decreased. The only fairs that can overcome this condition are the State fairs where an additional appropriation from the State treasury can be made. All other fairs must suffer.

Respectfully submitted.

INTERNATIONAL ASSOCIATION OF FAIRS AND EXPOSITIONS,
CHAS. A. SOMMA,
Chairman, Government Relations Committee.

Mr. W. F. Satterthwaite? Is Mr. Satterthwaite in the committee room?

(No response.)

The CHAIRMAN. Mr. Charles Gold, of New York City?

Mr. Gold.

Mr. GOLD. Mr. Chairman, may I point out that three witnesses supporting the present proposal testified last Thursday and took some 2 hours of the committee's time. I know that since then a new rule has been invoked limiting the time of speakers to 10 minutes. I am asking the chairman if I may have my time extended to one-half hour and I have arranged with the two subsequent speakers to waive their time in my favor, if the chairman will permit.

The CHAIRMAN. You are speaking for all three?

Mr. GOLD. I am speaking for all three.

Senator CONNALLY. We usually charge 10 straight and 3 for a quarter.

Mr. GOLD. I will be happy to limit my time to 25 minutes.

STATEMENT OF CHARLES GOLD, NEW YORK, N. Y., REPRESENTING RETAIL MANUFACTURING FURRIERS OF AMERICA, INC.

Mr. GOLD. My name is Charles Gold, I am from New York City, and I appear for and on behalf of the fur tax committee which represents and speaks for the Nation-wide retail fur industry. This committee is sponsored by the only Nation-wide fur association, the Retail and Manufacturing Furriers of America, which is a non-profit-making incorporated association made up of the following affiliated associations:

Greater New York Retail Furriers Associations, Inc.;
Chicago Retail Manufacturing Furriers' Association;
Milwaukee Retail Manufacturing Furriers' Association;
Master Furriers' Guild, of Washington, D. C.;
Furriers' Association, of Baltimore, Md.;
Iowa-Nebraska Retail Furriers' Association;
State of New Jersey Retail Manufacturing Furriers' Association;
Indiana Sales Retail Fur Merchants' Association;
Manufacturing Furriers' Association of Pittsburgh;
Buffalo Fur Merchants' Association;
Albany Retail Furriers' Association;
Furriers' Guild of Hartford;
Retail Fur Merchants of New Haven;
Colorado Springs Retail Fur Association;
Furriers' Guild of Boston;
Greater Cincinnati Retail Furriers' Association;
Cleveland Retail Furriers' Association.

Senator CONNALLY. It is a sort of holding company?

Mr. GOLD. No; it is an association which enjoys a membership of furriers in many cities, among them Chicago, Milwaukee, Washington, D. C., Baltimore, and the other cities in the list I have enumerated. Those are the membership associations affiliated with the parent body.

In addition, the committee is supported by associations in Detroit, San Francisco, Portland, Spokane, St. Louis, Seattle, St. Paul, and Minneapolis, besides a great many individual retail furriers unaffiliated with any association for the simple reason that there are no associations in their vicinity.

I have been associated with the retail fur industry for many years and, therefore, know something of it for that reason, as well as the fact that my wife has been and is actively engaged in operating her own retail fur establishment, continuing an enterprise which is more than 50 years of age.

Senator CONNALLY. Are you counsel for this organization?

Mr. GOLD. Yes.

Senator CONNALLY. You are a lawyer, aren't you?

Mr. GOLD. Yes; I am, sir. We come here to suggest that for one time the Government can use a bottleneck to its own advantage, which I hope to establish to the satisfaction of this committee.

We oppose section 2401 of the proposed law, which is the section pertaining to the tax on furs. We feel that the proposal is uneconomic, inequitable, and so difficult of collection that it would prove unprofitable to the Government.

That, too, we hope to establish to your satisfaction.

The CHAIRMAN. You favor putting it on the manufacturer or wholesaler?

Mr. GOLD. No, sir; only as a second alternative. We go beyond that. We submit that the tax should be placed at the point where there are just 111 handlers of furs—the dressers or curers of the furs.

In other words, we suggest the levy be made at the bottleneck of the industry; the place through which all skins must pass, and we point out in that connection that no skins can be used for any purpose, whether in fur coats, gloves, trimmings, millinery, and so forth, unless it is first subjected to a curing treatment.

The CHAIRMAN. I don't want to anticipate you, but the dressers own the furs, skins?

Mr. GOLD. No, sir.

The CHAIRMAN. But you want to tax at that point?

Mr. GOLD. Yes; we submit this plan: That the tax be 10 percent at the point of dressing, computed on the value of the skins, plus the dressing charge; the tax to be paid at the time of dressing and curing by the skin owner, whether he be a manufacturer or skin dealer. At the same time he would file duplicate affidavit of value with the dresser; the dresser, in turn, would collect the tax and pay it over to the Government.

Senator BARKLEY. How does the value of that skin at that particular point compare with its value after it is finished and ready for a garment?

Mr. GOLD. Well, our calculation is some 35 percent, on the general average; perhaps as high as 40 percent of the price at which they are sold to the consumer; but there are many considerations which we think weigh in our favor.

Senator CONNALLY. Let me ask you this: Don't many of the manufacturers of furs do their own dressing? They would if you made the tax at the point of dressing, as you suggest?

Mr. GOLD. No; it takes a lot of equipment and considerable skill, and there is an awful lot of risk involved in that, and I doubt very much that they would take the risk of dressing, themselves.

Senator CONNALLY. These muskrats we have in the South, Louisiana, where do they dress those?

Mr. GOLD. They find their way, in most instances, to the markets in Chicago and New York, where they are sold in auction lots, large quantities, and then the purchasers send them out to a dresser for dressing or curing.

Senator DAVIS. How many manufacturers of furs are there in the United States?

Mr. GOLD. There are some 2,300 manufacturing furriers and over 4,000 retail furriers. There are, if my recollection serves me well, 25,000-odd specialty shops as well as 5,000 department stores who might be handling furs and fur-trimmed garments. Under the proposed tax the manufacturers of fur coats, fur-trimmed coats, and everyone in the various categories selling fur garments must report to the Treasury Department their sales made directly to the consumer.

Senator DAVIS. How much do you suppose it would cost to collect that tax?

Mr. GOLD. I would not venture a guess. It would take a great deal of money and manpower to collect this tax in view of the fact that there would be involved millions of pairs of fur gloves, gloves made of fur, which are sold in small ware stores and shops, there are thousands of these little ladies stores and shops that sell this item who would have to report under the proposed law. We figure that, in addition to those outlets, there would be the stores which sell furred millinery and other fur novelties; in all, upward of 70,000 reporting outlets.

Senator DAVIS. If taxed at the source, how many outlets would you say there would be from which the tax would be collected?

Mr. GOLD. All told, there are 111 fur dressers who process skins for the entire market, made up of manufacturers in the big cities, some skin dealers, and a few custom furriers; but all told, there are only some 1,500 who own the skins and send them to the processors for dressing.

Senator BARKLEY. Why do you suggest that this 10 percent be levied on the value of the raw skin, instead of waiting until it is processed and levying a tax after that operation, when its value is thereby enhanced?

Mr. GOLD. We do; not on the resale price, but on the value of the skin and on the charge made for the dressing.

Senator CLARK. You are not objecting, then, to the payment of a tax of 30 percent at the time of dressing rather than a 10-percent tax at retail?

Mr. GOLD. I don't think there is need for that amount of tax. We say that at the point of retail sale, the resistance we will meet from customers; the evasions which will take place in the industry on the part of unscrupulous merchants, and by those many outlets who will not even know there is a tax, such as these little shops, we say that all these will serve to reduce the amount collected to a point where it will not exceed the revenue obtainable under our plan by which all those unsatisfactory conditions would be obviated, by a tax at the point of dressing.

Senator CLARK. Then the tax would be 30 percent instead of 10 percent?

Mr. GOLD. You see, under the retail sales tax, if the fur be worth more than the other items of value in the garment, in other words, if it is not the component of chief value the tax provision does not apply. Under the old manufacturers' tax, manufacturers developed garments wherein the fur going into the garment was worth less than the cloth, and they had that skill developed so well the Treasury Department admitted then the tax was not worth while. Chairman Doughton, in 1938, reported that the tax occasioned numerous difficulties, and finally recommended that it be removed. Now, I respectfully ask if it caused so much trouble dealing directly with the manufacturer under the old tax, how much more difficult would it be to determine the question which must be decided under the proposed bill, namely, the component material of chief value in the garment. The retailer knows nothing at all about the cost of production and the manufacturer will not give him the information; it is a trade secret.

Senator RADCLIFFE. I understand your objection to the tax on the retailer is based on the cost of collection and also on sales resistance?

On what distinction would you attempt to place the question of sales resistance in the matter of a fur item and other commodities that might be subject to retail taxes? In other words, is there anything in the nature of that business, your business, that would justify such a distinction?

Mr. GOLD. Well, to begin with, it is here proposed to levy a tax of 10 percent. Furs usually run pretty high——

Senator RADCLIFFE (interposing). I mean in the nature of the business itself. Do you feel that the sales resistance in regard to a matter of furs in the case of retail sales would be greater than that to be found in the sale of other commodities? Is there anything distinctive to the fur business that would accentuate such resistance in the sale of those items?

Mr. GOLD. Yes; I imagine the higher price of furs. Women might consider they were buying something in the nature of a luxury, and adding 10 percent would make it seem very much a luxury and in many instances push the price beyond their ability to buy, and they would decline to purchase.

Senator RADCLIFFE. Is that because furs are regarded as a luxury?

Mr. GOLD. The better-priced furs are so regarded, and the proposed tax might serve to convince the buyer. Talking of the lower-priced furs, they are not luxuries and, in that respect, cheap fur coats, selling at $59 and $49 would bear a tax, whereas cloth garments trimmed with fur and selling for $300 and $400 under the present law, might not, in many instances, be subject to such a tax. That is true for the simple reason that every item of expense going into such a fur-trimmed garment, the material itself, the items of operation, cutting, tailoring, sewing, sponging, everything, every conceivable expense, by the ruling of the Treasury Department, would be figured into the value of the cloth skeleton. It has happened in the past and I can see that it will happen again, that very expensive cloth coats will not bear any part of the tax and $59 fur coats will.

Senator RADCLIFFE. If there must be a tax, you prefer it at the point of the dresser and, if that is not practicable, at the point of manufacture, rather than the retailer?

Mr. GOLD. By all means. It has been said we are merely trying to shift this tax from the point of retail to the point of the dresser. Now, the manufacturer made that statement and goes on to say that the retail sales tax is the easiest method of all to collect for those engaged in the industry, for the simple reason that no one will be required to pay a tax until the item is sold to the consumer.

Senator BARKLEY. This item under your proposal would raise only one-third of the revenue?

Mr. GOLD. That is not so, sir. We will be catching all the furs used in trimming cloth garments, which otherwise might escape, especially in view of the way they are planning these cloth garments. We will be catching all the skins used in millinery lines; we will be catching all the skins sold by the tax evader, and, we know there would be plenty of those; and we will be leveling off the competition of wholesalers who will thus be unable to pass on the savings in taxes. So the customers' resistance, the evasions, the skins that are lost in the trimming of cloth garments, the skins used in millinery and gloves, and there are millions of those—all of those items will earn a revenue for the Government; whereas, under the revenue bill as now written, they will bring nothing.

Senator CONNALLY. It helps your business to tax a garment, not of fur, because it helps to sell a garment all fur?

Mr. GOLD. I didn't catch that.

Senator CONNALLY. I say it helps your business to have a tax on cloth garments—garments not of fur, because it helps to sell a garment, a fur garment?

Mr. GOLD. Oh, yes.

Senator CONNALLY. That is true?

Mr. GOLD. Yes.

Senator CONNALLY. So you have a double purpose—you get rid of the retail tax and you hurt your competitor under this plan?

Mr. GOLD. We put our competitor on an even, level basis.

Senator CONNALLY. That is true. Now, you speak about this sales resistance. You are going to have an increased price under this tax, regardless of where paid. Wouldn't the prospective customer just feel as well about it, be just as happy, if she knew the price was less but she was also paying a 10 percent tax in there, than if you told her the tax was already placed and had been figured in the price? Wouldn't she sort of say, "Well, this coat is only worth $150, but I have to pay $15 tax?"

Mr. GOLD. The reaction is not that at all, sir. We know that where there are sales taxes, a great many of these women make an effort to devise schemes to avoid the tax. I am told that these women resort to the practice of having such things sent to their country homes, and ordered from their country homes, to get away from the city limits, and thereby avoid paying a 2 or 3 percent sales tax.

Senator CONNALLY. They could not go to Europe to avoid the United States tax?

Senator BAILEY. That is only in New York.

Senator DANAHER. Mr. Gold, I have here a splendid letter, and I want to check the facts as stated in it. The writer says there are less than 120 skin dressers in the United States, most of them located in the cities of Chicago and New York. Is that correct?

Mr. GOLD. That is a matter of fact, sir. That is substantially correct; and we can go one step further and say 90 percent of the furs processed in this country are dressed by 25 firms in 2 metropolitan areas, New York and Chicago; and if the Government wished to go that far, they might place experts in those places and have a guaranteed collection of 90 percent of that tax.

Senator DANAHER. I understand in Canada the tax is levied on the dresser and the Canadian Government has found it works successfully.

Mr. GOLD. Yes; that is so and has been so for 22 years.

Senator DANAHER. And articles of which the fur is the chief component of value would not be then left to any such uncertain and indeterminate test as under this tax at retail?

Mr. GOLD. Yes; that is true. I might point out, in the same connection that Mr. Printz, speaking the other day, stated that one storekeeper might have in his establishment two cloth-skin garments, so resembling each other that the experts even could not differentiate between them in point of value, and that, nevertheless, one might be taxable and the other not taxable, as the cost might have varied due to the fact that skins might have been purchased in different seasons, and because of other conditions.

Senator RADCLIFFE. Mr. Gold, do you happen to know whether the skin dressers have expressed any opinion as to where this tax should be collected?

Mr. GOLD. Some of the dressers have, but the largest dressing and dyeing association, representing some eight or nine who do about 75 or 80 percent of the dressing and dyeing of furs in this country, have not gone on record either way. As a matter of fact their largest member was the chairman of a committee which was sponsoring the very thing I am supporting here today; a dressing tax.

Senator RADCLIFFE. Do you know of any argument the manufacturers have advanced as to why the tax should not be levied on them?

Mr. GOLD. Yes; their main argument is, first, that no one need finance the tax until the garment is sold to the customer when, for the first time, the tax will be payable. We say we are ready to advance whatever moneys are necessary toward financing the tax to avoid the resistance which would inevitably follow an attempt to collect the tax at retail, and the many other difficulties we experienced at the time the last tax was in effect. Then, we submit that the Government will get as much money from collecting from 111 sources as they would get from the 70,000 to 75,000 potential retailers even though the rate be 10 percent.

Senator TAFT. What about the difficulty of valuing at the time of dressing?

Mr. GOLD. There are three or four answers to that. First of all, we are convinced that the values will be accurate and correct, because the skin owner will be committed to his own value and will be limited by those values, in the event he presents a claim for damage or loss occasioned by dressing.

Second, his own purchase bill in the auction rooms will be persuasive evidence, and I might say a good portion of the skins used in this country are so bought. His own bills can be used to refute a false valuation.

Thirdly, we say that if he values his skins at less than the true value, the Government will not be out of pocket because at the end of the year, he will show a greater profit for income-tax purposes. So I think it is more than likely he would prefer to make proper and accurate valuation rather than to pay the increased income tax in higher brackets at the end of the year.

The CHAIRMAN. From whom do you propose to get this tax?

Mr. GOLD. We propose that the tax be collected from the 1,500 skin owners who send these skins to be dressed.

The CHAIRMAN. You don't propose that the dresser pay the tax?

Mr. GOLD. No, sir. I might say that the NRDGA—that is, the National Retail Drygoods Association—supports our viewpoint even though they appeared here and suggested a manufacturers' tax. We have a letter from their secretary so stating, and their attitude is the same as ours; they want to avoid all these things I have told you about.

Now, the tax, if and when imposed—and I sincerely hope it will be imposed—will be quite simple to collect.

Senator BARKLEY. Your tax is on the raw pelt?

Mr. GOLD. The raw pelt, plus the dressing charge.

Senator BARKLEY. How is the owner going to know what the ultimate charge will be?

Mr. GOLD. When he sends the skin in, he sends it at a fixed charge; the value of the skin he already knows because he has bought it.

Senator BARKLEY. They are just raw skins and he takes them into the skin dresser and the skin dresser tells him how much he is going to charge for the service of dressing. The tax is then paid on the value of the raw pelt and on the dressing charge?

Mr. GOLD. Yes; without speculating as to the enhancement in the value of the fur, but we may take it for granted that the value is well known to the owner for the reasons I have mentioned.

Senator CONNALLY. What percentage of the cost of the finished garment is the undressed skin?

Mr. GOLD. About 35 percent.

Senator CONNALLY. Exactly; so we would lose 65 percent, wouldn't we?

Mr. GOLD. I think, Senator Connally, the expense involved in collecting the tax, the reduced volume by the legitimate merchant, the fact that the skins will find their ways into channels for sale without any tax being paid on them, and the other reasons which I have enumerated, all support our position that there will be no loss in revenue under our plan. The net result in those cases where there is evasion on the tax is that it results not only in the loss of the fur-tax revenue but that man cheats the Government out of income tax with the legitimate merchant suffering at the same time and to the same extent by having reduced business volume and lower income tax.

Senator BARKLEY. Do you know to what extent or whether the further down the line of the finished garment or finishing process you will locate this tax the greater is the opportunity for pyramiding it after it leaves the original point?

Mr. GOLD. That is an argument that has been advanced by the manufacturers. We say that if the market will permit, you may trust the skin owner or manufacturer to find the highest selling level; he need have no excuse for bringing it up to that level. When they come here

and say any such thing, we question it because we all know that manufacturers like all others seek to make a profit. Should the market go the other way, we have good reasons to believe and hope that everyone along the line from the dresser to the retailer will help to absorb that tax.

Senator BARKLEY. I am wondering whether instead of absorbing the tax he adds to and thereby increases his own profit?

Mr. GOLD. I will assume there may be some pyramiding, yet the mark-ups are not so great as to penalize the customer. I think the Government would wind up with more under our proposed plan; under the present bill too many skins would escape; too many problems of administration are involved, and a great many fur-trimmed cloth coats would be so constructed as to have skins of less value than the cloth. Under such circumstances the competitive feature becomes involved. The Government not collecting on the large volume of fur-trimmed cloth and many novelty items, its income would be reduced to that extent. Under my plan, I am convinced that every one of those skins going into every one of those fur-trimmed garments would bring their share of the revenue into the Treasury.

Senator DANAHER. May I have one further moment to submit this thought, as contained in this letter:

> The proposed tax law imposes the retail sales tax on "articles made of fur on the hide or pelt, and articles of which such fur is the component material of chief value."

My correspondent says:

> Who shall determine whether the fur on a fur-trimmed garment is the component material of chief value? The retailer would have to make an estimate of the value of such fur, which in most cases would be a mere guess on his part. The manufacturer would not want to disclose the value of the fur on such garments, unless the statute makes such disclosure mandatory on the part of the manufacturer. The confusion that is created leaves a legal loophole for the unscrupulous merchant to place a low appraisal on the fur in fur-trimmed cloth coats. With the tax collected at the point of dressing all fur will pay the tax, regardless of where or how it is used, or how much or how little is used in a garment.

Is that a fair and correct appraisal of the situation?

Mr. GOLD. I agree with it wholeheartedly. It is a very fine statement of the situation.

Senator CONNALLY. Have you any statistics as to the value of the annual sale of fur coats?

Mr. GOLD. It is our opinion that without the resistance that would follow this kind of a tax, I should say, $400,000,000; $350,000,000 to $400,000,000; I have been corrected on that—$350,000,000.

The CHAIRMAN. The estimate on this item figures $20,700,000 at 10 percent.

Mr. GOLD. Yes; I am aware of that.

Senator CONNALLY. You sold more last year than the year before?

Mr. GOLD. Yes; I think 1940 was better than 1939. I might point out that there was a similar tax between the years 1932 and 1938, a 10-percent tax. The gross revenue at no time exceeded $7,765,000, and it was admitted generally that it was a very difficult tax to collect. In addition, it presented a great many administrative problems.

The CHAIRMAN. That was a manufacturer's tax?

Mr. GOLD. Yes; it was a manufacturer's tax and by certain regulation of the Treasury Department, we can pretty much know that if it

had been at retail and there were no greater evasions it would have brought 10½ or 11 million dollars, because the Treasury Department ruled that the manufacturers' selling price are about 65 percent of the retail selling price, and so scaling the figures to make allowances for that, the tax would have brought 10½ to 11 million dollars; that is not making any provision for evasions and the difficulties presented by this tax which would stimulate evasions.

Now, may I just point out that Chairman Doughton of the Ways and Means Committee stated in 1938 with respect to this tax that he favored repeal——

Senator CONNALLY (interposing). Was that with respect to the tax on all furs?

Mr. GOLD. The tax on fur garments plus fur-trimmed items.

Senator CONNALLY. Was he advocating repeal of the tax on the whole fur garment or simply clothing with fur on it?

Mr. GOLD. The entire tax, and the reason he advanced was there were so many administrative problems present, especially in determining which was the component part of chief value, that the tax, in his opinion, should be removed, and he did state that the tax was unprofitable in the same report.

Now, in the recent report submitted by the congressional Ways and Means Committee, they made a statement along the same line. As a matter of fact, when one first reads the report one is led to believe they were going to wind up urging the adoption of the plan which we are advocating. Then, after recognizing the difficulties of a manufacturer's tax, they suggest a provision which involves collecting from some seventy to seventy-five thousand outlets of fur, which is so much more difficult. In addition, under this proposed plan, it is necessary to assume that the retailer would be able to determine whether fur is the component material of chief value of cloth garments trimmed with fur.

Now, as to the records being made available to these storekeepers, Mr. Printz testified here last Thursday and made it pretty clear that they would not wish to make known to their outlets, the storekeepers, the mark-up of their merchandise. As a matter of fact, that was the reason that prompted him to submit a plan that all fur coats selling under $71 be deemed to be such that the component material of chief value in them was not fur and be exempt, and that all fur-trimmed cloth garments selling in excess of that amount be placed in the other category and pay a tax. Then the suggestion came from one of the Senators for the limitation of $50.

I have here a fur-trimmed coat which sells for $68, and also a fur coat which sells for some $35 or $38, and the fur coat is of a much poorer quality than the fur on the cloth coat, yet the former would bring a tax while the latter would not. The furs on this cloth coat should bring a larger tax at the point of dressing, but the way it is made up it would escape a tax, unless there was an exemption plan used. Now if that was used, we will have two difficulties still; the difficulty of determining whether the fur in a more expensive cloth garment is the commodity of chief value or the cloth, and if you make a blanket catch-all provision that all fur-trimmed coats selling over $71 will pay a tax, you run into two problems again: First, that you would be taxing a cloth coat in which the fur might be of less value

than the cloth and be confronted with legal attack on the charge of discrimination; second, a great deal of fur trimmings would escape the tax.

Senator GEORGE. You have occupied 35 minutes.

Mr. GOLD. As a matter of fact, I imagine I have not been able to get very far with the points I wished to discuss, due to my answering questions. May I have a moment to peruse this?

The CHAIRMAN. Have you a written brief?

Mr. GOLD. I have a statement here which is quite lengthy. I have not filed it because it would take longer than the prescribed time. I want to say that the National Retail Dry Goods Association has expressed complete accord with our proposition. They told me—their secretary in conversing with me said—they are in favor of the tax at the point of dressing. The only reason they came here and proposed a manufacturer's tax was that they felt there might be some legal obstacles to a point of dressing tax. When I explained to them that the tax would not be paid by the dresser, but that it would be paid by the titleholder of the skin for the privilege of submitting it to a processing operation, he said, in his opinion, that removed the question of illegality, if there was any, and that we had his wholehearted support. I have here a letter showing Mr. Hahn's total agreement with our suggestion.

The CHAIRMAN. You may put it in the record.

Mr. GOLD. Yes. Furthermore, the Fox-Breeders Association, which represents the breeders who breed more than 80 or 85 percent of all animals bred in this country, are in total agreement with us. Three or four of the largest jobbers are in agreement with us that the tax at the point of retail sale will bring us the same experience which we had before, added sales resistance resulting in curtailed sales by at least 25 percent. I tell you this, gentlemen: My own wife told me that customers have said that if there is going to be a tax on furs, they would buy cloth coats. Now, I hesitated to tell that to members of the committee yet, strange as it may seem, at breakfast only today the chairman of our tax committee from Baltimore made just the same statement. He said his customers have said that if the tax on furs is imposed, they will buy cloth coats.

The CHAIRMAN. Of course, taxes do generate some resistance. I want to ask you this: When it comes to an importer of dressed fur, finished furs, ready to go into a garment, the Treasury is going to be pretty much at a disadvantage in determining the value of that coat; is it not?

Mr. GOLD. As to imported skins?

The CHAIRMAN. Yes.

Mr. GOLD. Those already dressed before they come into the country?

The CHAIRMAN. Yes.

Mr. GOLD. There is a tariff on that type of skin.

The CHAIRMAN. Yes; I know that, but this tax bill imposes a levy on all manufactured furs. If you transfer the tax as you suggest you would have importers of dressed furs bringing skins in here that could not be valued without considerable effort and difficulty on the part of the Treasury; there wouldn't be much way of checking it.

Mr. GOLD. I might point out that the Government has experts who could very well do that.

The CHAIRMAN. I know, but I doubt if there are very many Government experts who could differentiate between furs in many instances from a value standpoint. They might have some idea, but the difficulty still appears to me to be there.

Mr. GOLD. I might point that these skins that come in are all purchased in the markets abroad and are valued by the owners at the time they are bought.

The CHAIRMAN. But our Government would not be able to keep much of a check on those who might want to take advantage of the Government by importing skins, as I have mentioned.

Mr. GOLD. My statement on that is that a duty could be imposed. Checking up on values is not difficult. There are many experts in our market who could place an accurate value on such skins. As a matter of fact, they would welcome the opportunity to do it for the Government. All those skins are purchased either for resale or for manufacture and carry a definite value.

The CHAIRMAN. Supposing that you had somebody who purchased some skins outside the United States, in Canada for instance, and he brings in already finished furs at low valuation? I mean the fellow who wants to smuggle them in; he brings them in, and pays the duty?

Mr. GOLD. We have the same problem with finished garments. There are any number of our workers who, despite the prohibition in union agreements not to do so, make a practice of turning out garments for friends and relatives, in their own homes.

The CHAIRMAN. I was asking the question for information, but in the case of a high-priced fur, where the temptation is so great to get them dressed outside and bring them in, the Government would have to have some finished experts.

Mr. GOLD. Of course, there are duties now.

The CHAIRMAN. I understand that, but you are arguing against this retail tax. It is the 10 percent on the retail sale. That is one of the things which must be in the Treasury's mind; the difficulty of fixing the correct value on the furs.

Mr. GOLD. They can get that information; there are thousands of experts in our markets.

The CHAIRMAN. If you have anything else to put in, you may do so.

Senator BARKLEY. All furs that come into this country pay a tariff?

Mr. GOLD. Yes.

Senator BARKLEY. And under your plan the tax would be paid at the point of dressing?

Mr. GOLD. Oh, I think adjustments must be made to increase the tax on dressed furs that come in.

The CHAIRMAN. Then you would have the difficulty of ascertaining what was paid for the dressing service. You are proposing to tax this fur when it reaches the hands of the dresser.

Mr. GOLD. I am addressing myself to the major problem.

The CHAIRMAN. Wouldn't that raise a very great difficulty for the Treasury?

Mr. GOLD. I don't think so. I think when you consider the savings in time and manpower in collecting from only 111 dressers as compared with some 75,000 outlets, and surmounting the other difficulties which I have mentioned, that on the whole the Treasury's burden would be lightened.

The CHAIRMAN. Well, Mr. Gold, if you have any additional statement, you may put it in the record.

Senator JOHNSON. Did I understand you to say that 80 percent of the producers of fox pelts favor your plan? I am quite interested in that. As I understand your plan it could be very well that the tax would be passed on to the producers of pelts. I am sort of surprised at that statement.

Mr. GOLD. Well, I have here something on that.

Senator JOHNSON. Put that in the record; so that the producers favor the plan you have suggested.

Mr. GOLD. Yes; the breeders of over 80 to 85 percent of the skins favor it.

Senator DAVIS. The retailers favor the plan of collecting at the source?

Mr. GOLD. At the point of dressing. The retailers; the department stores; three or four of the largest jobbers of furs; the breeders are in favor of it, and I am hoping, of course, that we are making a good enough showing here to have the members of the committee favor it.

Now, the telegram sent to us which explains my previous statement is this: It is written by Dr. L. J. O'Reilley, president, American National Fur Breeders Association.

The American National Fur Breeders Association offers full cooperation to RMFA fur tax committee. We feel not only ourselves but the entire fur industry would suffer greatly from proposed retail tax.

Senator JOHNSON. That is saying he opposes the retail tax, but there is nothing in it to indicate that he supports your plan.

Mr. GOLD. Dr. O'Reilley attended a convention in Milwaukee June 18-21 at which I was present. He spoke, and he approves of our plan wholeheartedly.

Senator JOHNSON. Are you going to put something in the record to that effect?

Mr. GOLD. I have nothing more but this telegram; but with the permission of the chairman I can get within the course of a day or two, something more from Dr. O'Reilley or the association; and, with the permission of the committee, I should like to have it in the record.

The CHAIRMAN. Any reasonable extension of your remarks you wish to put in the record you may do so.

Senator DANAHER. I would like very much to incorporate this letter dated August 15, 1941, from the Buffalo Fur Merchants Association in the record.

The CHAIRMAN. Yes; it will be put in the record.

(The letter submitted by Senator Danaher is as follows:)

BUFFALO FUR MERCHANTS ASSOCIATION, INC.,
Buffalo, N. Y., August 15, 1941.

The HONORABLE JOHN A. DANAHER,
The United States Senate, Washington, D. C.

DEAR SIR: In the tax bill now under consideration by the Senate Finance Committee a tax is imposed on the retail sales of furs. The retail fur industry, as a whole, has no objection to a tax being placed on furs under the present emergency, provided that such tax is imposed in such manner that it will bring the largest amount of revenue to the Government after the cost of collection is deducted, without discrimination and injury to the retail fur industry. The tax on furs should be imposed at the point of dressing of skins for the following reasons:

1. *Ease of collection.*—There are less than 120 skin dressers in the United States, most of whom are located in the vicinity of New York City and Chicago. These dressers are well-established concerns, which maintain adequate bookkeeping systems, so that the auditing of the tax would be quite simple and inexpensive to the Government. On the other hand, there are over 40,000 retail fur outlets in the United States, many of whom do not maintain adequate books, if any. It is an irresistible conclusion that the cost of supervision and collection from 120 tax sources will be infinitesimal as compared to the cost of supervision and collection from forty-odd-thousand tax sources.

2. *Eliminates discrimination.*—A tax placed on the retail sales of fur coats discriminates unfairly against the fur coat, which is admittedly a necessity in northern climates. Millions of dollars worth of fur is used annually for trimming cloth coats; the fur so used will escape the retail-sales tax entirely, if the fur is not the component material of chief value. The bulk of fur coats sold cost less than $100, and are not a luxury to the women who wear them, as these cheap fur coats may be the only warm garments many women possess. Thousands of fur-trimmed cloth coats sell for $200—even up to $500. Yet all such fur-trimmed garments and the fur thereon will be sold tax-free, even if the value of the fur equals 49 percent of the total cost of the garment. And who is to determine the value of the fur on a fur-trimmed cloth coat to decide whether it should be sold tax-free or subject to tax? By having the tax collected at the point of dressing, all fur would pay its share of the tax, regardless of whether it was used for a fur coat or a fur-trimmed coat.

3. *Prevents fur bootlegging and unfair competition.*—Among the forty-odd-thousand retail fur outlets, there are bound to be some chiselers, who will evade the tax through fraud and improper records. Undoubtedly the Internal Revenue Bureau can cite innumerable instances discovered when the previous fur tax was in force. It is undoubtedly a safe estimate to say that for every instance caught by the Revenue Bureau, there were at least 10 who were not detected. In addition, there are many people who do fur work at home, as well as some stores who sell an occasional fur coat. These outlets cannot be checked by the Revenue Bureau except at great expense, and because of lack of proper books, evasion of the tax cannot be proven. Yet these sales, often made without the addition of the sales tax, compete unfairly with the legitimate retailer, who conscientiously adds the tax to every sale. The fur dressers on the other hand, are well-established, reputable concerns, who would not stoop to tax evasion.

4. *Will not injure fur industry.*—The placing of the tax on retail fur sales will curtail the sale of furs and fur coats. When a similar tax was imposed on retail fur sales in Canada, a large department store in Toronto reports that its sales of fur garments dropped 50 percent, and when the tax was transferred to the dressers, the volume of sales of fur coats increased immediately. There was the same reaction in the United States when the last fur tax was imposed on retail sales. The imposition of a tax on the retail-sales price creates a tremendous sales resistance in the mind of the prospective customer. When the sales of fur garments are decreased, the whole fur industry suffers, including trappers and fur farmers, dressers, skin dealers, and fur-coat manufacturers, as well as retail furriers and department stores.

5. *Does not create confusion.*—The proposed tax law (sec. 2401) imposes the retail-sales tax on "Articles made of fur on the hide or pelt, and articles of which such fur is the component material of chief value." Who shall determine whether the fur on a fur-trimmed garment is the component material of chief value? The retailer would have to make an estimate of the value of such fur, which in most cases would be a mere guess on his part. The manufacturer would not want to disclose the value of the fur on such garments, unless the statute made such disclosure mandatory on the part of the manufacturer. The confusion thus created leaves a legal loophole for the unscrupulous merchant to place a low appraisal on the fur in fur-trimmed cloth coats. With the tax collected at the point of dressing, all fur will pay the tax, regardless of where or how it is used, or how much or how little is used in a garment.

The fur dressers, wholesale skin dealers and coat manufacturers, especially the fur-trimmed cloth coat manufacturers, are using the pressure of their various organizations to have the tax imposed on retail sales, in utter disregard of the fact it will produce less revenue for the Government and do considerable injury to the industry, as a whole.

This organization, composed of retail furriers in the city of Buffalo, is giving you the above information so that you may be thoroughly cognizant of the disastrous effect of a fur tax placed on retail sales. The furriers of Buffalo feel certain that you will realize the justice and fairness of their position, and urge you to use your influence, as a member of the Senate Finance Committee, to see that the tax on furs is collected at the point of dressing, where it rightfully and logically belongs.

Very truly yours,

GASTON ROSENTIEL.

Mr. GOLD. May I read just one very brief statement, in view of the testimony given here last Thursday before your committee? In which it was claimed that 3,000 members of the fur industry, which I represent, are making a national effort to obtain public and congressional approval of a fur tax which will benefit the Government by adequate taxes, and the consumers by holding down prices, and the fur workers by removing the threat to their employment, and our industry, to which you gentlemen are looking for tax revenue in this emergency.

Yes; to the limited extent of our small resources, we are doing our best to that end. I should like you gentlemen to see for yourselves the advertisements we have placed in the trade paper Women's Wear Daily. In fact, it will be a privilege to us if you will examine these advertisements; you will find in them restatements of the facts which have made the Canadian method a success for over 20 years—a method we urge you to adopt.

Our dues are $5 a year, obviously most insufficient to engage in expensive efforts. Those advertisements, the inescapable expenses of arousing the members of an industry to the threat that faces them, are being supported by voluntary contributions averaging less than $15 and all going to the fur-tax committee, not to the treasurer of the R. M. F. A. If we succeed, we believe we shall have performed a service for the fur industry.

I might point out in this connection that the chairman of the tax committee is Mr. Jack Fine, of Baltimore, his cochairman is Mr. P. W. Wilderson, general manager of Cownie Furs, of Des Moines, Iowa; and the rest of the committee embraces members from many parts of the country, consisting of reputable business people.

Senator CLARK. What does that fund amount to?

Mr. GOLD. Some $6,000.

Senator CLARK. Some $35,000 has been mentioned here.

Mr. GOLD. I have given you the correct amount, sir.

The CHAIRMAN. Thank you, Mr. Gold.

(Through an extension of remarks permitted by the chairman, Mr. Gold submits the following briefs, telegrams, and excerpts from advertisements placed by the fur-tax committee, Retail Manufacturing Furriers of America, Inc., in trade papers, referred to in his testimony:)

[Telegram]

WAUSAU, WIS., *August 20, 1941.*

IRVING GENFAN,

Retail Manufacturing Furriers of America, Inc., Tax Committee:

Clarifying previous wire of position this association representing 90 percent fur breeders of the United States unqualifyingly support, endorse, and plea action your committee will be successful in having tax placed at point of dressing.

DR. L. J. OREILLEY,

President, American National Fur Breeders Association.

[Telegram]

NEW YORK, N. Y., *August 19, 1941.*

CHARLES GOLD,
Capitol Park Hotel, Washington, D. C.:

In answer to your telegram, may I state that the tax committee collected so far about $5,800. The average contribution is less than $15 which includes contributions from fur jobbers, skin dealers, and specialty shops who are in full accord with our purpose and plan that the tax be placed at the point of dressing to insure complete collection by the Government at a minimum cost. This will eliminate unscrupulous methods through outlets especially fur trimmed cloth coats, fur trimmings, hats, gloves, slippers, and every conceivable fur article sold to the consumer. We estimate that through this recommendation of ours, at least $75,000,000 worth of fur will become taxable which ordinarily would escape taxation. Under our proposal, evasion of tax payments, unscrupulous competition, and consumer resistance will be eliminated.

LOUIS KROLL,
Treasurer, Retail Manufacturing Furriers of America, Inc., Tax Committee.

Excerpts from advertisement in Fur Trade Review, July 31, 1941:

The American National Fur Breeders Association offers full cooperation to Retail Manufacturing Furriers of America fur tax committee. We feel not only ourselves but the entire fur industry would suffer greatly from proposed retail tax.

AMERICAN NATIONAL FUR BREEDERS ASSOCIATION,
By DR. L. J. O'REILLEY, *President.*

In place of collecting from nearly 15,000 retail shops in Canada we collect from only 14 places—the dressers. It requires very few inspectors to check our records. The collection of the tax at the point of dressing is the simplest, sanest, and most economical procedure known. Canadian authorities would not entertain any other method.

F. D. BURKHOLDER, LTD.,
By FRANKLIN D. BURKHOLDER.

Excerpt from advertisement in Women's Wear Daily, Tuesday, July 22, 1941:

[Pencil notation: "Largest Fur Jobbers in United States"]

KRUSAL & KRUSAL, INC.,
New York, July 21, 1941.

Mr. SIDNEY A. HAAS,
Retail Manufacturing Furriers of America Fur Tax Committee,
New York, N. Y.

DEAR MR. HAAS: In answer to your inquiry, we believe the proposed retail tax threatens to reduce the volume of the entire fur industry to such an extent as to cause severe losses to many of its members.

We support the Government in its defense program and believe the fur industry should carry its share of the burden. To achieve this end, we support a tax at the point of dressing which we feel will prove more desirable for the Government, the fur industry, and the public.

Very truly yours,

KRUSKAL & KRUSKAL, INC.,
By J. W. KRUSKAL, *President.*

Excerpt from a letter reproduced in an advertisement in the Women's Wear Daily, Friday, July 25, 1941 (on letterhead of executive offices, National Retail Dry Goods Association, 101 West Thirty-first Street, New York), addressed to Retail Manufacturing Furriers Association, 16 East Fiftieth Street, New York, N. Y., signed by Lew Hahn:

When the new revenue bill goes to the Senate Finance Committee our taxation chairman will unquestionably address himself to the fur tax. I am sure that retailers generally will agree that the logical place for a fur tax is where the fewest possible number of business concerns will be obliged to serve as tax collectors. That would be, of course, at the point of the final dressing of the pelt.

Excerpt from an advertisement in Women's Wear Daily, Friday, August 1, 1941:

WHAT THE PROPOSED RETAIL TAX MEANS TO EVERY FURRIER

Collecting 10 percent above the price of every fur garment in addition to existing sales taxes.

Fur-trimmed garments of which fur is the component part of less value will escape taxation and therefore compete unfairly with fur garments.

Additional bookkeeping, reports, and inspections.

Unethical competition from unscrupulous wholesalers and retailers.

An increase in competition from home shops and tailors who are not established firms.

A decrease in sales of furs which will not only shrink your volume and profit, but the volume of the entire industry.

Loss of customer good will because consumer will inadvertently feel animosity at your collecting the tax.

A large portion of the gross revenue collected will be dissipated by the high cost of collecting, litigation, and policing necessary on the part of the Government and will never reach the Treasury.

Collecting the tax on repairs which would entail complete itemizing of all materials to the customer.

Payment of the tax to the Government each month even if garment is unpaid for by the customer or only partly paid for.

BRIEF SUBMITTED IN BEHALF OF THE NATION-WIDE RETAIL FUR INDUSTRY BY CHARLES GOLD, GENERAL COUNSEL FOR RETAIL MANUFACTURING FURRIERS OF AMERICA, INC.

THIS BRIEF PROPOSES THAT THE TAX ON FUR BE PLACED AT THE POINT OF DRESSING

Prefatory statement.—This brief is submitted in support of certain proposals made by the proponent for the placing of any projected tax on furs at the point of dressing.

The retail fur industry is fully aware of the Government's urgent need for additional revenue in connection with the proposed emergency defense measures. The retail fur industry furthermore is of the opinion that the entire fur industry is able to contribute to the country's great need for additional funds.

It is respectfully submitted, however, that the tax should be so imposed as to work as little hardship on the consumer and the fur industry or any portion thereof as may be possible.

This brief sets forth a plan by which the tax can be spread over the whole industry without imposing too great a burden on any one branch thereof.

The proponent, an incorporated trade association, has affiliated with it 19 incorporated retail furrier associations, and a large number of individual retail furriers, in various sections of the country. The names of the affiliated associations follow:

Greater New York Retail Furriers Association, Inc.
Chicago Retail Mfg. Furriers' Association.
Milwaukee Retail Mfg. Furriers' Association.
Master Furriers' Guild of Washington, D. C.
Furriers' Association of Baltimore, Md.
Iowa-Nebraska Retail Furriers' Association.

State of N. J. Retail Mfg. Furriers' Association.
Indiana Sales Retail Fur Merchants' Association.
Manufacturing Furriers' Association of Pittsburg.
Buffalo Fur Merchants' Association.
Albany Retail Furriers' Association.
Furriers' Guild of Hartford.
Retail Fur Merchants of New Haven.
Colorado Springs Retail Fur Association.
Southern California Retail Fur Merchants' Association.
Furriers' Guild of Boston.
Greater Cincinnati Retail Furriers' Association.
Cleveland Retail Furriers' Association.

Thus, it appears that petitioner represents the interests of the retail furriers in all sections of the country.

The proponent, in order to ascertain the opinion generally entertained by retail furriers throughout the United States, has caused certain canvasses to be made and has invited expressions of sentiment. The petitioner is now in a position to state that the entire retail fur industry clearly favors the following plan for taxing furs:

The retail fur industry is fully aware of the Government's urgent need for additional revenue, and it is in full accord with the Government's intentions to levy a tax on furs. However, the retail fur industry, mindful of its experiences and occurrences under previous taxes, urges upon the Government:

First. That the tax should not be imposed at the point of retail sale.

Second. That the tax should be imposed at the point of dressing of fur skins.

Reason A.—In view of the limited revenue to be derived from a tax at the point of retail sale, policing and collecting the tax from possibly more than 70,000 outlets would prove an insuperable problem and most costly to the Government.

There are presently more than 18,000 establishments which sell furs directly to the consumer. In addition, there are more than 24,000 establishments which are potential outlets of furs to the consumer.

There are between 70,000 and 75,000 actual and potential retail outlets of furs to the consumer consisting of:

Wholesale fur manufacturers practically all of whom engage in direct-to-consumer business	2,290
Wholesale manufacturers of fur-trimmed cloth coats, many of whom do a large volume of direct-to-consumer business	4,400
Women's read-to-wear shops—many presently retailers of furs—all of them potential retailers of furs	25,820
Department stores	4,074
Retail furriers (exclusive of specialty stores)	4,918
Small ware stores, millinery stores, and others selling furs or articles made of or containing	30,000
Total	41,502

The foregoing takes into account tailor-furriers who make new garments and remodel old ones; home-furriers, most of whom have no established or discernible place of business and who remodel and make furs for the consumer. Many of this latter group studiously avoid disclosing their activities as they are union members and face the loss of their union cards if found to be engaged in their own business.

It is reasonable to state that furred millinery and furred gloves and other fur-trimmed novelties are being sold each year in upward of 25,000 such establishments.

In addition to these there is on the fringe of the retail fur industry a group of racketeering clothiers and furriers who employ prepossessing women as "fronts" to insert in newspapers "personal ads" purporting to be from women who "must sacrifice wardrobe, only slightly worn, at a mere fraction of the purchase price.

The latter group would find a business stimulating and further encouragement for their activities in a retail-sales tax, as they would be able to offer additional inducements, while enlarging in fact on their fraud of the public by pretending to their innocent customers that the sales were not taxable as the furs were second hand.

Needless to say, home furriers and racketeering furriers, though they are not to be classed together, offer very unwholesome and in almost all instances unfair and unethical competition to the legitimate fur establishment. This competition would undoubtedly become even more unfair were the tax placed at the point of retail sale.

It must appear quite clearly that finding many of these outlets, not to speak of policing, examining, and collecting a tax from them, would be nearly impossible and very costly to the Government.

In short, if the tax were levied at the point of retail sale, the Government would be confronted with the tremendously difficult task of policing and collecting from possibly 42,000 recognizable direct-to-consumer fur outlets and many thousands of tailor furriers and home furriers.

As to the cost of enforcing a tax at the point of retail sale, it may be pointed out that the Treasury Department conceded during the last excise tax (1932–38) which was payable by the manufacturer of the fur article that enforcement was so difficult and the cost so high as to make the tax unsound.

In fact, these two factors and certain problems of interpretation led to the repeal of the tax. (See report of House Ways and Means Committee, No. 1860, dated March 1, 1938.)

Reason B.—A tax at the point of retail sale may offer temptations to violate the law to consumers and merchants (wholesale manufacturers, jobbers, and retailers) alike.

While the fur excise tax was in effect (1932–38) it was alleged and in many cases established that numerous wholesalers and retailers of furs omitted to pay the tax.

This memorandum will neither discourse on the reasons, philosophic and psychologic, which explain these failures to pay the tax, nor will it endeavor any extenuation thereof. Suffice it to say that in some instances the temptation to pocket the tax was too great. In other instances consumers, sensing or knowing the financial embarrassment of sorely pressed merchants, induced them to engage in cash, unrecorded transactions free of tax. In some cases the merchant could not, because of poor production equipment or management, continue in business unless he compromised his honesty and conscience and pocketed the tax.

Regardless of what prompted the evasion of tax, the Government was the loser thereby, and law-abiding merchants found it more difficult daily to compete and to continue in business.

Almost all wholesale fur manufacturers are engaged in the direct-to-consumer business. In many instances during the last tax some wholesalers, to obtain more direct-to-consumer business, held out the promise of a wholesale price and the illegal lure of a tax-free transaction which was consummated by an unrecorded all-cash transaction.

It is self-evident that the merchant who charges, collects, and pays to the Government a tax cannot compete against the merchant who waives the tax or who pockets a collected tax.

That these things occurred under the old tax is proof sufficient that they would reoccur under a new similar tax.

All legitimate retail furriers are especially anxious to avoid the repetition of these destructive practices in the future. A legitimate merchant has no means of competing against such practices.

These could be avoided by use of proponent's proposal to tax at the "point of dressing." The inducement to the unscrupulous customers and merchants to avoid the tax would not be present.

Reason C.—A tax at the point of dressing lessens the likelihood of income-tax fraud.

The Department will readily recognize that under a retail sales tax the unscrupulous merchant who neglects or omits to pay his fur tax, either with or without the connivance of his customers, will surely not include such transactions in his income-tax report.

Thus, the Government likewise would sustain a loss in respect of such firm's income taxes (corporate and individual).

Reason D.—A tax at the point of retail sale would result in numerous inequities which should be avoided.

In addition to the objections inherent in the foregoing arguments, the following should be given consideration:

(*a*) A tax at the point of retail sales places the wholesaler who sells at retail at an advantage over the custom furrier.

(*b*) Should the law provide (as in the past) certain exemptions for fur-trimmed cloth coats, the inexpensive fur coats would be at a disadvantage.

Under the previous law, where a fur trimming was less valuable than the skeleton cloth coat, the transaction was nontaxable. Thus it frequently happened that a $60 or $70 fur collar was used to trim a $75 cloth skeleton and the entire garment was exempt. Nevertheless a fur coat wholesaling for $89 was taxed.

(*c*) Each year a retailer, however small, enters into hundreds of transactions ranging from a few dollars upward. The larger furrier engages in thousands of such transactions. It would impose untold hardships upon them to require that they maintain detailed records for tax purposes, all of which could be avoided by a tax at the point of dressing.

(*d*) Certain possible regulations would impose great hardships upon retailers

The Revenue Department in the past required a tax to be paid on repairs and alterations of furs on the whole charge therefor unless the customer was given an itemized bill showing the number of skins used, the charge for each, and the charge for labor.

The Department might require this once again under the new law. It is impossible to portray adequately the hardship resulting from such a regulation.

To enumerate the number of skins used invites lengthy discussions on the charge for labor and the charge per skin.

To omit the enumeration of skins from the bill would subject the furrier to the payment of a tax on the whole bill.

This too could readily be avoided by the use of the proponent's plan.

The retail fur industry urges that the tax be at the point of dressing

The tax plan would be as follows:

1. The tax would be 10 percent on the value or of the skin owners' cost for the skins, inclusive of dressing charges. If deemed necessary by the Government this tax might even be made 10 percent, to insure reaching thereby the quota on furs suggested by the Treasury Department.

2. The owner of the skins would be required to deliver to the dresser (together with the skins) an affidavit of valuation in duplicate.

3. The dresser would forward periodically to the Internal Revenue Department the original valuation affidavits, together with a statement of charges for dressing of all skins and a check for the payment of taxes collected by him from the skin owner.

This plan is submitted by the retail fur industry as the most logical taxation plan for the following reasons:

Reason 1.—Policing and collecting the tax under this plan would be quite simple, as there are only 111 fur dressers.

At this point it might be advisable to direct attention to the fact that all fur articles and garments are made of dressed furs. The dressed fur skins find their way into the finished garments and other articles made of or trimmed with fur in the following manner:

The fur skin is first trapped and then sold to a collector of skins, who ships it, along with others, to the fur auction or to the skin dealer, who in turn sells these skins to the wholesale fur manufacturer or to the custom retailer. The retailer deals directly with the consumer, whereas the wholesale manufacturer deals with the jobber of furs, the retail storekeeper, and the consumer.

However, before these skins can be manufactured into complete garments or used in other articles or as trimmings they must be dressed.

Statistics regarding the dressing of fur skins:

1. Seventy percent of all skins are dressed for wholesale manufacturers.
2. Twenty-five percent are dressed for skin merchants.
3. Five percent are dressed for custom retailers.
4. All these skins are dressed for less than 1,500 firms.
5. All these skins are dressed by 111 fur-dressing firms.
6. Eighty percent of the fur-dressing business is done by firms located within 25 miles of the heart of New York City.
7. Ten percent of the furs are dressed in the vicinity of Chicago, and the balance of less than 10 percent in other portions of the United States.

It immediately becomes apparent that collecting a tax on fur skins which must pass through 111 establishments for dressing, at the request of less than

1,500 skin owners, is quite simple and in direct contrast to the gigantic problem of ascertaining the identities of the tens of thousands of retail outlets (of manufactured furs), policing them, examining them, and collecting the tax from them.

The simplicity of collecting the tax at the point-of-dressing plan is further emphasized by the fact that 83 percent of all skins dressed are dressed within 25 miles of the New York City fur market, and by the further fact that over 90 percent of all skins dressed are dressed by less than 25 fur dressers.

The close cooperation of the Internal Revenue Department with these 25 fur dressers would insure the collection of over 90 percent of the tax. Insofar as the balance of the skins dressed at the other 86 plants (consisting of about 10 percent of all skins dressed) are concerned there could be no evasion worth mentioning.

Reason II.—Administration problems and costs would be at a minimum.

The ease of collecting a tax at the point dressing of furs is so manifest as to require but little discussion. Checking the books and records of the 1,500 skin owners, all identified, is both simple and inexpensive.

This is especially so when it is borne in mind that the large bulk of the dressing processes is done for a small group of wholesale manufacturers and skin dealers.

Contrast to the economy and ease of administration of this proposed tax the great problems and the great expense inherent in the proposed retail-sales tax, which would require the examination of a maze of transactions, schemes, and tax-evasion devices engaged in by the unscrupulous persons who might be found in any and all branches of all of the fur industries.

Reason III.—A tax at the point of dressing of fur skins would bring a larger sum of money to the Government than a retail-sales tax (or a manufacturers' sales tax).

The total value of skins dressed, inclusive of dressing charges, is $200,000,000. The Government would obtain, by imposing a 10 percent tax at this point, the sum of $20,000,000. Very little expense would be required for the enforcement of the said tax, thus leaving the Government practically the whole amount received.

A tax upon the retail sale or manufacturers' sale would bring considerably less than $20,000,000, as evidenced by the experience of the Government under the last tax.

During the period that the last fur excise tax was in effect (1932–38) the Government never obtained in any one year even as much as $8,000,000. The tax at that time was on the sale by the manufacturer of an article made of fur. The Government received the following revenues annually from the said tax:

Year:	*Amount*
1932–33	$7,546,275
1933–34	7,655,000
1934–35	2,675,732
1935–36	3,321,057
1936–37	5,919,329
1937–38	5,368,398

Reason IV.—A tax at the point of dressing of fur skins is equitable, in that it secures participation from all branches of the fur industry.

If the tax were placed at the point of dressing, all persons engaged in the fur industry from the skin dealer to the retailer, and every user of fur as trimming in any industry, such as gloves, millinery, slippers, coats, etc., might participate in the absorption of the tax. In other words, if at any time the detail market were not favorable, all divisions engaged in the fur industry and other fur-using industries might absorb part of the tax by making proper adjustments in their calculations to offset part of the tax item.

On the other hand, if the tax were imposed at the point of retail sale, none of the other divisions of the industry would make any contributions to this end and were the consumer demand to be weak the retailer himself would be forced to absorb this tax item by making the retail selling price sufficiently attractive so as to encourage sales.

Reason V.—The affidavits of valuation would be accurate.

The valuations furnished to the dresser would of necessity be true valuations as they would be the basis of all claims by the owner for loss by fire, theft, and more important from damage during dressing process. Furthermore checking these valuations would be a simple matter for the Government.

The skin owner's cost bills representing purchases (which are almost always made at large auction sales) could always be utilized to refute false valuations and false low valuation would result in large profits and high income taxes—less desirable to the skin dealer and manufacturer (most of whom pay income taxes in the higher brackets) than paying the proper dressing tax.

Under the most unfavorable circumstances, the Government would have no greater problem than to make a careful check of the activities of the 111 fur industries.

Reason VI.—A tax on fur skins at the point of dressing would be constitutional.

Revenue acts of the past have repeatedly utilized a processing tax or a tax at the point of processing as a means of obtaining revenue.

The Revenue Act of 1939 contains a number of so-called processing taxes. See section 2470 (a) (1) which imposes a processing tax on coconut palm and palm-kernel oils, fatty acids, etc.

In the case of *Cincinnati Soap Co.* v. *United States* (301 U. S., 308, 81 Law Ed. 1122), the Court was called upon to determine the constitutionality of the tax imposed by section 602½ (a) of the Revenue Act of 1934 which was the predecessor of section 2470 of the Revenue Act of 1939.

The Court held that the tax imposed upon the first processing of oil was a valid tax upon a manufacturing process for revenue purposes and did not violate the due-process clause of the fifth or tenth amendments.

Likewise processing taxes have been imposed upon lubricating oils, sugar, oleomargarine, and renovated butter. These taxes and taxes of a like nature have repeatedly been held to be constitutional.

The Treasury Department is too familiar with these holdings to require further enlargement on the subject.

The decision of the Supreme Court in the case of *United States* v. *Butler, et al.*, which declared unconstitutional the processing tax under the Agricultural Adjustment Act has no bearing upon the instant matter.

In the *Butler case* (297 U. S. 1), the Court held that the purpose and plan of regulating the activities of farmers was an invasion by the Federal Government of the jurisdiction of various States and thus unconstitutional.

Finding that the underlying motive of the act was illegal and that the use of moneys in the furtherance of this purpose was improper, the tax by which the moneys themselves were to be raised was likewise and for that reason only found to be unconstitutional.

Although the A. A. A. was a tax at the point of process or manufacture, nothing in either the majority or minority opinions in the *Butler case* held the tax as such to be unconstitutional.

Reason VII.—A tax at the point of dressing has proved successful in Canada.

The Canadian Government has employed a point of dressing tax on fur skins for the past 22 years with eminent success.

Furthermore, the tax in Canada was approximately the same as that recommended by proponent.

From the year 1926 to the year 1939, the tax was 8 percent. It was in 1939 that the tax was raised to 12 percent. Section 86, subsection 4a of the Special War Revenue Act reads as follows:

"There shall be imposed, levied, and collected a consumption or sales tax of 12 percent upon the current market value of all furs dressed and/or dyed in Canada payable by the dresser or dyer at the time of delivery by him."

Surely the success of the Canadian fur dressing tax should constitute conclusive proof of the efficacy of this procedure.

Proponent for the reasons set forth above urges:

First. That the tax should not be imposed at the point of retail sale.

Second. That the tax should be imposed on the dressing of fur skins.

Respectfully submitted.

CHARLES GOLD,

General Counsel for Retail Manufacturing Furriers of America, Inc.

WHY A TAX ON FUR AT POINT-OF-SALE IS UNFAIR TO CONSUMER, WILL INJURE THE INDUSTRY AND BE COSTLY TO ADMINISTER; WHEREAS: AN ALTERNATIVE TAX, AT POINT-OF-DRESSING, WOULD YIELD MORE REVENUE TO THE GOVERNMENT WITHOUT HARMFUL EFFECT UPON THE CONSUMER OR THE INDUSTRY

A proposal, submitted by 3,000 members of the fur industry, and unique in that here an industry virtually volunteers to be subject to taxation.

The more than 3,000 members of the retail fur industry, represented by the undersigned, are aware of the existing national emergency, acknowledge the necessity for special taxation, and want to contribute their share.

To this end, on behalf of the fur industry, they propose that a tax be levied on the industry which will be absorbed by it and not assessed directly against the consumer.

Such a tax can be set up if levied at the point of dressing the fur skins.

And, in the opinion of 3,000 fur men, this is a more effective alternative than the now existing proposal to tax at point of retail sale, for these reasons:

1. It will benefit the consumer.
2. It will be simpler to police and collect.
3. It will cost less to police and collect.
4. It will result in more revenue to the Government.
5. It will apply equally to all fur users.
6. It will insure accurate valuations.
7. It will be in the best interests of labor, defense, and the industry.
8. It has worked in Canada and will work here.

1. THE CONSUMER WILL BE BENEFITED BY THE TAX ON FURS IF IT IS IMPOSED AT POINT OF DRESSING INSTEAD OF AT POINT OF SALES

This is the confirmed opinion of more than 3,000 qualified members of the fur industry.

There was a time when furs were exclusively the privilege and raiment of the rich. This is no longer true.

Today, the fur industry could not exist if it had to depend on the rich alone for its business.

Today, it is the average American woman, the woman of modest means, who does the bulk of the fur buying.

This is obviously as it should be.

The wealthy woman, who lives in comfortable homes and who spends her outdoor moments in heated cars, actually has no need of a fur coat from the standpoint of basic necessity. The value of furs to her is one of prestige, of the accenting of beauty, and the enjoyment of lavish wardrobes.

But to the working girl, the housewife, the student, a fur coat is not a luxury but a very basic necessity. It is she who must walk for blocks in driving rain or pelting snow to reach the bus or the train or the streetcar she can afford to use. It is a plain matter of keeping warm, of protecting health, so that the daily job of earning a living or caring for those who do or preparing to do so can go on during the months when bad weather complicates living.

The fur industry, sensing its social obligation, recognizes the right of the woman of poor or modest means to buy fur garments as a basic and prior right over that of all other consumers.

It is she whom the industry increasingly seeks to serve.

And in thus serving her, it serves itself—a perfect case of enlightened self-interest.

Now, if, as is proposed, the cost of a fur garment is raised by 10 percent by the imposition of a point-of-sale tax, the average American woman, whom we have seen to be the one who needs the comfort, warmth, protection, and beauty of furs in her life, is sure to suffer.

A 10-percent increase may mean that she can no longer afford to have a fur coat at all.

She, who needs it most, may have to be satisfied with a cloth coat which gives her neither the service nor protection of a fur garment.

The retail fur industry wants to make it possible for the average American woman to continue to own and enjoy furs.

It can only do this with the cooperation of the Government in securing a tax fair to consumer, industry, and Government alike.

The proposed 10-percent tax at point of retail sale is not fair. It places the entire burden on the consumer.

The tax at point of dressing is fair. For, with the tax placed here, the entire fur industry from raw fur source to retailer can and will bear a portion of the tax load in order to lighten the burden on the consumer and thus keep demand for furs high, business active, profits and subsequent tax gains to the Government assured.

2. A TAX AT POINT OF DRESSING CAN BE POLICED AND COLLECTED EFFICIENTLY AND SIMPLY

Why? Because it's the bottleneck of the industry. There are only 111 dressing plants, but there are 70,000 to 75,000 potential fur outlets for fur articles.

You can't police a huge metropolis with a village constable!

And it's impossible to keep check on 75,000 establishments without a large and expensive force of collectors, bookkeepers, clerks, inspectors, etc.

Much criticism has been leveled at bottlenecks in industry.

Yet here is one bottleneck which can serve to advantage!

Let us pause for a moment and consider what is meant by dressing a fur.

When a pelt is sold at one of the big auctions to which thousands of trappers send their furs, it is in a raw state.

Before the skin can be made into a coat it must be "cured." This is one of the jobs done by the dresser. The skin is made pliable, given toughness and wearing quality, and processed so the hairs will not shed.

Another service performed by the dresser is to dye the skin. The shade and blend is usually prescribed by the owner. The dresser does not own or deal in skins. He is merely a processor.

An undressed skin is a raw skin and one which cannot be used in manufacture.

On either side of the point of dressing, the business of getting fur from animal to coats for consumers, fans out from and into the hands of thousands of people involved in various aspects of the fur industry.

To place a tax at any other point is to create a gigantic problem.

This inefficient and unnecessary complication of admistration is one of the chief objections to the proposal for a tax at point of retail sale.

The simplicity of collecting the tax at the point of dressing is further emphasized by the fact that 80 percent of all skins are dressed within 25 miles of the New York City fur market.

Furthermore, more than 90 percent of all skins dressed are handled by less than 25 percent of the total of 111 fur dressers.

The close cooperation of the Internal Revenue Department with these 25 fur dressers would insure the collection of more than 90 percent of the potential tax.

3. COST OF COLLECTING A TAX AT THE POINT OF DRESSING WOULD BE AT A MINIMUM

One of the main advantages of the tax at point of dressing would be that it would take the impost out of the tin-cup collection class and make it a profitable and just levy.

The ease of collecting a tax at the point of dressing of furs through the existing 111 firms handling this business is obvious.

Contrast with the economy and ease of administration of the point of dressing tax the numerous problems and the great expense inherent in the proposed point of retail sale tax. This would require the examination of a maze of transactions, possible schemes, and tax-evasion devices, and a general policing of tens of thousands of retail fur outlets.

4. INCOME TO THE GOVERMENT FROM A TAX AT POINT OF DRESSING WOULD FAR EXCEED ANY OTHER TYPE OF TAX ON FURS

This point needs no support. The tax that yields the greatest revenue—and still is fair and equitable—is preferable, although still painful.

It was once said that "taxation without representation is tyranny." It is equally true that taxation without effective administration and maximum return is an abuse of serious nature.

The total value of skins dressed, inclusive of dressing charges, is $200,000,000 annually.

The Government would obtain, by imposing a 10-percent tax at the point of dressing, the sum of $20,000,000. A 10-percent tax at the point of dressing would net more than the Government is seeking.

Since so very little expense would be required for the enforcement of the point of dressing tax, the Government would receive and benefit by practically this whole amount.

A tax imposed at the point of retail sale would bring considerably less than $20,000,000, as is evidenced by the experience of the Government under the last fur tax.

During the period that the last fur excise tax was in effect (1932-38) the Government did not obtain in any 1 year even as much as $8,000,000. At that time the tax was levied on the sale by the manufacturer of an article made of fur. The Government received the following revenues annually from this tax:

Year:	*Income*	Year—Continued.	*Income*
1932-33	$7,546,275	1935-36	$3,321,057
1933-34	7,655,000	1936-37	5,919,329
1934-35	2,675,732	1937-38	5,368,398

5. A TAX AT POINT OF DRESSING WOULD INSURE EQUITABLE AND INCLUSIVE ASSESSMENT

Under the proposed point of retail sale tax, the manufacturer of cloth garments which are fur trimmed escapes assessment. Thus he will be enabled to price his fur-trimmed cloth coat at an even lower figure when he competes with the furrier in the retail field.

This is unfair and will tend to depress the fur market.

A tax at point of dressing will be collected from all users of furs, for whatever purpose.

Obviously this is both fair and democratic.

6. A TAX AT POINT OF DRESSING WOULD INSURE ACCURATE VALUATIONS BEING PLACED ON THE FURS FOR TAX PURPOSES

When the owner of a fur sends it to the dresser a certain valuation is placed on it.

This valuation is the basis for any claims which might be made later because of loss from fire, theft, or damage during the dressing process.

Obviously the owner of the fur is going to declare it at its full and accurate value. His statement of their worth, fixed at point of dressing, would then provide the Government with a fair and accurate estimate for taxation purposes.

Furthermore, checking these valuations would be a simple matter for the Government.

It would be simple because the tax-collection agency would need check only the books of the comparatively small group of 111 dressers.

Such a task is insignificant compared to the work and expense of checking these valuations individually with thousands and thousands of retailers.

The skin owner's cost bills representing purchases (which are almost always made at large auction sales) could always be utilized to refute false valuations and false low valuation would result in large profits and high income taxes—less desirable to the skin dealer and manufacturer (most of whom pay income taxes in the higher brackets) than paying the proper dressing tax.

It also follows that it is much more difficult to arrive at a fair and accurate valuation at point of retail sale. This is because so many variables have entered into the picture. A finished coat can be priced anywhere within a considerable range. But a skin has a definite price tag.

Taking the valuation of the furs at point of dressing is the only way to secure a fair and accurate valuation.

This is not true of the proposal to tax at point of retail sale.

7. A TAX AT POINT OF DRESSING WOULD BE IN THE BEST INTERESTS OF DEFENSE, LABOR, AND THE INDUSTRY

The fur industry is a highly specialized field.

Trappers, fur fabricators, dyers, and dressers cannot apply their experience in other fields.

This means industrial maladjustment, unemployment, and a decrease in national production if an unfair tax jeopardizes the fur industry.

Nor can the skilled workmen employed in the fur industry be classified among those whose talents can be converted to defense work.

A jeweler can use his talents in making instruments for flying or navigation. A machinist can be converted into an expert airplane worker.

But a breeder, trapper, or skin dresser operates in such a specialized field that their experience and skill cannot be diverted into other channels.

In connection with this picture, it should also be noted that the fur industry indirectly contributes to the defense picture by freeing materials vital to preparedness. Huge amounts of wool, leather, cotton, and other fabrics are made available for uniforms and other purposes as a result.

For these additional reasons, then, it is important that a tax on the fur industry be one which does not threaten its very existence.

This means it should be a tax at point of dressing.

8. A TAX AT POINT OF DRESSING HAS ALREADY PROVEN ITSELF SUCCESSFUL IN CANADA

It is only common sense to profit by somebody else's experience.

The proposal to tax furs at point of dressing works.

A tax at point of retail sale is an experiment and might be a failure.

In fact the former excise tax on furs—repealed in 1938 because it was impractical and too costly to administer—revealed the same weakness in structure that would occur if an attempt were made to tax furs at point of retail sale.

The oil tax, collected from fur manufacturers, proved unsound because there were too many outlets to police and collect from.

Yet a tax at point of retail sale would expand even that unwieldy set-up.

Let us take a look at the point of dressing tax employed by the Canadian Government.

It is approximately identical with the one herein recommended.

From 1926 to 1929 the Canadian tax was 8 percent. In 1939 it was raised to 12 percent. Section 86 of the special War Revenue Act reads as follows: "There shall be imposed, levied, and collected a consumption or sales tax of 12 percent upon the current market value of all furs dressed and/or dyed in Canada, payable by the dresser or dyer at the time of delivery by him."

This plan has proved eminently successful. It has yielded revenue beyond expectation. It has been economical to administer. It has worked no injustice to consumer or industry.

The success of the Canadian fur dressing constitutes conclusive proof of the foregoing reasons in favor of a tax at point of dressing.

RETAIL MANUFACTURING FURRIERS OF AMERICA, INC.,
FUR TAX COMMITTEE,

(Signed) JACK FINE, *Chairman, Baltimore, Md.*
P. W. WILDERSON, *Co-chairman, Des Moines, Iowa.*
LOUIS KROLL, *Treasurer, New York City.*

The foregoing subscribed to by leading associations, such as the National Fox Breeders' Association, leading firms and individuals within the entire fur industry, and such interested organizations as the National Retail Dry Goods Association.

TAX COMMITTEE, RETAIL MANUFACTURING FURRIERS OF AMERICA, INC.,
New York, N. Y., August 19, 1941.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Yesterday I promised that I would present to you additional data on the question of imported furs.

At the present time, there is a tariff on the importation of dressed skins, paragraph 1519 (a). This duty is 25 percent ad valorem. There is no tax on undressed (raw) furs.

Clearly, the importer would not be inclined to import dressed skins in preference to undressed skins for the simple reason that he would be compelled to pay a 25-percent duty. As to the imported undressed skins, they would pay their share of the tax when dressed or cured, under our proposal.

At this very moment the Government has in its employ a number of experts who determine the values of imported dressed fur in order to insure the collection of the full duty.

We believe that placing the fur tax at the point of dressing will benefit the Government—by adequate taxes—and the consumers—by holding down prices—and the fur workers—by removing the threat to their employment—and our industry—to whom you gentlemen are looking for tax revenue in this emergency.

Although I fear that the pressure of time upon your committee does not permit it, I do wish you and your colleague Senators would have an expression from a Canadian official of their satisfaction with the more than 22-year successful operation of their fur tax—operated on the basis we now recommend.

Respectfully yours,

CHARLES GOLD, *General Counsel.*

The CHAIRMAN. Mr. Zachry.

STATEMENT OF A. L. ZACHRY, ATLANTA, GA., PRESIDENT, ATLANTA RETAIL MERCHANTS ASSOCIATION

Mr. ZACHRY. Mr. Chairman and gentlemen of the committee, my name is A. L. Zachry. I am president of the Atlanta Retail Merchants Association and a director of the Georgia Mercantile Association. I am appearing here in behalf of the Georgia retailers.

I shall confine my remarks to the retailers' excise taxes.

I shall present three reasons why the proposed taxes on jewelry, furs, and toilet preparations should be imposed at the level of manufacturing rather than at the retail level.

Let me say at once that retail merchants are completely willing to pay their share of the national-defense effort. But the proposed retail excise taxes will not be paid by the retailer. He cannot afford to absorb a 10-percent tax, because he does not make anywhere near that much net profit. He must, therefore, pass the tax along to the public.

The three reasons are: First, an excise tax at the manufacturing level will be easier to administer and will offer less chance for evasion. Second, they will be cheaper to collect. Third, the burden of determining the exact amount of the tax is tremendously easier for manufacturers than for retailers.

I should like to discuss each of these reasons briefly.

1. The tax at the manufacturing level is easier to administer. Obviously, there are fewer manufacturers producing these lines than there are retailers selling them, and there will be fewer returns to audit. More careful auditing will prevent evasion, and the more efficient collection will undoubtedly yield a larger net return to the Government. Take furs, for example. You have already been told that there are more than 40,000 retail fur outlets in this country, about 1,500 fur manufacturers. To impose the fur tax at the manufacturing level would require the auditing of about 1,500 returns as compared with more than 40,000, a ratio of about 1 to 25. This example is conservative. Furs are a specialized business.

Many kinds of retail units sell jewelry and practically all of them sell toilet preparations: Department stores, drug stores, 5-and-10-cent stores, crossroads stores, wayside stands, beauty parlors, and barber shops.

Moreover, the retail store carries a tremendously larger number of different items than are made by a single manufacturer. For instance, of the large number of different items carried by such units as department stores, drug stores, and variety stores, some would be taxable and some would not. It is inevitable that many retailers, with no intention whatever of evading taxes, would fail to report the sales of tax-

able items, simply because of the sheer size of the physical job of classification. The manufacturer specializes in a few items and, therefore, could make the determination with relative ease.

2. The tax at the manufacturing level is cheaper to collect. This is closely related, of course, to the first reason. The Government is interested most of all in net revenue. That is why this is worth separating as a special reason. Mr. Sullivan, Assistant Secretary of the Treasury, in his own testimony before your committee, gave an excellent illustration which proves that the tax would be cheaper to collect at the manufacturing level than at the retail level. He said that 3,800 extra employees would be required to collect the proposed use tax on automobiles, which was expected to yield $160,000,000. He contrasted this with the gasoline tax, which yields $343,000,000 and is collected by 15 employees, and with the tobacco tax, which yields $698,000,000 and is collected by 88 employees. The contrast might not be so startling with the jewelry, fur, and toilet preparations taxes, but if you combine the evasion possibilities with collection costs, it is reasonable to suppose that a larger net revenue would come from taxes at the manufacturing level.

The cost of collecting these retail taxes from the wide variety of retail outlets would be tremendous. We are in sympathy with the fact that a certain amount of revenue must accrue from these taxes. We do not believe that the net result of a retail tax on these items will be as great as a tax placed at the manufacturing level because of the excessive cost of collection. We are as interested as you are, in being sure that the money raised by any such tax will go primarily to defense projects and that too much of it will not be absorbed by administrative costs.

3. The determination of the tax is easy for manufacturers and may be impossible for retailers. The third and last reason can be illustrated best by simple illustration. Suppose that a retailer is selling some costume jewelry, say a necklace, for 25 cents. He cannot collect 2½ cents as tax. He must either collect 2 cents or 3 cents. If he collects only 2 cents, he must himself absorb a portion of the tax, a half-cent, which is 2 percent of the selling price, or approximately his net profit. If he collects 3 cents, there will be plenty of customers to complain and accuse him of gouging them. But, under the bill, as passed by the House, the retailer would be compelled to take one course or the other. On the other hand, the manufacturer sells these necklaces by the dozen. The retailer will probably pay somewhere between $1.80 and $2.40 a dozen for these necklaces which he retails for 25 cents each. You can readily see that it will be a simple matter for the manufacturer to compute and remit the exact tax on any such amount.

These examples could be cited without end. It would be particularly illuminating if you would take a personal trip through the toilet preparations departments of department stores, variety stores, or drug stores. But since the principle should now be clear, I will not take up your time with more examples.

You will hear, of course, that since the manufacturer's price is inevitably lower than the retail price, the Government's revenue would be less from a tax at the manufacturing level. That depends in part upon the rate of the tax imposed.

Nevertheless, I wish to emphasize again that even at the same rate the net revenue to the Government will be greater, after taking into consideration the simplicity of administration and audit, the cheapness of collection, and the questions involved in determining the exact amount of the tax.

For these reasons, I urge you to change the House bill by placing the jewelry, fur, and toilet preparations taxes at the manufacturing level.

The CHAIRMAN. Any questions?

(No response.)

The CHAIRMAN. There are no other witnesses here this afternoon. We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:25 p. m., a recess was taken until 10 a. m., Tuesday, August 19, 1941.)

REVENUE ACT OF 1941

AUGUST 19, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

The first witness this morning is Mr. Livingston W. Houston, of Troy, N. Y.

STATEMENT OF LIVINGSTON W. HOUSTON, TROY, N. Y., CHAIRMAN, COMMITTEE ON GOVERNMENT FINANCE, NATIONAL ASSOCIATION OF MANUFACTURERS

The CHAIRMAN. You are appearing for the Committee on Government Finance, of which you are chairman, of the National Association of Manufacturers?

Mr. HOUSTON. That is correct, sir.

The CHAIRMAN. You may proceed.

Mr. HOUSTON. My name is Livingston W. Houston, Troy, N. Y.

In order to help conserve time we have prepared a number of charts which will be presented to you as I proceed. I think it will be helpful.

The National Association of Manufacturers, through its committee on Government finance, has carefully studied the major task of financing the tremendous cost of national defense. The association has a membership of about 8,000 active companies, which employ about two-thirds of the total number of those gainfully employed in manufacturing industry. It is also probable that most of the companies now producing for national defense are represented in our association.

May we assure your committee that in addition to considering its responsibilities to productive enterprise specifically, the association has been constantly mindful in its study of the fiscal problems of Government, of the general good of the entire Nation, and the need to subordinate all private interests to our major task of building an unsurpassed bulwark of defensive strength.

A financial program to meet the present defense needs should be so planned that a substantial portion of Government costs be paid from current receipts, that a maximum number of citizens contribute their fair share, that a general rise in prices be avoided as far as possible, that post-defense adjustments be not made unnecessarily difficult, and that the maximum defense effort be not curtailed.

We, therefore, suggest that the fiscal program required to place the finances of the Government on a sound basis during this emergency cover the following four main points:

1. The establishment of most stringent economy in the ordinary expenditures of Government through savings in all nonessential items of nondefense spending.

2. Securing additional revenue from taxes in a form and by rates which will neither interfere with national productivity, dry up the sources of Government revenue, or intensify the difficulty of post-defense adjustments.

3. The correction of unsound features of the tax structure whose deterrent effects have been distorted by recent increases in rates and whose inequities will be further amplified by proposed increases in rates now under consideration.

4. The required remainder of funds not secured through economies in spending and by additional taxes should be met by borrowing, designed in such manner that it be subscribed to as far as possible by individual investors out of current earnings.

Critical need for Government economy.—It does not seem just for Congress to consider tremendous new tax burdens without taking prompt and decisive action to eliminate nonessential Government spending. (See chart No. 1.) We urge Congress at this time, when it is demanding great sacrifices from the people, to slash every possible dollar of nonessential spending.

We feel Congress may well approach today's nonmilitary spending as any good business manager approaches his budget in times of emergency. The new items added to fundamental costs are those which should be examined first in seeking to reduce over-all expenses. In the last decade Federal civil spending has expanded over 100 percent. (See chart No. 2.) An item-by-item examination of Federal costs over the period 1932–42 shows an aggregate of $3,665,197,000 of added nonmilitary expenditures in 114 specific categories.

These added costs are here arranged for you in a tree-like structure to symbolize the obvious need to prune Government outlays in the interest of its taxpaying citizens.

The less that is spent for nonessentials by the Government the easier will be the task of your committee in its search for required revenue. Economy ranks first as a means of securing funds to finance today's national emergency.

A healthy tax burden.—Earlier this year and entirely independent of recommendations of the Treasury Department and Congress, the association approved the raising of three and one-half billion dollars additional revenue through taxation in the current fiscal year. In reaching this conclusion, we were guided by the principle that the Government should impose the greatest tax burden possible without disrupting productive enterprise and the defense efforts of the Nation. (See chart No. 3.)

The maximum amount of taxes which may be imposed without harmful effect to a Nation cannot be determined with certainty in advance. But there is some evidence to show that only about one-fourth of the national income can be continually diverted to Government without harmful results to the Nation. For example, the available data on the ratio of taxes to national income in France, Germany, and England shows that they have rather consistently maintained about this 25-percent ratio.

We call your attention to this chart showing the amount of Federal taxes required to attain a 25-percent ration of all taxes—Federal, State, and local—to various assumed levels of national income. For example, with national income at its present level of about $85,000,000,000, and taking into consideration an estimated eight and one-half billion dollars of State and local taxes which must be paid, Federal taxes of twelve and three-fourths billion dollars can be imposed within the 25-percent ratio.

On June 1 the Treasury estimated that the total receipts of the Federal Government for the current fiscal year 1942 would be slightly over $10,000,000,000, under the present law. To attain a 25-percent ratio of all United States taxes to the current $85,000,000,000 level of national income, there remains an additional 2¾ billion dollars to be collected from new taxes in the current fiscal year. The Treasury Department's estimate of the revenue to be collected during the 1942 fiscal year from the new tax bill is almost a billion dollars less than this amount of 2¾ billion dollars, but there is a possibility that these revenue estimates may be understated in the light of the rapidly rising trend of national income.

Where present taxes fall.—A careful examination of the sources of Federal revenue leads to the inevitable conclusion that corporations and a comparatively small group of individual taxpayers have been depended on to carry the major share of record-breaking tax loads. (See chart No. 4.)

Corporations have assumed their full share of the increased tax burden of recent years. The corporate form of business enterprise has become the chief source of Federal revenues, as well as a major source of income to individuals in the form of dividends, salaries, and wages. In 1933 the corporation-income, excess-profits, and capital-stock taxes brought in 19.8 percent of the total receipts of the Federal Government. By 1936 this proportion had grown to 21.4 percent, and corporations are now being counted upon to contribute the largest portion of this year's receipts, with 31.1 percent of the total. Corporations are also subject to State and local taxation equal on the average to more than a third of the net profits before Federal taxes apply.

The present individual income-tax structure is erected on a very small base, taking in only about one-sixth of all possible taxpaying units. (See chart No. 5.) As the need for revenue increased with expanded Government activities, the relatively few have borne greater and greater tax burdens. Tax act after tax act has imposed heavier rates, so that the schedule proposed by the bill now under consideration would be appreciably higher than in the World War period. We have skimmed most of the tax cream from the fairly well-off income groups.

New sources of tax revenue needed.—A calm appraisal of the long-used tax reservoirs finds them drained fairly dry. Sheer necessity should now force the Nation to look for new tax sources. While moderate increases in some of the present taxes may be in order, we have reached the conclusion that the additional revenue required by the Government to finance the defense program may be most easily and fairly achieved through—

1. Some increase in the existing rate upon normal corporate income;
2. An increase in the present 4-percent rate on individual normal income;

3. A broadening of the tax base through a decrease in the individual income-tax exemptions and credits; and

4. A form of general sales tax.

As representatives of industry we are pleased to express our acceptance of a heavier rate upon the normal income of corporations even though, under the proposed new rates, almost one-third of such normal earnings will be handed over to the Federal Government.

In these days of heavy taxes on business earnings, it is important to realize that profits seldom exist entirely in the form of cash. Quite frequently, a very large proportion of profits may be tied up in the form of receivables, inventories, or capital accounts and are not available in cash form. This is particularly true with many companies at the present time because of the tremendous expansion in production due to the defense program. Under such conditions, Congress should consider that many companies may encounter a very serious problem in trying to provide the cash with which to pay present heavy profits taxes.

A very serious consequence of unduly heavy taxation of corporation is the depletion of cash surplus or reserves which may make it very difficult, if not impossible, to live through any prolonged post-defense depression which is almost sure to come.

The entire amount of the combined net income of all profitable corporations in the United States during the present year is estimated to be $15,000,000,000 before the application of anticipated normal and excess-profits taxes of approximately $4,000,000,000. (See chart No. 6.) If the practice of past years continue, more than 70 percent of this aggregate net income will be distributed as dividends during the coming year leaving only some $3,000,000,000 out of a great business of probably more than $150,000,000,000 in the hands of corporations for necessary expansion and for a cushion against the hardships of the post-defense period. This slim margin should be carefully protected in the general interest of the entire Nation, and is a main reason why we urge no increased taxation of so-called excess profits at this time. Congress may well consider some special incentive to business organizations to stimulate the building of reserves to be used to cushion the coming post-defense emergency.

Also, it must be appreciated that the taxation of income in the hands of a corporation is not the final time it is taxed, but the same income is also subject to both the normal tax and surtaxes when received by the individual owners of the corporations.

Under existing conditions ability to pay is rapidly being shifted from corporations to individuals. This is an important reason for broadening the individual tax base. The need for revenue is so great that the great mass of people in the lower brackets must be called upon to contribute their share of needed taxes. Corporations and those in the upper brackets should pay their full share, but their ability to carry additional tax loads is comparatively limited.

Reliable analysis of the national income shows that 75 percent of all incomes received are in the hands of those with incomes of less than $5,000, which are relatively untouched by Federal taxation. (See chart No. 7.) This great group of individuals also are the purchasers of the great bulk of goods consumed in the country and must be considered first in any contemplated check of inflation. The real danger of price inflation lies in increasing tremendously the money in the

hands of this great section of the public in relation to a limited supply of goods.

This is no plea to relieve the well to do from their just taxation. It is merely a recitation of the facts in regard to the limited taxpaying ability of corporations and those with better-than-average earnings. A very substantial part of large incomes now goes into Government coffers. There is general acceptance in and out of Government that present heavy rates on the upper brackets have long since passed the point of diminishing returns.

We recognize that through hidden taxes the average person is already contributing a sizable percentage of his income to Government and we would not here advocate any increase in this present tax burden if the tremendous sums required by national defense could be soundly raised without calling for sacrifice on the part of every person in the United States. (See chart No. 7a.) A relatively small contribution from the great number of average Americans will help produce the great additional tax revenue the armament program demands, and at the same time the people will have a better appreciation of how the Government requires their support.

A sounder tax bill.—The tax bill now before you may be substantially improved in two major ways:

1. By a broadening of the tax base and a lowering of exemptions for the purpose of the normal tax upon individual incomes. (See chart No. 8.)

2. By the enactment of a general sales tax as a major source of Federal revenue and as an effective means of spreading the cost of national defense over the great body of our people.

We commend the retention in the new tax bill of the two yardsticks for measurement of excess-profits taxes. This optional method is required by the basically unsound nature of excess-profits taxation in its application to our intricate and sensitive structure of business. The excess-profits tax should aim at profits derived from the defense program. It should not be used as a vehicle of business control of social reform.

Although we approve the suggested increase to 30 percent of the corporation normal tax in this emergency, we are of the opinion that the present excess-profits-tax rates are now about as high as they should go. As a matter of basic principle, we consider the proposed method of computing excess-profits taxes without giving effect to normal taxes as unsound, because this method will consider as "excess" earnings which are actually normal. The proposed new method also is a subterfuge by which the effective rates of tax upon so-called excess earnings are increased.

In the present intensive search for Government revenue matters of long-standing tax inequity have received scant attention. However, we ask leave to submit for the record a list of suggested amendments to the law which will be constructive and in the long run tend to bring in a greater amount of revenue to the Government.

Among the most unsound features of our corporate-tax structure are the capital-stock and related declared-value excess-profits tax. They do not belong in an equitable tax structure under any circumstances. As a matter of common fairness, if they are not repealed, and particularly in view of the proposed increase in the capital-stock tax, provision should be made to allow an annual declaration of stock value.

FEDERAL GOVERNMENT DEBT

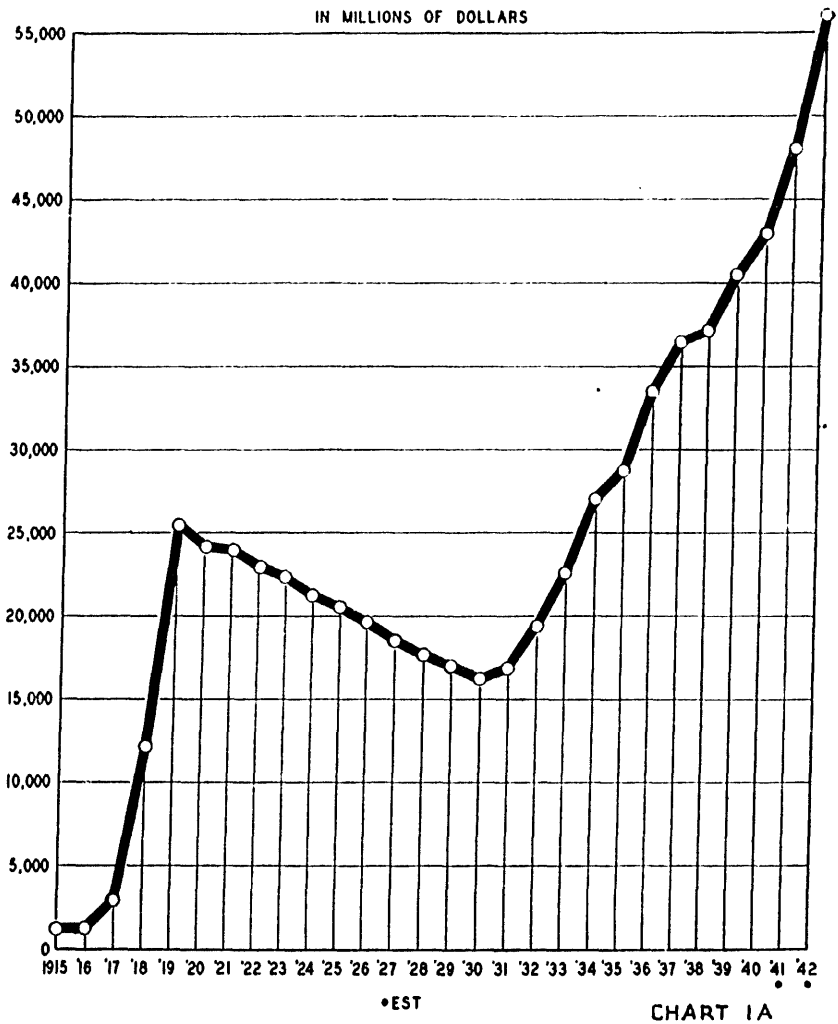


CHART IA

A TREE TO BE PRUNED

INCREASES IN 114 NON-MILITARY ITEMS—SUMMARIZED

(ACTUAL 1932 — BUDGETED 1942)

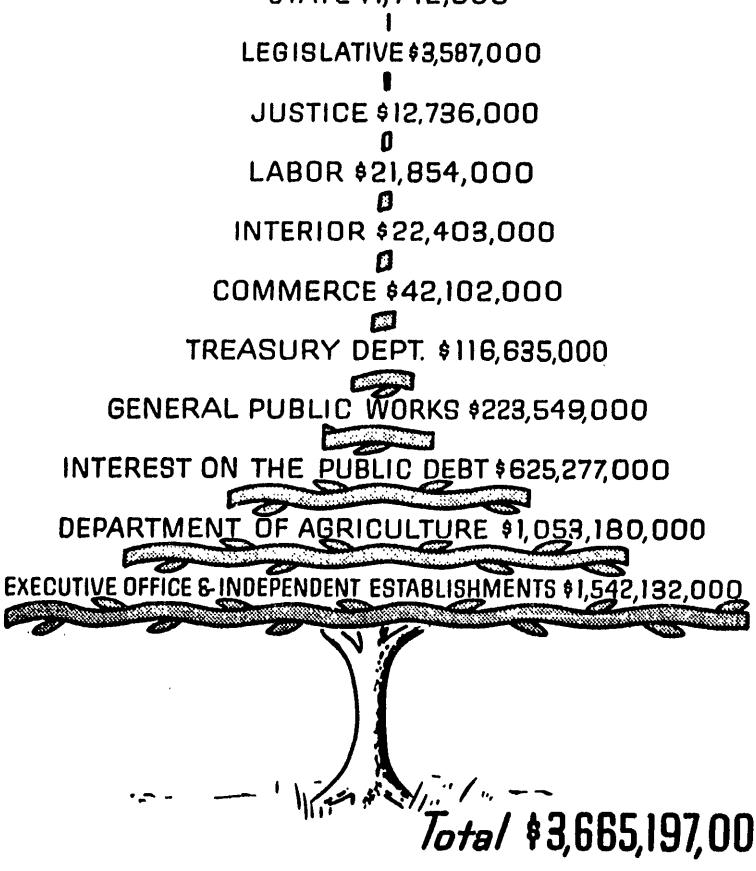
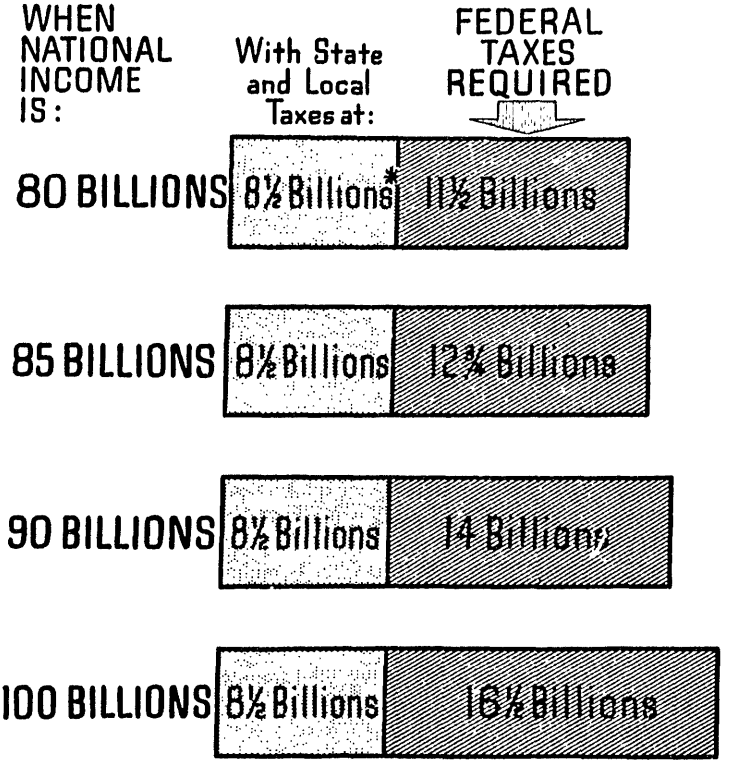


CHART 2

TO ATTAIN 25% RATIO OF ALL U.S. TAXES TO NATIONAL INCOME



*Assumed to be constant

CHART 3

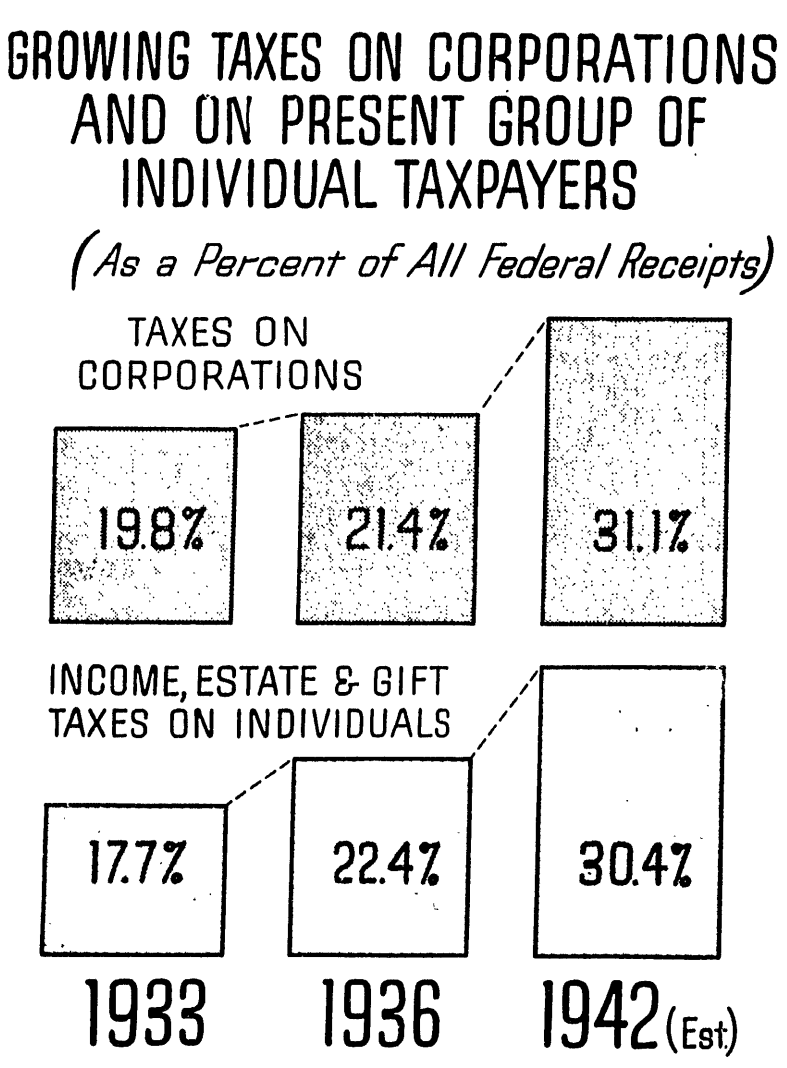

GROWING TAXES ON CORPORATIONS AND ON PRESENT GROUP OF INDIVIDUAL TAXPAYERS
(As a Percent of All Federal Receipts)
TAXES ON CORPORATIONS
19.8%
21.4%
31.1%
INCOME, ESTATE & GIFT TAXES ON INDIVIDUALS
17.7%
22.4%
30.4%
1933
1936
1942 (Est.)

CHART 4

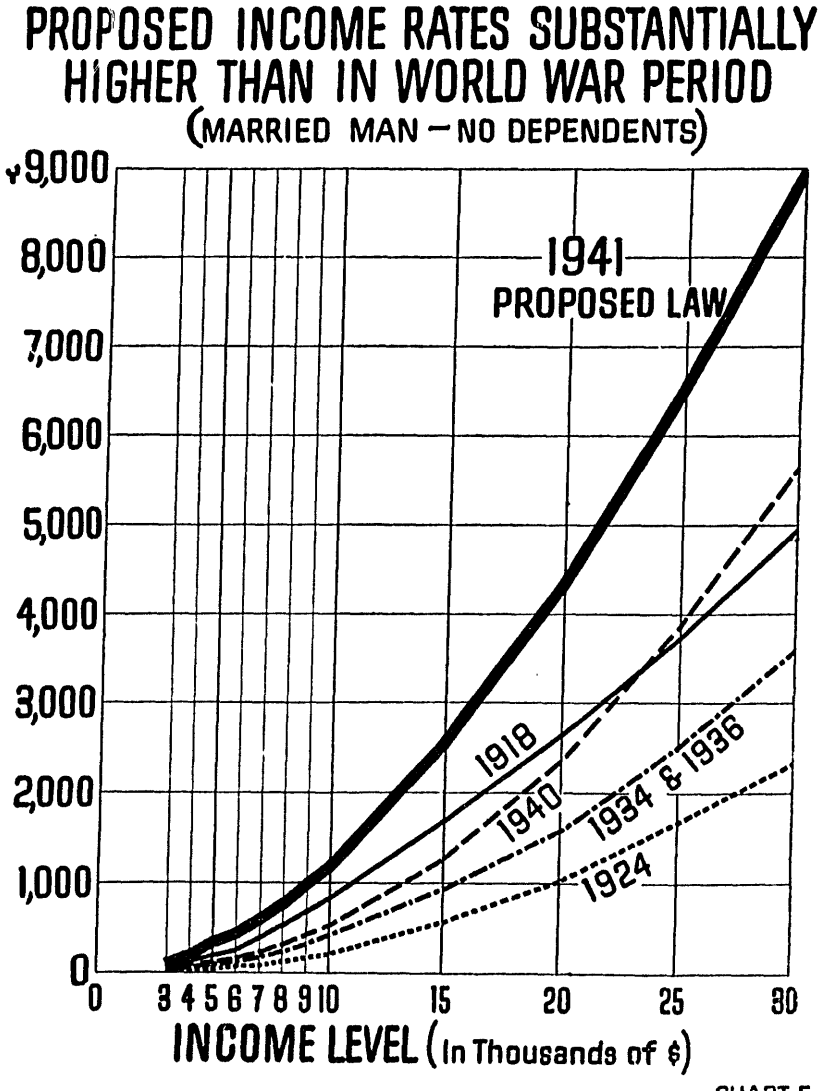
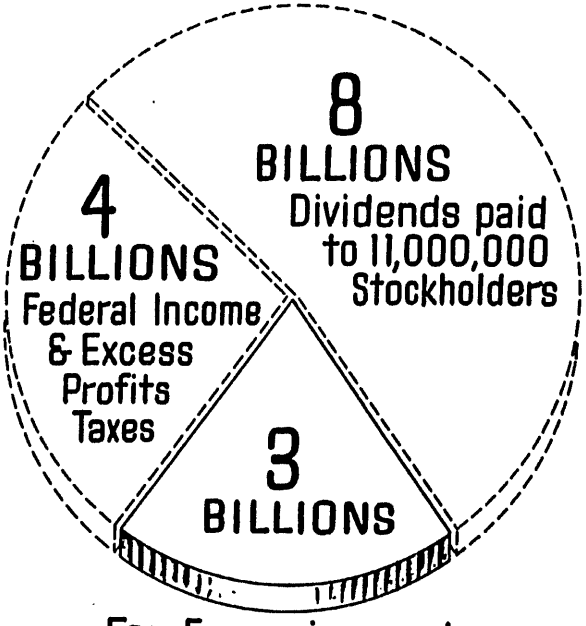

PROPOSED INCOME RATES SUBSTANTIALLY HIGHER THAN IN WORLD WAR PERIOD
(MARRIED MAN — NO DEPENDENTS)
$9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
1941 PROPOSED LAW
1918
1940
1934 & 1936
1924
0 3 4 5 6 7 8 9 10 15 20 25 30
INCOME LEVEL (In Thousands of $)

CHART 5

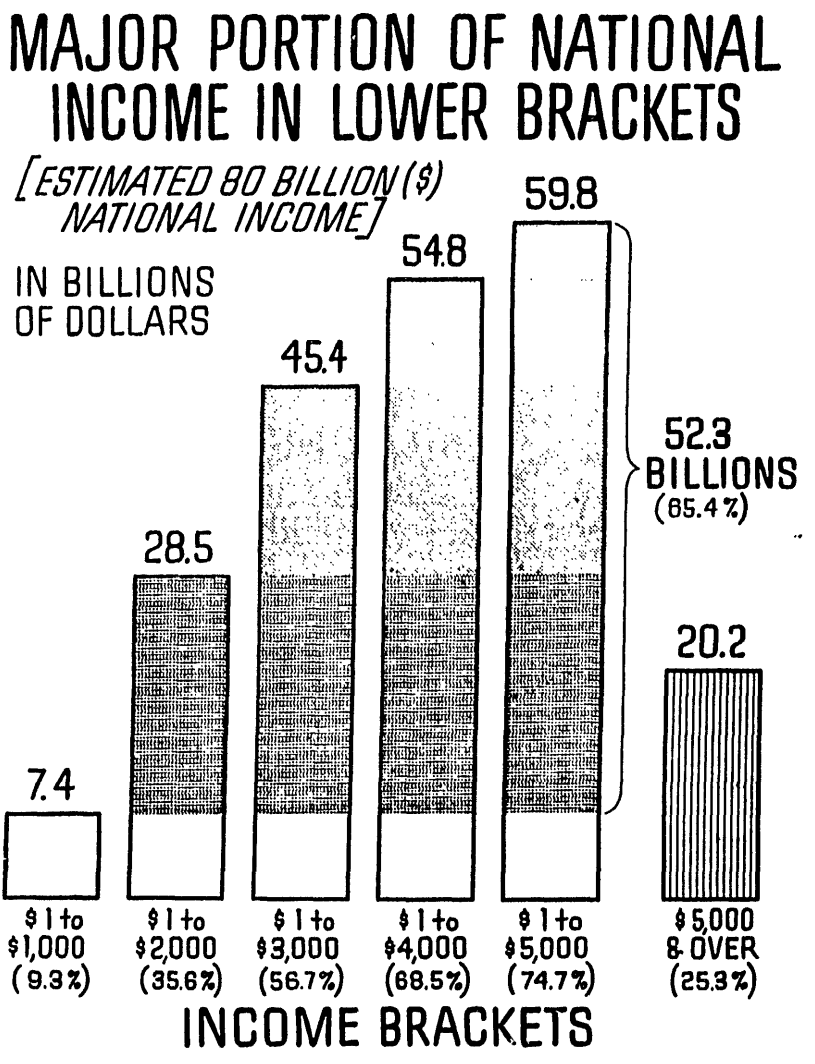
OUT OF A GROSS BUSINESS OF PROBABLY OVER 150 BILLION DOLLARS

ONLY 3 BILLIONS AVAILABLE TO CORPORATIONS AFTER TAXES AND DIVIDEND PAYMENTS



For Expansion and Reserves of 500,000 Corporations

CHART 6

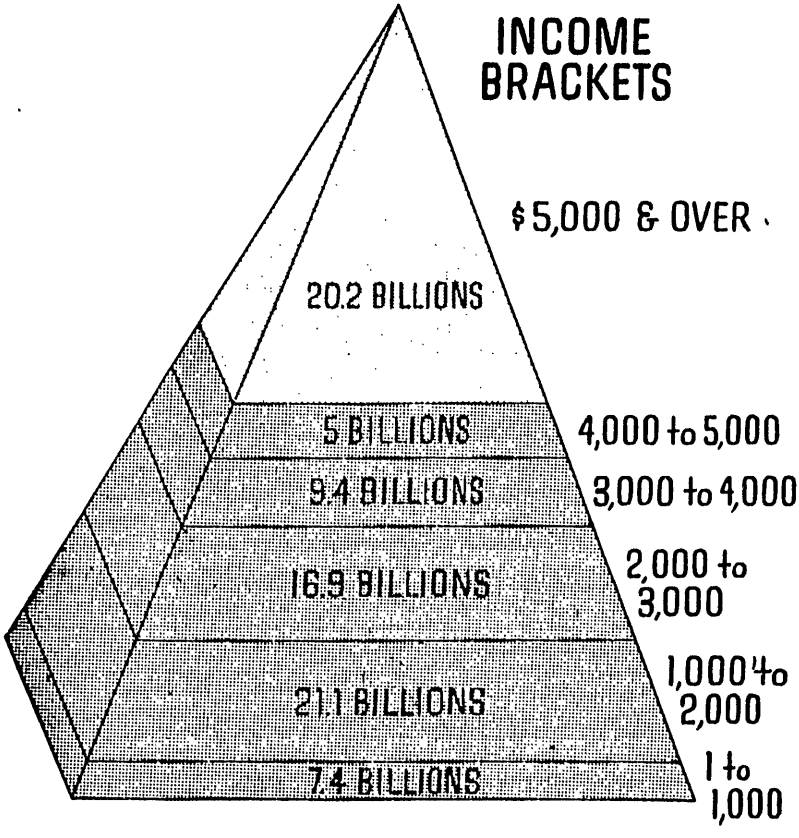


SOURCE: NATIONAL INDUSTRIAL CONFERENCE BOARD

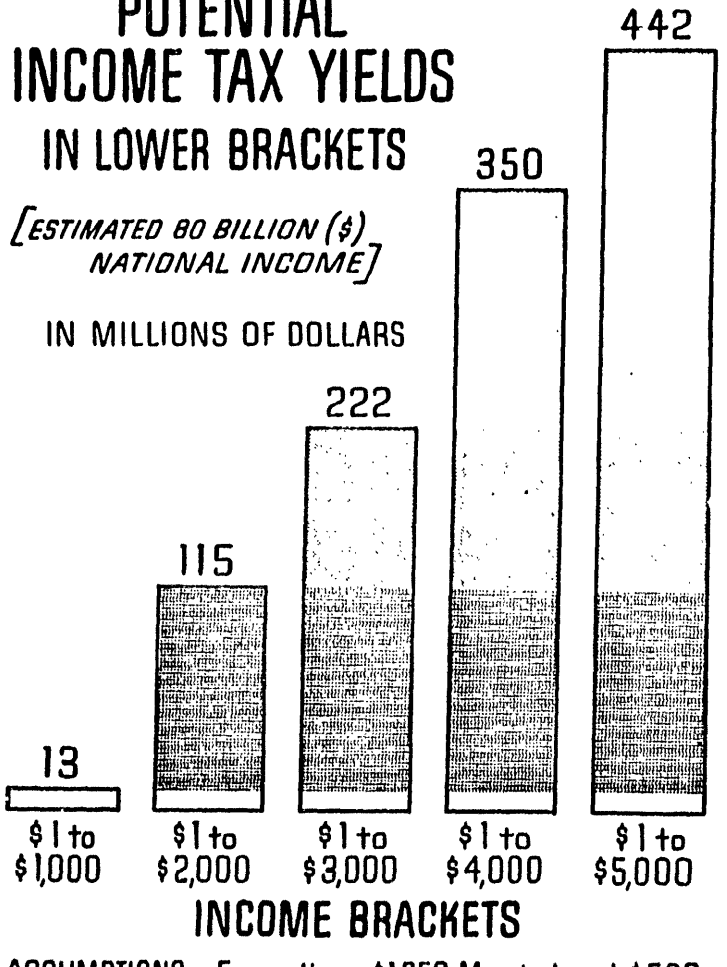
CHART 7

PYRAMID OF NATIONAL INCOME

(ESTIMATED 80 BILLION DOLLARS)



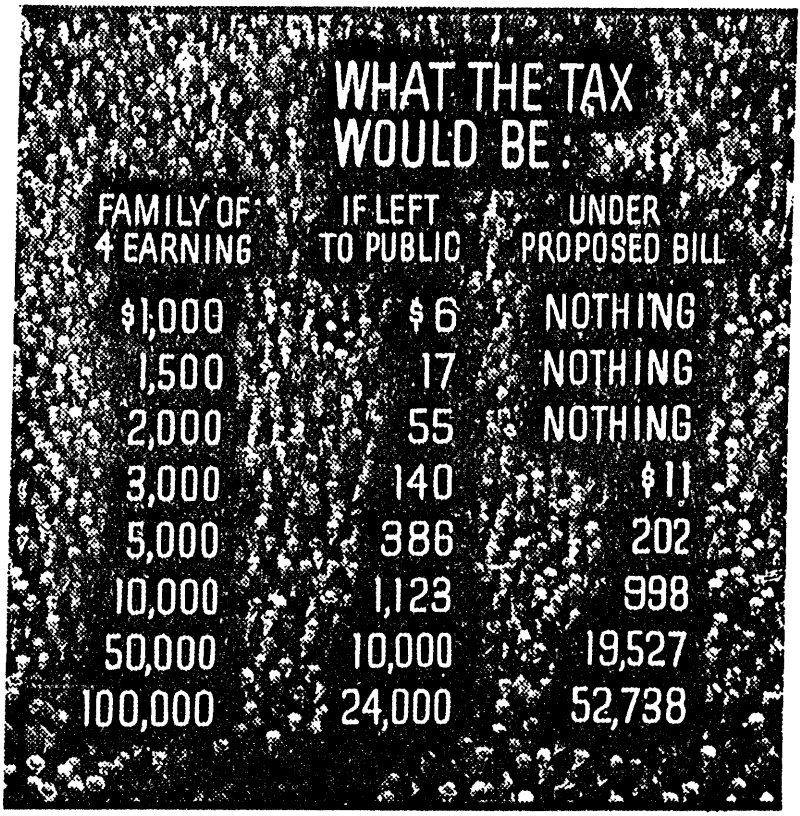
SOURCE: NATIONAL INDUSTRIAL CONFERENCE BOARD CHART 7A



SOURCE: NATIONAL INDUSTRIAL CONFERENCE BOARD

CHART 8

PUBLIC FAVORS CONTRIBUTION FROM LOWER BRACKETS



SOURCE: AMERICAN INSTITUTE OF PUBLIC OPINION CHART 9

The CHAIRMAN. Mr. Hester, will you give your name to the reporter?

STATEMENT OF CLINTON M. HESTER, WASHINGTON, D. C., WASHINGTON COUNSEL, UNITED STATES BREWERS' ASSOCIATION

Mr. HESTER. My name is Clinton M. Hester, Washington, D. C. I am the Washington counsel for the United States Brewers' Association, with headquarters at 21 East Fortieth Street, New York City. This association has been in continuous operation since 1862 and is the only national trade association representing the brewing industry. Its membership comprises about three-quarters of the industry measured on a production-volume basis.

Early this year the United States Brewers' Association selected the firm of Ford, Bacon & Davis, Inc., nationally known engineers of New York City, established in 1894, to make an economic survey of the brewing industry. As a result of this study Ford, Bacon & Davis determined that the Federal and State Governments would have received approximately $10,000,000 more in tax revenue from the brewing industry than they did receive last year had there been no increase in the excise tax on July 1, 1940. In addition, the loss in volume of beer sold following the imposition of this tax has driven many small breweries out of business.

Senator CLARK. Let me ask you, Mr. Hester, the brewing industry made no opposition to the increase in the tax in 1940, did it?

Mr. HESTER. That is right; it gladly accepted it, and found out afterward that it affected the industry seriously.

This $10,000,000 loss to Government is due to the fact that tax rates on beer have increased to the point of diminishing returns. The purpose, of course, of any increase in tax rate is to produce more tax revenue. If, by reason of increasing the tax rate on a product, the amount sold decreases to such an extent that there is no increase in tax revenue as a result, then the point of diminishing returns has been reached.

Experience indicates that the sales volume of mass consumed commodities follows the trend of national-income payments. For example, during the past 5 years there has been a close correlation between national-income payments and the volume of beer sold. In other words, in years when national-income payments rose beer sales increased, and when national-income payments declined beer sales likewise declined in approximately the same proportion.

However, this relationship of beer sales to income payments ceased with the imposition of the dollar defense tax on July 1, 1940. Since that date national-income payments have increased so that the fiscal year just ended has been 16.3 percent higher than the average of the preceding 5 years. On the other hand, during this same year beer sales lagged, and the year closed with a decrease in sales amounting to 1.4 percent below the preceding year and about 0.6 percent below the average of the preceding 5 years.

If beer sales had followed the trend of national-income payments during the fiscal year 1941 and increased 16.3 percent, as did national-income payments, there would have been sold a total of 61,164,000 barrels instead of 52,289,000 barrels which were sold.

On the basis of actual sales, the Federal and State Governments received $380,000,000 in excise taxes. This was at the rate of $6 Federal and $1.26 weighted average State tax, making a total of $7.26 per barrel. Had there been no increase in the excise-tax rate last year and had beer sales followed the upward trend of national-income payments, the 61,164,000 barrels would have returned a tax revenue to Government at the $5 Federal rate existing prior to July 1, 1940, plus the $1.26 State rate, of $383,000,000, or $3,000,000 more than was actually collected.

This is not all of the loss to Government. The loss in beer sales has resulted in a reduction of net earnings to the industry estimated at $27,000,000. The combined income- and excess-profits tax rate for the Federal and State Governments for the calendar year 1940 was 24.9 percent. Thus there was an additional loss to Government from income and excess-profits taxes estimated at $6,700,000, which, added to the $3,000,000 loss in excise taxes sustained last year, makes a total loss to Government of about $10,000,000. This does not take into account additional revenue from income and excess-profits taxes which would have been received by Government if the 61,164,000 barrels had been sold.

From this it is evident that the point of diminishing returns has not only been reached, but passed, and once it has been passed further increases in excise tax rates on beer may be expected to result in further decreases in tax revenue to Government.

Looking at the year just commencing, the national income, according to recent Government figures, is presently running at the annual rate of $87,000,000,000 as compared to $80,000,000,000 at the close of 1940. If beer sales for the full fiscal year 1942 should follow the presently indicated projected rise in national income, they would be at the annual rate of 66,000,000 barrels. This would yield to Government an excise tax revenue of $410,000,000, computed at the tax rates of $5 Federal and $1.26 State. This would be $30,000,000 more in excise tax revenue alone, than was actually collected for the fiscal year just ended.

This anticipated sale of beer is indeed not out of line. Twenty-seven years ago, in the year 1914, more than 66,000,000 barrels of beer were sold to a population of only 97,000,000 people, whereas the population today is over one-third greater.

Senator CLARK. What was the tax at that time?

Mr. HESTER. The tax was a dollar. The Federal tax has increased 600 percent. The total taxes have risen from $1 in 1914 to $7.26 today.

Senator CLARK. You had no State taxes, either.

Mr. HESTER. That is correct.

Senator DANAHER. And beer only cost a nickel.

Mr. HESTER. Yes. There is an apparent ceiling in the consumer price of beer, to go beyond which results in a disproportionate loss in the volume of beer sold. Following the tax rise last year the brewers passed on about 80 percent of the increase to the retailers. In turn about half of the retailers increased the price of beer to the consumer, either by using a smaller glass, or increasing the unit price. This resulted in a major loss in volume of beer sold by the industry.

The increase in the unit price of bottled and canned beer worked a particular hardship on the small local brewer, since it brought his product directly into price competition with the nationally advertised brands.

We make no attempt to defend those retailers who increased the price of their beer in excess of the amount of the tax increase. Of course, the brewers are prohibited by Federal and State law from having any control over the retail distribution of their product. However, in justice to the retailers it should be pointed out that they operate on a small margin which is indicated by the heavy mortality among them. Moreover, the loss in sales volume, due to the increased price, may well offset the apparent profit indicated by the increased prices.

If excise taxes are further increased and passed on to the consumer, as they must be, this practice of increasing retail prices, resulting in reduced volume, will undoubtedly continue and spread throughout the retail trade to the further detriment of the industry and Government alike.

Our problem, in a sense, is a mutual one. The Government and the brewing industry are partners in an $894,000,000 sales volume business. These two partners divided $428,000,000 in the fiscal year 1941, Government receiving for excise, income, and excess-profits taxes alone $395,000,000, and the brewers $33,000,000, or an average of 63 cents a barrel for the industry as a whole. The remaining $466,000,000 went for wages, farm produce, local taxes, the purchase of other materials, and all other costs necessary to make and sell the beer.

Senator BROWN. Mr. Hester, those figures indicate to me in a general way that the Federal and State tax is 50 percent of the purchase price; is that correct?

Mr. HESTER. That is correct.

Senator BROWN. In other words, beer sells for around $15, and the tax is somewhere around $7.25, a barrel.

Mr. HESTER. It is a little higher than that, it is somewhere around $16.

The industry is not a profitable one, generally speaking. A few companies make most of the profits and the largest number make little or no profits. It is a hazardous industry from the financial standpoint, as is well known.

We are firmly of the opinion that the industry will be seriously crippled by an increased excise tax on beer and that neither Government nor the industry will receive as much in revenue as they would if no further increase in excise tax is imposed.

The brewing industry is not competitive with national-defense industries, and it fits into the economy of the Nation at this time as well as in normal times.

We respectfully submit to you that no further increase in excise tax should be imposed on beer.

Mr. Chairman, Ford, Bacon & Davis made a report, referred to in my testimony, dated March 27, and a supplement to that report, dated May 7, which were based upon the past and current data up to the end of the calendar year 1940. These reports were submitted by me as part of my testimony before the Ways and Means Committee on May 14, 1941.

I wish to submit these reports to this committee, but in the spirit of economy, I will not ask to have these reports reprinted, but instead I will ask that the record show that they may be found in full on pages 1080 to 1106, inclusive, volume 2, in the hearings of the Committee on Ways and Means, Revenue Revision of 1941. I recommend the reading of these reports as they are germane to this case.

Since our appearance before the Ways and Means Committee, the fiscal year of June 30, 1941, has been completed, and Ford, Bacon & Davis has prepared another supplement that brings the essential information in the earlier reports down to date, as of June 30, 1941. This supplement is dated August 6, 1941, which I ask to have included as a part of my testimony before this committee.

In addition to the afore-mentioned reports submitted to the Ways and Means Committee was also a country-wide survey prepared by Opinion Research Corporation which was a study made by a series of interviews with retailers serving beer for on-premises consumption, which shows that 49 percent of the retailers called on increased the price of beer to the consumers either by reducing the size of the glass or increasing the unit price in the case of bottled and canned beer. This report is also germane to the case and is published in the hearings of the Ways and Means Committee above referred to, on pages beginning with 1107 to 1111, inclusive.

The Director of Opinion Research Corporation, Dr. Claude Robinson, was formerly director of Dr. Gallup's well-known Institute of Public Opinion.

(The supplement to the report of Ford, Bacon & Davis is as follows:)

SUPPLEMENT TO REPORT DATED MARCH 27, 1941; EFFECT OF THE EXCISE TAXES ON THE BREWING INDUSTRY, AUGUST 6, 1941

By FORD, BACON & DAVIS, INC.

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Beer consumption decreases.
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Disposition of the brewery sales dollar.
Summary.
Conclusions.
Chart A—Distribution of the brewers' sales dollar.
Exhibit No. 1—Withdrawals of beer in fiscal years 1905 to 1941, inclusive, omitting prohibition years

FORD, BACON & DAVIS, INC.,
New York, N. Y., August 6, 1941.

UNITED STATES BREWERS' ASSOCIATION,
New York, N. Y.

DEAR SIRS: Since the preparation of our main report, Effect of Excise Taxes on the Brewing Industry, dated March 27, 1941, and the supplement to that report dated May 7, 1941, the fiscal year July 1, 1940, to June 30, 1941, has ended and additional information has been made available.

For the purpose of bringing down to date the information on the subjects of beer consumption, national income, and taxation contained in these reports, this supplement has been prepared. It should be read in conjunction with the previous reports.

With the close of June 1941 the first full year's effect of the excise tax increase of $1 per barrel of beer, effective July 1, 1940, can be analyzed. Since this supplemental report immediately follows the end of the fiscal year 1941, the data prepared herein are on the basis of fiscal years ended June 30, whereas the exhibits in the earlier reports, based on data as of December 31, 1940, were generally on the calendar-year basis.

We make no attempt to defend those retailers who increased the price of their beer in excess of the amount of the tax increase. Of course, the brewers are prohibited by Federal and State law from having any control over the retail distribution of their product. However, in justice to the retailers it should be pointed out that they operate on a small margin which is indicated by the heavy mortality among them. Moreover, the loss in sales volume, due to the increased price, may well offset the apparent profit indicated by the increased prices.

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BEER CONSUMPTION DECREASES

Exhibit No. 1 shows the withdrawals or apparent consumption of beer by fiscal years 1905 to 1941, inclusive, in barrels and in gallons per capita.

An analysis of exhibit No. 1 shows the withdrawals or apparent consumption of beer for the fiscal year 1941 was less than 1940 by 725,000 barrels, and less than the average of the 5 preceding years by about 300,000 barrels.

NATIONAL INCOME PAYMENTS INCREASE

This decrease in beer sales has been despite the increase in national income payments and the increase in salaries and wages as reported by the Department of Commerce in the Survey of Current Business.

The following table, based on indices representing total income payments by months for the fiscal years of 1940 and 1941, published by the Department of Commerce, is evidence that the national income has been constantly increasing since the spring of 1940, when defense expenditures began to assume real importance. The monthly average income-payment index has increased from 109 to 120 between the fiscal years of 1940 and 1941, an increase of approximately 10 percent.

Month	Adjusted indexes representing total income payments, 1935-39=100		Month	Adjusted indexes representing total income payments, 1935-39=100	
	Fiscal year ended June 30, 1940	Fiscal year ended June 30, 1941		Fiscal year ended June 30, 1940	Fiscal year ended June 30, 1941
July	104.6	111.7	February	110.1	123.0
August	106.5	113.3	March	108.8	123.7
September	107.8	114.6	April	109.1	124.5
October	109.1	115.8	May	110.1	127.7
November	109.9	116.6	June	110.2	[1] 128.3
December	111.2	119.0			
January	110.6	121.3	Monthly average	109.0	120.0

[1] Estimated.

Despite this increase in national purchasing power, beer sales decreased in the year following the excise-tax increase of July 1, 1940.

GOVERNMENTAL REVENUE FROM BEER EXCISE TAX DECREASES

On pages 11 to 14 in our main report we presented a discussion that shows that the trend of beer consumption since 1935, after the industry became stabilized, was closely related to the trend of national income payments. This relationship remained fairly constant up to July 1, 1940, at which time the $1 per barrel increase in Federal excise tax became effective. In the fiscal year of 1941, following this tax increase, this relationship between the trends of beer sales and national income ceased. Beer sales in 1941 were actually considerably lower than in the fiscal year 1940 but slightly lower than for the average of the 5 preceding years, whereas income payments resulting principally from defense expenditures increased materially in the fiscal year 1941.

It is entirely reasonable to assume that the established relationship of beer sales to national income would continue unless disturbed by other factors such as the excise tax increase referred to.

As a result of this actual decrease in beer sales, the amount of revenue derived from excise taxes from the brewing industry by Government was actually less with the increased tax rate in effect than it would have been had the old tax been retained permitting beer sales to increase proportionally with the increased national purchasing power.

The following table is a computation to show the effect of the increased excise tax and the estimated consumption of beer that should result from the increased purchasing power in the fiscal year of 1941 had there been no tax increase last year:

	National income payments, million dollars	Beer consumption	
		Thousand barrels	Barrels per $1,000 of income payments
5-year average, fiscal years 1936 to 1940, inclusive	68,925	52,582	0.763
1941, actual	80,162	52,289	.652
1941, estimated on basis of no increase in tax as of July 1, 1940	80,162	[1] 61,164	.763

[1] Computed. This computed figure of 61,164,000 barrels of beer is determined by multiplying the 5-year average beer consumption factor per $1,000 of income payments (0.763) by $80,162,000,000, the estimate of income payments in the fiscal year 1941 prepared by the Department of Commerce.

The total Government tax revenue for the fiscal year ended June 30, 1941, with a $1-per-barrel Federal tax and a weighted average State tax of $1.26 was approximately:

$$52{,}289{,}000 \text{ barrels} \times \$7.26 = \$380{,}000{,}000$$

Had there been no increase in excise taxes last year, and if beer sales had increased proportionately to income payments, there would have been over 61,000,000 barrels of beer sold. The tax rates would then have been $5 per barrel Federal, plus $1.26 State taxes, making a total of—

$$61{,}164{,}000 \text{ barrels} \times \$6.26 = \$383{,}000{,}000$$

From this computation it is seen that Government actually lost about $3,000,000 in excise-tax collections in the first full year following the increase in excise tax and because of the lower volume of beer sold.

This anticipated sale of beer is indeed not out of line, as 27 years ago, in the year 1914, more than 66,000,000 barrels of beer were sold to a population of only 97,000,000 people, whereas the current population is over one-third greater.

GOVERNMENT LOSES INCOME TAXES

This indicated $3,000,000 loss in excise-tax revenue to Government is not all. In our former report we analyzed the corporate earnings of industry based on the questionnaires received and determined that the loss in net earnings to the industry after the curtailment of consumption following the increase in excise tax, resulted in a decrease in income and excess-profits-tax revenue to Government of at least $6,700,000.[1] This amount, added to the indicated loss in excise-tax revenue, is approximately $10,000,000, due entirely to lower earnings because of the decreased consumption of beer.

If, on the other hand, beer sales had followed the trend of national purchasing power and had increased 10 percent the corporate earnings of the industry would naturally have increased and the income-tax revenue, instead of decreasing, would have been substantially greater.

From this we conclude that the critical point in beer taxation has been passed and the law of diminishing returns has operated to the detriment of Government income.

By this we mean that the increased tax of $1 per barrel effective during the last fiscal year, during which time there was a 10-percent increase in consumer purchasing power, that Government has received less revenue in excise and income taxes by at least $10,000,000 with the increased rate in effect than it would have received had the old rate been retained.

Once the point of diminishing returns has been passed further increases in tax rates may be expected to result in further decreases in tax revenue to Government.

A CEILING TO CONSUMER PRICES

In our previous report we stated that the majority of the brewers attempted to pass on the tax increase of July 1, 1940, because they could not absorb the

[1] Computed at the rate of 24.9 percent (the industry's average income and excess-profits tax rate in the calendar year 1940) on the estimated reduction of $27,000,000 in net earnings which followed the tax rise of $1 per barrel of July 1940. This will be greater if based upon the probable higher income and excess-profits tax rate that will prevail on 1941 earnings.

additional burden; that the tax was passed on to the retailers by the wholesalers because the operating margin of the wholesaler was too small to absorb this tax; and that a large part of the retailers passed the tax on to the consumers either through charging more per unit of sales or by cutting the size of the glass used for the same price.

The basis for these statements was an analysis of the 217 usable returns as stated in our earlier report of March 27, 1941, and supplement of May 7, 1941, representing 67 percent of the industry based on volume of sales in 1940. The answers to the questions asked were made by the brewers from their observations following the tax increase of July 1940, in the territories served by them.

The answers naturally varied in importance as a large brewer may serve several States and a small brewer may be confined to a few counties. These answers indicated the following broad trends in price changes to consumers following the Federal tax increase of July 1, 1940:

ON-PREMISE CONSUMPTION

Draft beer.—Majority indicated no change in unit price of 5 cents for a "short" beer and 10 cents for a "regular."

Majority indicated a reduction in size of glass of from 1 to 4 ounces, generally averaging a reduction of about 15 to 20 percent.

Packaged beer.—About half indicated an increase in price per bottle usually from 10 to 15 cents and half indicated no change in price. No one reported increases involving odd-cent prices.

OFF-PREMISE CONSUMPTION

Packaged beer.—Majority indicated that almost the exact amount of the tax increase was passed on which was equivalent to 1 cent per three 12-ounce packages. The use of odd-cent prices for delicatessen and grocery-store merchants was common.

Subsequent to the issuance of our main and supplemental reports, the Opinion Research Corporation made a study of beer retailers and issued a report dated May 10, 1941. This study was reported as a survey made by personally interviewing proprietors of retail beer-dispensing places (other than cocktail lounges or de luxe establishments) in 29 cities of the United States where draft beer is sold. The purpose of the survey was to determine whether and how the retailers passed on the tax increase of July 1940 to the consumers. The report stated that the survey was made in a manner to insure a representative cross section or sampling. The principal findings reported in the Opinion Research survey are as follows:

On-premise consumption

	Percent
Draft beer:	
Retailers that reduced size of glass used for draft beer	29
Retailers that reduced amount of beer sold per unit presumably by drawing a larger head	8
Total reducing size of unit sold for former unit price	37
Packaged beer: Price of unit reported as increased	32

Eliminating duplications, the report stated that 49 percent of the retailers called on, increased the prices of draft beer, packaged beer or both. It was also stated that the interviewers experienced considerable reluctance on the part of the retailers interviewed in admitting that they had reduced the amount of beer sold for the former unit price. For this reason the percentages reported may be an understatement of the actual situation.

The facts and findings of this report by Opinion Research Corporation confirm the statements of the brewers in the questionnaire survey made by us.

A study of all of this information, obtained from entirely different and independent sources, and made by different procedures substantiates the conclusion in our earlier report and supplement to the effect that there is a ceiling that limits further advances in the consumer price without a disproportionate loss in volume of sales.

EFFECT ON THE BREWING INDUSTRY

The foregoing arguments against further increases in excise taxes on beer have been based purely on the effect on tax revenue to the Federal and State

Governments. No mention has been made of the effect of the increasing taxes on the brewing industry itself.

The curtailment of beer sales, however, has wrought considerable damage to the industry, particularly the small brewers.

In our supplementary report of May 7, 1941, we analyzed the financial returns of breweries representing 67 percent of the volume of sales in the calendar year 1940. Over 40 percent of the number analyzed producing 14 percent of the beer sold in 1940 sustained an actual loss of 58 cents per barrel in that year. Since most of the companies that did not return questionnaires averaged sales of less than 50,000 barrels per year, and were smaller than the average loss companies analyzed, the assumption follows that over 50 percent of the brewers producing nearly half of the beer sold operated at a net loss in 1940 and that moderate profits were made by only a relatively few companies.

Such a situation naturally might be expected to lead to business failures. The number of brewers has been decreasing since 1935. The reduction in the number of breweries operating has been as great in the year 1940 as in the 4 preceding years and the number of breweries operating is currently decreasing. As reported by the Treasury Department the number of operating breweries since 1935 is—

Year:	*Number of operating breweries*
1935	750
1936	732
1937	720
1938	696
1939	[1] 653
1940 (December)	[2] 559
1941 (June)	[3] 539

[1] Reduction of 97 since 1935.
[2] Reduction of 94 since 1939.
[3] Reduction of 20 in 6 months and of 114 since 1939.

DISPOSITION OF THE BREWERY SALES DOLLAR

Based on the available information the total estimated wholesale sales of the brewing industry for the fiscal year 1941 was $894,000,000.

The cost of producing and selling the beer including the purchase of over $160,000,000 of farm products such as barley malt, hops, corn, rice, etc., and the wages, salaries, miscellaneous taxes, and other expenses incident to manufacture absorbed $466,000,000, or 52 percent of the gross sales amount.

The remaining $428,000,000 was divided between the Federal and State Governments as excise and income taxes and the brewers as a profit on their business venture. This division was:

To Government	$395,000,000
To the brewers	33,000,000

The following table states this break-down in total amounts, in amounts per barrel of beer sold and in percent of total sales:

Profit-and-loss statement for brewing industry estimate for fiscal year ended June 30, 1941

	Total amount	Amount per barrel	Percent
Total wholesale sales of 52,289,000 barrels of beer	$894,000,000	$17.10	100.0
Cost of production and selling	466,000,000	8.91	52.1
Amount divided between Government and brewers	428,000,000	8.19	47.9
Federal and State Government excise and income-tax receipts	395,000,000	7.56	44.2
Profit to the brewers	33,000,000	.63	3.7

This table is graphically illustrated by chart A appended to this supplement.

It is apparent from this analysis that Government has about 12 times the interest in maintaining the industry than the brewers who own the businesses.

SUMMARY

The analyses of the facts revealed in the first full year of operation following the Federal tax increase of July 1940 fully substantiate the findings made in our earlier reports.

The last fiscal year has reflected a steady increase in the rate of national income amounting to an average of about 10 percent. Beer sales which followed the trend of national earnings up to July 1, 1940, actually decreased following the tax increase both as compared to 1940 and to the average of recent preceding years.

A computation of beer tax revenue based on the actual fiscal year figure indicates that Government received about $10,000,000 less money with the increased rate than it would have received with the increased volume of sales had no increase in rate been imposed. This indicates that the point of diminishing returns for beer sales and tax revenue has been passed.

Most of the last beer tax increase was passed on to the consumer either in increased prices or smaller amounts sold at the former unit prices both of which resulted in decreased sales. The extent to which the tax increase was passed on to the consumer has been established by the independent survey of retailers by Opinion Research Corporation. If further increases in excise taxes are imposed this trend of increasing consumer prices and decreasing volume may be expected to continue and become a greater factor to the detriment of the industry and to Government.

CONCLUSIONS

From a review of our findings as presented in our previous report and supplement and in the light of the additional information presented in this second supplement, we are of the opinion that our previous conclusions as stated below have been substantiated. These are:

1. There is a ceiling limiting further advances in the price to the consumer without a disproportionate loss in volume of beer sold.

2. The tax level has reached a point where more revenue to Government cannot be anticipated through a further increase in present tax rates; in fact, it seems probable that less revenue would result should an increase in rates be imposed.

Very truly yours,

(Signed) FORD, BACON & DAVIS, INC.

EXHIBIT No. 1 (August 1941).—*Withdrawals of beer in fiscal years 1905 to 1941, inclusive, omitting prohibition years*

Fiscal year ended June 30	Population of United States	Withdrawals of beer	
		Barrels	Per capita (gallons)
1905	83,983,420	49,460,000	18.3
1906	85,581,189	54,052,000	19.8
1907	87,178,958	58,546,000	20.8
1908	88,776,727	58,748,000	20.5
1909	90,374,496	56,303,000	19.3
1910	91,972,266	59,485,000	20.0
1911	93,346,101	63,217,000	21.0
1912	94,719,936	62,109,000	20.3
1913	96,093,771	65,246,000	21.0
1914	97,467,606	66,105,000	21.0
1915	98,841,441	59,747,000	18.7
1916	100,215,276	58,584,000	18.1
1917	101,589,111	60,730,000	18.5
1918	102,962,946	50,175,000	15.1
1919 [1]	104,336,781	30,540,000	9.1
1934 [1]	126,332,738	32,266,000	7.9
1935	127,222,161	42,229,000	10.3
1936	128,111,584	48,760,000	11.8
1937	129,001,007	55,302,000	13.3
1938	129,890,430	53,926,000	12.9
1939	130,779,853	51,817,000	12.3
1940	131,669,275	53,014,000	12.5
1941	132,600,000	52,289,000	12.2

[1] Prohibition years 1920 to 1933 omitted.

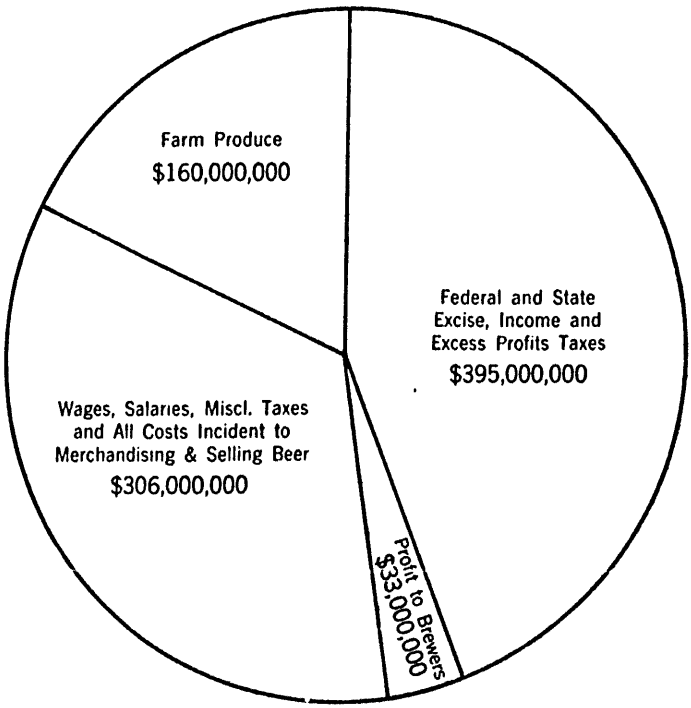
Sources: U. S. Census. U. S. Treasury Department, Bureau of Industrial Alcohol.

CHART A

DISTRIBUTION OF THE BREWERS' SALES DOLLAR

COMPUTED FOR FISCAL YEAR ENDED JUNE 30, 1941

Ford, Bacon & Davis
Engineers



Total Estimated Industry Sales
For Fiscal Year Ended June 30, 1941-$894,000,000

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Senator CLARK. You spoke of large breweries and small breweries. Have you any way of breaking down what you call large breweries and small breweries as to the number?

Mr. HESTER. There are about 50 large breweries and about 480 small breweries.

Senator CLARK. When you say "small breweries" you mean local breweries, breweries doing local trade?

Mr. HESTER. That is right; the local business.

Senator GUFFEY. How many of the small breweries closed in the last 2 or 3 years?

Mr. HESTER. In 1935 there were 750 breweries in this country. I might say in 1914 there were about 1600. Today there are less than 540 breweries, and in the past year there have been about 40 brewery failures.

Senator LA FOLLETTE. Mr. Hester, may I ask were Ford, Bacon & Davis given a free hand in making this study?

Mr. HESTER. Their study was absolutely objective. As a matter of fact, it was made in this way: They handled it entirely with the industry and the association had nothing to do with it.

Some of the information upon which their findings were based is information which is contained in the income-tax returns of the brewers to the Treasury Department. Senator La Follette, we would be pleased to have this committee inspect the income-tax returns of every brewing corporation in this country.

Senator CLARK. Mr. Hester, I read some place that the sales of beer for June of this year were very much below the sales of beer for June of last year, and, on the other hand, the sales of beer for July were very much above the sales of beer for July last year. Is that correct?

Mr. HESTER. I am glad you brought that question up.

The Treasury has not released its official figures yet, but the situation is this: In June of this year beer sales were 4 percent below beer sales of June of last year. Last year beer sales were way up because of the fact that Congress did not impose any tax, any floor-stock tax, on the retailer, so they bought up. Consequently this adversely affected beer sales in July of last year.

For July last year beer sales were 5.6 percent below the previous July. This year the sales are way up for July. As a matter of fact, we estimate they are up 20 percent for July, but in June they were down 4 percent. Weather influences beer sales. Weather averaged 4 percent warmer this July than July last year. April, May, and June of this year were very much warmer than the corresponding months of last year. In January this year beer sales were up 9 percent, then in February and March they were down 1½ percent, and in April they went up about 8 percent, and in May 10 percent, and then went down again in June, and for the fiscal year, this year—this is the amazing thing about it, and I think it is the focal point in the whole case—where the national income has gone up tremendously beer sales for the past year were actually 1.60 percent below the fiscal year 1940. National defense expenditures are affecting beer sales and if it had not been for such expenditures beer sales would have been still lower than last year.

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

Senator CLARK. I want to ask one other question, Mr. Chairman.

Mr. Hester, you spoke a while ago of the method by which the retailer absorbs this increased price of beer, by cutting down the size of his glass or increasing the price of the bottle.

Have you got any way of showing what the actual effect has been since this increase in tax on the size of the glass and the price of the container?

Mr. HESTER. The situation is this, the United States Brewers' Association employed Opinion Research Corporation, whose director is Dr. Claude Robinson, former director of the Gallup Institute poll, to make a survey throughout this country and determine just what was done by the retailer, and they found that 50 percent of the retailers either cut the size of the glass or increased the price of the bottled beer, and that was the cause of the loss in volume which so seriously affected particularly the small brewer.

Senator CLARK. Have you got that report, Mr. Hester?

Mr. HESTER. Yes; I just asked the chairman if I could incorporate it in the record by reference to volume 2, page 1107, of the House hearings.

The CHAIRMAN. Yes; it may be included in that manner.

Mr. HESTER. In conclusion I would like to suggest that the more money our Government has to raise for national-defense purposes, the more it should give consideration to the operation of the law of diminishing returns.

The CHAIRMAN. Thank you very much.

Mr. Joseph Obergfell.

STATEMENT OF JOSEPH OBERGFELL, CINCINNATI, OHIO, GENERAL SECRETARY AND TREASURER, BREWERY WORKERS' INTERNATIONAL UNION, AND FIRST VICE PRESIDENT, UNION LABEL TRADES DEPARTMENT, AMERICAN FEDERATION OF LABOR

The CHAIRMAN. Mr. Obergfell, you are general secretary and treasurer of the Brewery Workers' Union of the American Federation of Labor?

Mr. OBERGFELL. Yes, sir.

The CHAIRMAN. You are appearing on the beer tax?

Mr. OBERGFELL. Yes, sir.

The CHAIRMAN. All right, you may proceed.

Mr. OBERGFELL. My name is Joseph Obergfell and I appear before you as the general secretary and treasurer of the Brewery Workers' International Union and first vice president of the Union Label Trades Department of the American Federation of Labor and the wage earners in general, in protest against any increase in tax on beer.

In doing so, we are mindful of the great task confronting you, to provide funds to enable our Government to carry out the tremendous defense program.

It is not because we seek to shirk any personal responsibility in these critical times that we are concerned over and opposed to any increase in the tax on beer. Our concern and our opposition arise solely from the realization that an added Federal tax on beer will not only not bring about the results desired by our Government, but

will work to the economic disadvantage of thousands of loyal Americans.

The restoration of the brewing industry created employment opportunity for more than a million wage earners.

In addition to employment opportunity to workers engaged directly in the brewing industry, there are more than 10,000 wholesalers, and approximately 330,000 retailers, affording a widespread volume of employment.

Many thousands of employees were added by allied industries engaged in supplying and servicing the brewing industry affording employment to building tradesmen, employed in maintenance and new construction work; metal tradesmen, employed in the maintenance and construction of new machinery; printing tradesmen, printing billions of labels used on bottle beer, plus other printing matter used in the brewing industry; glass-bottle blowers; coopers; box makers; carton manufacturers; and many others, too numerous to mention.

In addition, more than 100,000 full-time farm workers are engaged in the production of brewery crops, consisting of barley malt, corn, rice, and hops, as well as workers engaged in the processing of grain used in the brewing industry.

Beer is the beverage of moderation, consumed largely by the wage earners—the workers who, with limited earnings, cannot purchase a commodity priced beyond their means.

Proof of this was witnessed following the $1 Federal-tax increase in July 1940. Many breweries throughout the country were financially unable to absorb this added tax, and were forced to pass it on to the consumer. The result was that consumption of beer declined. Over 725,000 barrels in the first fiscal year following the tax increase. And this was directly responsible for the closing of 43 breweries, and the ensuing loss of employment to countless workers in the brewing and allied industries. This despite the fact that industrial employment and pay rolls were constantly reaching new heights, and industrial activity in general was at an all-time high.

The brewing industry cannot absorb a further increased tax on beer, and will be compelled to pass it on to the consumer, hence a further decline in the consumption is certain to follow. More breweries will be forced to suspend operations, and still more workers will be thrown out of employment.

From the viewpoint of the worker, this is serious enough, but there is still that other important factor to be considered.

A further tax increase would, unquestionably, reduce the sales, since even with the added tax, less revenue would be derived by the Government, so that under those conditions no one would benefit, least of all, the Government.

There are certain facts concerning the present proposed beer tax which should be considered in the interest of all concerned.

In the first place, the tax is now so high that no further increase in tax to the Government can be expected from an increase in the tax, and in all probability, if an additional tax is placed on beer the revenue will actually diminish.

We view with apprehension any increase in Federal tax on beer, and are firmly convinced that it would bring about an unwholesome

condition, such as prevailed during the prohibition era, namely, home brewing would, unquestionably, be revived, with all its attendant evils.

I direct the committee's attention to the fact that the brewing industry pays in excess of $1,000,000 in Federal taxes daily.

Certainly any additional tax on beer, which has already reached a point of diminishing returns, is inadvisable.

Brewery pay rolls totaled approximately $100,000,000 in 1940, based on the record of the United States Department of Labor.

Speaking for the workers—we know they are ready and eager to pay their full share of our national-defense costs. They are willing to make whatever personal sacrifices may be necessary for the welfare and safety of our country; even greater sacrifices than they have so far been called upon to make.

I most respectfully urge that the committee give consideration to this protest, which is made in all sincerity.

The CHAIRMAN. Are there any questions, gentlemen?

Senator CLARK. Mr. Obergfell, you represent the Brewery Workers' International Union?

Mr. OBERGFELL. The Brewery Workers' International Union.

Senator CLARK. What is the state of unionization in the brewing industry?

Mr. OBERGFELL. How is that?

Senator CLARK. To what extent is the brewery industry unionized?

Mr. OBERGFELL. One hundred percent, practically.

Senator CLARK. What is the record of the industry with regard to industrial strife?

Mr. OBERGFELL. It has been free of industrial strife, I can safely say.

Senator CLARK. What can you tell us about the average age of the brewery workers, taking them by and large?

Mr. OBERGFELL. The average age of brewery workers is approximately 56. Forty percent are above 56 years of age. The men are required to serve an apprenticeship. With prohibition, naturally there was practically no apprenticeship, and hence we have the number of older men who were working in the brewery industry at that time. The younger men have now reached the age average of 56 years, the men that were in the brewery industry before prohibition.

Senator CLARK. Are those men readily adaptable to other employment if they were thrown out of employment as brewery workers?

Mr. OBERGFELL. No; they are not. They cannot very well go into defense industries. Then, too, in the closing of these 43 plants that I referred to in the last year, many of them are the smaller plants located in small cities where there are no industries in which these men might find suitable employment for men in that age.

Senator CLARK. It is not so easy for a man 56 years of age, who devoted his life to one industry, to adjust himself to another industry?

Mr. OBERGFELL. No.

Senator CLARK. Has the American Federation of Labor given any consideration to these studies that have been made as to the effect of excise taxes on the brewery industry?

Mr. OBERGFELL. Yes; it has; and I may say that Mr. I. M. Orenburn, secretary and treasurer of the Labor Trades Department, who usually speaks for the federation in these matters, was to speak on behalf of the federation's position in this instance, but Mr. Orenburn had to leave the city.

Senator CLARK. That is all.

The CHAIRMAN. All right; we thank you very much, Mr. Obergfell.

Mr. Henry B. Fernald.

STATEMENT OF HENRY B. FERNALD, MONTCLAIR, N. J., CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

The CHAIRMAN. You are appearing on behalf of the tax committee, American Mining Congress?

Mr. FERNALD. I am Henry B. Fernald, of Montclair, N. J., chairman of the tax committee of the American Mining Congress.

I am appearing before you representing the mining industry to speak regarding certain features of the corporate income and profits taxes.

We make no protest against the proposed increase in tax rates. We recognize the needs for revenue and the conditions which call for high rates of taxation. Questions we raise are as to the substantive basis on which such rates are to be imposed. The importance of these substantive questions is greatly increased with the increase in rates. Matters of relatively minor importance under the 6- or 12-percent income-tax rates of 1917 and 1918 become of great importance under the proposed 30-percent income-tax rate of this bill. Even some of the questions which we urged as important under the 24-percent income-tax rate and the 25- to 50-percent excess-profits-tax rates of the 1940 act become of even greater importance under the proposed 30-percent income-tax and 35- to 60-percent excess-profits-tax rates.

We stand on the following principles:

1. The income tax should be applied only to true net income.

2. The excess-profits tax should be applied only to true excess profits and should not be imposed on what are in fact only normal profits.

3. No desire for revenue justifies imposing a crushing tax burden on some who may be caught by technicalities of the law, which is intended to deal fairly and on an equitable basis with all taxpayers.

Our recommendations are all intended to make these principles effective in the law. The points which we urge are as follows:

I. *Need for immediate amendment.*—Some of the points we mention are pure technicalities but technicalities are not merely academic problems for the taxpayer. A few words difference in technical provisions of this law may fall with heavy impact on a taxpayer. If he sees them meaning ruin to him it is small consolation that to other taxpayers they are not of major importance.

These matters are of vital present importance. The taxpayer must now look to see what this law will mean to him and his affairs in its practical application. Inevitably he finds a paralysis of effort if he must fear that in spite of all he can do the technicalities of this tax law will probably mean ruin for him.

Some points we urged for your consideration last year and were then told that in the pressure for revenue they could not be adequately considered at that time but as soon as that Act was passed, they would be considered and could be enacted before time for filing the 1940 tax returns. Then, in March of this year, we were told that only a few most important amendments could be considered at that time but that other matters would be considered and could be included with retroactive effect when the new revenue bill came up within the next few weeks. Now we are told again that, in the pressure for revenue, the present bill must be speeded to prompt enactment without consideration of many of these amendments, and that there will be opportunity for their consideration in a new bill, perhaps in October. We recognize the urgency of the situation and the problems before you. We realize that the act cannot at the present moment be given the general revision it should have, but we do urge most earnestly upon you the importance of acting now upon some of these amendments.

They are not merely administrative in their nature. They relate to the very substance to which the heavy tax rates of this bill are to be applied. The words of the tax bill and the methods of computation under it are not the mere academic papers of a college student. When enacted by the Congress, they carry the sovereign authority of the Government, with the power of taxation to destroy. So we urge you, with the solemn thought of the power which rests in your hands and your duties to the people of the country, now to make those changes in substance of this bill which are necessary to keep it from being a crushing burden on those to whom it will apply.

II. *As to the excess profits of mines.*—I can only briefly refer to the general situation of mines at the present time. The Government is urging and the mines are trying to provide maximum increases of output to meet our terrible shortage of metals for defense needs. The need is not merely for direct munitions' use but for all the tremendous increase which indirectly arises incidental to the defense effort. Buildings, machinery, machinery to make machinery, power, housing, water and sewer facilities, transportation, and practically everything else in all the ramifications of providing facilities for defense production, as well as the vast output needed for defense production itself, are calling for increased metal and mineral output. The mines of the country recognize their special defense job, vital and overwhelming, to try to meet the challenge of this demand. I say to you for the mining industry that, regardless of what you do in this tax bill, we are going to continue to try to meet this challenge, but what you do in this tax bill may make it harder for us to do what you want us to do and what we take pride in trying to do. I know you do not want to place in our way the stumbling blocks of tax provisions which will interfere with this duty we have to perform, or will divert our energy and attention from the main job we have to do, or will make ruinous pitfalls for us when the job is done.

I think the situation is wholly unintended, but this is the situation. The excess-profits tax is imposed upon the income for the taxable year which exceeds the amount of a somewhat arbitrary credit. If the income for the taxable year exceeds such credit, that excess is treated as excess profits. The result is that a mere increase in the rate of extraction of a mineral deposit, limited in quantity, may result

in an excess-profits tax, even though no more than a normal profit per unit of production is realized. Thus the mere realization in this year of the profits which in normal course would be realized in a later year will make the subject to the impact of the excess-profits tax.

We make no protest against the imposition of the excess-profits tax in any case where the profits realized on output are more than normal profits. The Government is trying to hold metal prices to a normal standard. It may not be able to do so and still bring out all the marginal or submarginal production it needs. We do not know what we may have to face in increased costs. In some mines and within certain limitations, increased production may give reduced unit cost. In other mines, or when the point of maximum operating efficiency has been passed or where increased production comes from lower-grade ores, increased output can only be obtained at increased cost. If in any particular case, the profit per unit of output is more than normal, we expect the excess-profits tax to apply. We urge it should not apply when all that happens is that we will recover in this year the same profit which under normal conditions we would expect to realize later.

In the special situation in which the mines find themselves placed by the Government demands upon them for increased production, we urge that an amendment now be made which will allow to mining companies an excess-profits credit equal to the normal profit per unit of production.

III. *Depreciation and amortization.*—This problem is serious for the mining industry at the present time. Mines are not lightly adding plant and equipment today, or even replacing existing equipment. It is virtually impossible to do so in the priorities situation as it now stands unless the defense authorities recognize the facilities as needed for defense. Perhaps some of the additional plant and equipment may be expected to have a useful life after the emergency. Most of it, however, will simply be surplusage when the present emergency ends.

Under the law and regulations we believe there is no reason why the cost should not be written off over such probable useful life—whether that be 2, 3, 4, or 5 years—as ordinary depreciation (which under the statute is intended to cover exhaustion, wear and tear, and obsolescence). This is merely the recognition of sound accounting and business practices: The cost of facilities must be recovered from the profits they produce. The Treasury Department, however, has recently seemed doubtful about interpreting ordinary depreciation allowances in this way without clear indication that this is the intent of Congress.

It was largely for this reason that the special provisions for amortization were written into the law last year. Briefly those were intended to provide, in lieu of depreciation, for definite allowances to write off over 5 years (or less if the emergency should earlier terminate) the cost of emergency facilities provided by the taxpayer which the defense authorities certified as necessary in the interest of national defense. Under these provisions a taxpayer who had installed emergency facilities which were so certified by defense authorities would have its right to this special amortization. The provisions are fairly simply and reasonable so long as the taxpayer has no Government contracts.

If, in response to the urge of the defense authorities, a mining company constructs or installs additional facilities, receiving the so-called certificate of necessity, it will be entitled to write these off and deduct them from net income over the emergency period. Sometimes this may not be an adequate provision because some of these facilities will not be in use for the entire emergency period. We may have met the present desperate shortage before the emergency has ended. However, we may assume that the amortization provisions in many cases will reasonably care for the situation so long as the mining company sells none of its products to the Government but only sells its products through normal trade channels.

If, however, at any time the Government calls on the mining company for metal to be sold to any Government department or agency or asks the mining company to place itself in the position of a subcontractor (which demand the company probably could not reasonably refuse) then the provisions of section 124 (i), with regard to Government contracts, will come into force. If now or at any future date the taxpayer has a Government contract—and apparently every sale to a Government agency under a bid and its acceptance constitutes a contract—then the taxpayer cannot receive amortization allowances unless it obtains a certificate of nonreimbursement or a certificate of Government protection.

Even if the product supplied on a Government contract is only a small fraction of the total output from the property, the provisions of subsection (i) are effective as to the entire cost of the facilities.

I cannot take time to discuss all the technicalities which in practice have been imposed on obtaining certificates of nonreimbursement or certificates of Government protection. It is sufficient to point out that practically no certificates of nonreimbursement have yet been issued, even in those cases where the price under the Government contract was simply a going open market price or the Government-fixed price with no provision whatever in a contract or a bid with respect to reimbursement of any part of the cost of the facilities. The one seeking such certificate of nonreimbursement is required to prove that even an open-market price for his product does not take into account as a factor anything more than normal exhaustion, wear and tear. This is practically impossible for the taxpayer to prove.

On the other hand, to obtain the certificate of Government protection, a mining company must apparently enter into obligations which are virtually impracticable, if not impossible, to observe and efficiently operate the property. Perhaps the provisions are not unreasonable when a wholly separate plant is being constructed, but they cannot be satisfactorily applied to additional plant and equipment such as might be scattered here and there round the mine or in the mill or smelter in order to increase the production from existing facilities.

So long as subdivision (i) stays in the law the mining company must consider it has litle chance of coming under the amortization provisions. Certainly this was not the intention of the Congress last fall.

We hardly need argue whether it is sensible to say that so long as a mining company can avoid being in the position of having a Government contract it can obtain the benefit of the amortization provisions, but that if it responds to a Government request and

places itself in the position of having a Government contract it will be denied the rights it would otherwise have. I do not think we can afford to say we will force such a penalty on one who responds to a Government request for metals.

The entire subsection (i) should be eliminated from section 124.

Of course, if the Government is in fact reimbursing the taxpayer for the cost of the facilities so that the Government has an interest therein which should be protected, the place to provide for the protection of its interest is in the contract itself. We trust our defense agencies to spend the billions of dollars which they are spending—and I believe we rightly trust them—and we should be able to trust them in the relatively minor situations where the present subsection (i) might be applicable.

Actually, in the mining industry, we doubt if the amortization provisions are really the right basis for allowances to cover what is, after all, merely the depreciation of the additional facilities over their useful life. We would rather see a congressional declaration in the law which would give to the Treasury a clear expression of congressional intent that additional facilities, constructed or installed to meet an emergency demand, and any facilities which will have doubtful value by reason of overcapacity in the industry, should be subject to depreciation over the estimated period of their emergency use, with right of the taxpayer to claim revision of the original allowances if the emergency period proved shorter than originally estimated.

This we believe is simply the intent of the present law and regulations, but since the Treasury Department seems doubtful of its authority so to interpret and apply them, we urge such a congressional declaration to remove any question.

IV. *Rate schedule.*—The proposed rate schedule which appears in section 201 of the bill, amending section 710 (a) of the code, increases the rates of tax but still adheres to the schedule of dollar brackets of the present law.

For small corporations the schedule of dollar brackets is desirable so that the increasing rates of this graduated tax will not too quickly reach maximum severity over relatively small differences in amounts of income. While the schedule of dollar brackets does this for the smaller corporations, it has the wholly contrary effect for others.

An initial bracket of $20,000 is entirely too narrow a bracket to be appropriately applied to income of any substantial size. If income is $1,000,000, the first bracket will represent only 2 percent of the net income. This is too narrow a percentage to be made critical in determining the tax rate to be applied. On $5,000,000 of invested capital—which the bill recognizes is not to be considered that of a large corporation—the $20,000 bracket represents less than one-half of 1 percent on the invested capital.

Under the 1917 and 1918 acts, the brackets were broad. These were stated in terms of percentages of invested capital, but the brackets can just as readily be stated as percentages of excess-profits credit. The narrowest bracket in these earlier acts was equivalent to 40 percent of the credit, and the broadest over 100 percent of the credit.

With these percentages in mind, we believe the percentage brackets of the Senate rate schedule last year are as narrow as such brack-

ets should be. We accordingly urge the adoption in section 201 of this bill, of the bracket schedule of the Senate amendment of last year, but with the increased rates under the present bill applied thereto.

V. *Special 10 percent tax under section 201.*—This proposal to impose a special 10 percent excess-profits tax on the difference between the amount computed on the income method and the amount computed on the invested-capital method is a clear violation of the principle that normal profits should not be subjected to an excess-profits tax.

If and to the extent that profits are not in excess of the allowable credit they should not be taxed as excess profits. We believe it has been amply demonstrated by the testimony before your committee and before the committee on Ways and Means that it is essential to have the alternative allowances for an income credit and for an invested-capital credit, together with so-called special relief provisions, to avoid gross inequities. Whichever credit basis a corporation uses, it is only applying a basis which the law provides in order that normal profits shall not be subjected to an excess-profits tax.

Generally this proposed 10 percent tax would fall on corporations which had the misfortune not to have reasonable earnings on invested capital during the base period years. The bill proposes that because of their misfortune they are now to be penalized.

It even goes further. Because the law only allows the excess-profits credit for 95 percent of average base period earnings, the 5 percent arbitrarily disallowed is in effect now to be subjected to the 10 percent penalty. This is wholly unreasonable. To the extent that any corporation is entitled to the invested capital credit, it should not have all or a part of the amount of such credit subjected to a special penalty tax.

There is no sound reason for this special tax. It is not imposed upon a corporation which was not in existence during the base period, but is limited to those in existence (actually or constructively) before January 1, 1940. The new corporation, which had no base-period earnings because it was not then in existence, is not subject to this tax. The corporation in existence during the base period, which had no average base-period net income because it was then only developing its business or because it was so unfortunate as to have losses which wiped out its net income, would have the 10-percent tax apply to its entire earnings of the taxable year.

If a corporation formed in 1935 struggled for 4 years, barely managing to break even, then in December 1939, having proven it had a worth-while project, raised $1,000,000 additional capital, the special 10-percent tax might apply to its entire invested-capital credit. If the $1,000,000 new capital had not been obtained until 1940, the income credit would be increased by 8 percent of the new capital and the special 10-percent tax might not apply.

The reasons for not imposing such a tax are wholly apart from the difficulty, confusion, and involvements that such tax computations introduce into an already indefensibly complicated and obscure tax structure.

Section 710 (a) (2) should not be enacted.

If this special 10-percent tax is not imposed there will be no question for the amendments by section 202 with respect to disclaimer of credit.

VI. *Rate of return on invested capital.*—By section 201 (b) it is proposed to amend section 714 so as to cut down the credit for invested capital over $5,000,000 to a 7-percent rate; but continuing the 8-percent rate for invested capital not over $5,000,000. This 8-percent rate is generally far too low for a reasonable average return in the mining industry. It certainly should not be further reduced to 7 percent. We shall later refer to the total inadequacy of these rates under the proposed plan for computing excess-profits tax.

VII. *Denial of deduction of income tax in determining excess-profits tax.*—The bill proposed in section 204 a series of involved amendments to provide that the income tax shall not be allowed as a deduction in computing excess-profits net income. The difficulties in phrasing and applying these amendments would alone be ground for questioning their propriety.

The more serious ground for opposition is that the proposed plan of imposing the excess-profits tax without allowing deduction for income tax gives an unfair standard for determining the amount to which an excess-profits tax should apply. With regard to this we urge the following considerations:

(*a*) The earnings of any business are to be determined after deducting the income tax. This has long been recognized as the appropriate rule. It is the rule applied in determining earnings and profits for distribution as dividends under section 115. It is the business rule insisted upon by the Securities and Exchange Commission. It is the manifestly sensible rule. The amount of income which the Government takes in income taxes does not represent earnings which accrue to the benefit of the corporation. Excess profits should be determined only after the income tax has been deducted.

(*b*) The fact that under the 1917–18 laws the excess profits were determined without deducting the income tax furnishes no adequate precedent. Those acts were recognized as being so unfair and undesirable that even the Treasury Department itself recommended the repeal of the excess-profits tax.

In any event, an important difference in the situation is that for 1917 the income tax was only 6 percent; for 1918, 12 percent; and for 1919 and 1920, only 10 percent. The rate now proposed is 30 percent. Under the income-tax rates of 1917 to 1920 it was relatively unimportant whether the income tax was first computed and allowed as a deduction in computing excess-profits tax, or whether the excess-profits tax was first computed and allowed as a deduction in computing the income tax. There is a serious difference when the income-tax rate is raised to 30 percent. We should not treat, as subject to excess-profits tax, the 30 percent of corporate income which is payable to the Government as income tax.

A 9-percent allowance on invested capital for 1917, decreased by the 6-percent income tax, was an effective allowance of over 8½ percent. Where the allowance under the 1917 act was only 7 percent, this was equivalent to 6.65 percent after deducting the income tax. For 1918, the 8-percent rate of excess-profits allowance was equivalent to 8.8 percent after income tax. Under the bill the proposed rates of 8 and 7 percent are equivalent to wholly inadequate rates of 5.6 and 4.9 percent after deduction of normal tax.

These figures evidence (1) that the method which was relatively unimportant under the 1917–18 acts is exceedingly important under

the proposed bill; and (2) that a proposed effective allowance on invested capital of only 4.9 or 5.6 percent is a wholly inadequate allowance for normal profits. Certainly this is true as to the mining industry. Mining investments would not be made on any such basis of estimated net return.

A further important point regarding the 1917–18 acts is that, as heretofore stated, the brackets of excess-profits tax returns were relatively broad. Under the 1917 act the first bracket of 20 percent was equal to from 67 to 114 percent of the amount of the credit. The maximum rate did not apply unless earnings were about four times the amount of the credit.

Under the 1918 act the first excess-profits bracket was generally equivalent to about 150 percent of the credit. Even if the war-profits tax was applicable, only the minimum 30-percent rate would apply unless the total net income exceeded by more than 40 percent the amount of the exemption.

Consequently, in a majority of cases we were dealing under the 1917–18 acts with an income tax of from 6 to 12 percent and an excess-profits tax of 20 or 30 percent. Such a situation is no precedent for a tax bill where the income-tax rate alone is 30 percent and the excess-profits tax quickly rises to 60 percent.

The bill itself recognizes that under this plan it will give a wholly inadequate return for new money. Under Secretary Sullivan in his statement before the Ways and Means Committee (pp. 1338–1339 of the record of hearings) stated the Treasury recognized that 8 to 10 percent was probably the minimum rate which should be allowed for new money. He said:

> Under the 1940 Treasury proposal it was recognized that if business is to expand and investors are to put money into new corporations, an opportunity must be allowed to earn an adequate rate of return on new capital. The plan allowed an 8 percent return on new capital, with a 10 percent return up to $500,000, regardless of the earnings experienced during the base period on old capital.
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> * * * We would suggest also that the rate allowed on new capital be the same as that originally suggested; namely, 8 percent, with 10 percent for additions to capital that do not bring the total invested capital about $500,000. Any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely in the degree of risk they face. Accordingly, it is desirable not to set too low a maximum of return.

To approach this rate under the method of this bill a special provision of section 205 would amend section 718 of the law so as to allow as invested capital 125 percent of any new capital paid in. This would give effective rates on new money equivalent to 7 percent on the first $5,000,000 and to 61.125 percent on the remainder. It becomes a rather ridiculous procedure to say that we will adopt a method which we recognize will give an unreasonably low effective rate on capital, and then, because we realize this is an inadequate allowance, we will introduce the artificiality of allowing 125 percent of the amount of any new money. It is not the forthright position which the Government should take toward its people in a tax law. It cannot be expected to create confidence in investments.

We submit that excess profits should be measured only by what remains after payment to the Government of its income tax.

VIII. *Effect of this method on "Charitable, etc., deductions."*—Section 204 (d) makes certain amendments under the heading "Compu-

tation of charitable, etc., deductions" which are apparently intended to leave the computation of the deductions as at present with respect to the 15 percent allowable for charitable deductions, the 85 percent allowance for dividends received credit and the 50 percent net income limitation on percentage depletion. However, the inference of this provision—taken in connection with the changes made by section 204 (a)—seems to be that in computing the income tax the amount of the percentage allowable in each of these cases is to be computed on net income after deducting the amount of the excess-profits tax. We protest particularly that there should be no change in the limitation on the percentage depletion allowance as an income-tax deduction, nor in the dividends received credit.

The substance of section 204 (d) should have been inserted as a new subsection or paragraph in section 23, rather than a new subsection of section 711 (a) (1) and (2). However, if the method of the present law for computing excess-profits net income is continued there will be no occasion for the proposed change.

IX. *Excess-profits credit carry-over.*—Section 204 (e) proposes to amend section 710 (c) (1) defining the unused excess-profits credit, so as to require a recomputation of the amount of excess profits net income and excess-profits credit for 1940 as they would be under the law applicable in 1941.

This will mean to a considerable extent a complete recomputation for the year 1940. It will place a great burden on the taxpayer in preparing all the new recomputations for 1940 and on the Treasury Department in reauditing them.

However, the more serious objection is its manifest unfairness. The object of this carry-over is to place corporations as nearly as may be in a relatively equitable position. If a corporation had a larger excess-profits credit for 1940 than the amount of its income for that year, it was to have the benefit of the excess 1940 credit carried forward as a credit in the subsequent year. Corporations which had income equal to or more than the amount of their excess-profits credit for that year were entitled to have full allowance for the amount of that credit. This should not be changed by reason of any changes which might be made in the 1941 law. A corporation that had an excess profits net carry-over should not be denied the full amount of its credit for that year simply because changes are made in the method and amount of making the 1941 computations.

X. *Base period income.*—(*a*) *Average two out of 4 years' earnings.*—The present law requires the use of the average earnings for the 4 years 1936 to 1939 in determining the base period credit. If 1 year was a year of loss and only 3 years were years of income, the income amounts for the 3 years are to be used, but the total for these 3 years is to be divided by four (instead of by three) to get the average. If more than 1 year was a year of loss, the largest loss is to be disregarded, the loss for the other year or years is to be subtracted from the income of the years of income, and the net result is to be divided by four, to get the so-called average income. We believe this procedure is illogical and unfair. The worst that should be done is to divide 3 years to get the average.

These years 1936 to 1939 were not a period of normal earnings. 1938 was generally a poor year; often a year of loss; never a year

representative of normal profits. 1939 was generally a very subnormal year. Only 2 years of the base period can generally be considered as reasonably representative of normal earnings. We accordingly urge that the taxpayer should be permitted to take the average of 2 years of the base period as representing average base period income and that the 2 years' result should be divided by two to get the average.

(*b*) *Full allowance for average earnings.*—The present law allows only 95 percent of the average base period income to be used as an excess-profits credit. The sole apparent reason for this is the urge that it will yield more revenue.

No urge for revenue should be made an excuse for imposing the excess-profits tax on normal earnings. The whole principle of the excess-profits tax is violated when, in desire for revenue, we bow to false or arbitrary definitions or formulas in order to subject normal income to excess-profits tax. We cannot have a fair and sound excess-profits act if we set up a fixed goal of the amount of revenue which such a tax is to yield and then adopt such arbitrary definitions or plans of computation as will raise that revenue. The essential thing is to give the proper definitions and methods of computation for taxation of true excess profits. Then we may apply the rates and determine the expected yield.

(*c*) *Income attributable to base-period year.*—Where income of a taxable year is determined under section 721 to be attributable to a base-period year, the Finance Committee Report No. 2114, page 16 asserted that such income would be included in base-period income in computing the income credit. Treasury Regulations 109, section 30.721–1 state to the contrary. The law should be specifically amended to accord with the Finance Committee's report.

XI. *Invested capital.*—The present law uses the so-called tax basis for computing loss, as the basis for the invested-capital computations. The most that can be said for it is that it is a doctrine of convenience in spite of all its involvements and difficulties. Even this is doubtful.

Actually the best measure of invested capital to be applied to an excess-profits tax would be the value of the capital employed at the beginning of the excess-profits tax period. In no event should the invested capital attributable to property paid in for stock, be less than the value of the stock issued for it. Certainly the tax basis to the present company or to a predecessor on assets acquired many years ago has really no bearing in determining a present fair allowance for normal earnings. In addition, the present law (including the amendments proposed by the House bill) has certain serious defects.

(*a*) *Adjustments in case of a substituted or adjusted basis.*—Section 718 (a) (2), (a) (5), and (b) (4), and section 720 (b)—together with certain other sections of the law—provide for the use of a substituted or adjusted basis for the property. We believe it was a pure oversight in the drafting of these provisions that there was not included such a provision as was included in section 501 to insure that the adjustments to be made should be those appropriate to the basis which was used. Manifestly if the basis to be used was cost, the adjustments should be those based on cost. The wording of the law is capable of a contrary interpretation, which the Treasury has adopted that the adjustments under section 113 (b) of the code are in all cases to be

applied in determining a substituted or adjusted basis, even though they are not the adjustments appropriate to the cost or other basis which is made the starting point for these invested capital computations. The law should be immediately amended, and with retroactive effect, to make this clear.

(*b*) *Basis for computing gain should be used.*—The present law provides that the basis for computing invested capital should be the basis for computing loss. The object of the invested capital computations is to determine a taxable gain or profit. For this reason alone the property basis for computing gain should be used in computing invested capital. This is fair and in many cases will greatly simplify the computations.

(*c*) *Use of invested capital previously determined.*—Many bothersome and difficult questions regarding invested capital were determined under the 1917, 1918, and 1921 laws. It should not be necessary to go back for factual redetermination of all these questions when the lapse of time alone may make them much more difficult to prove. The invested capital as defined under the law is at best a rather uncertain measure of a reasonable excess-profits credit, and no great harm would be done if the taxpayer were now given the right to adopt the determinations of invested capital previously made and bring them down to date. This could probably not be made a universal rule because in some cases there would be more difficulty in bringing the earlier determinations down to date than in making the required new computations; and in others changes in the law might make new determinations appropriate. Furthermore, some taxpayers, after accepting earlier determinations, may have found that they failed to receive the allowances to which they were really entitled. Accordingly the provision to allow the use of the prior invested capital computations appropriately brought down to date should be an option granted to the taxpayer rather than a requirement of the law. It is the taxpayer who has the burden in the first instance of making all these invested-capital computations. If the taxpayer can simplify this work and wishes to simplify his difficulties by adopting the prior determinations, he should be permitted to do so.

(*d*) *Borrowed capital.*—The taxpayer should be allowed to include in invested capital the full amount of borrowed capital (whether this is represented by notes or is on open account).

(*e*) *Dividends in first 60 days of year.*—The special rule as to distributions during the first 60 days of the year is contrary to the principles applicable to dividend determinations under section 115 (a), will cause unsolvable conflict and confusion in the computations, and should be repealed.

(*f*) *Sansome earnings.*—With all the uncertainties and indefiniteness as to just what are to be included in the taxpayer's earnings and profits for the so-called "Sansome earnings," the provisions of section 718 (b) (3) should be changed so as to provide for their exclusion, instead of providing, as is now done, that they are in the first instance to be included in earnings and profits, and are then to be deducted as a separate item.

(*g*) *Distributions not out of accumulated earnings and profits.*—Section 718 (b) (1) provides for reduction of invested capital on account of the distributions which were not out of "accumulated earn-

ings and profits." Question has arisen as to the meaning of this term in view of the provisions of section 115, which provide for distributions as dividends out of the earnings and profits of the taxable year, even though no balance of accumulated earnings and profits may have at that time remained.

There seems no question that it was intended to reduce invested capital only to the extent the distribution was not out of earnings and profits, and not to require reduction on account of dividends out of the earnings and profits of the year when paid under the special provisions of section 115 (a) (2), which have stood in the law since 1936.

The question should be clarified by eliminating the word "accumulated" in section 718 (b) (1).

XII. *Special relief.*—In addition to the special provision we have recommended to allow an excess-profits credit based on normal earnings per unit of mine production, we urge the following more general provisions:

(*a*) There should be provision for special relief as to invested capital as well as with respect to income. Adequate provisions should be made to cover cases where capital is not a material income-producing factor and which are not cared for under the special provisions of section 725 regarding personal service corporations.

(*b*) There should be provisions for special relief in the case of a corporation formed after the end of the base period.

(*c*) Section 722 (b) (1) excludes from consideration low selling price of the product, low volume of sales, etc. Instead of specifically excluding these factors, they should be specifically included as grounds for granting relief.

(*d*) There should be no penalty tax when special relief is granted. There may be ground for the limitations in section 722 (c) as to the conditions under which special relief should be granted, but when the corporation has once established that it is entitled to special relief there is no sound reason for surcharging the corporation with an additional tax, as is done by the present section 722 (d).

(*e*) Adequate provision should be made for limiting the amount of tax required to be paid in the first instance where bona fide claims for relief under section 722 are filed.

XIII. *Supplements A and B.*—There is need that these supplements should be generally rewritten to state principles rather than the maze of specific formulae—in some cases almost unintelligible—which they now contain. Again realizing that this is probably impossible at the present time, we urge only the following amendments:

(*a*) Section 742 (f) should be eliminated as not in harmony with the other present provisions of this law and as not justified. There is no adequate reason for excluding the taxpayer's own base period net income for the period prior to its becoming an acquiring corporation under supplement A.

(*b*) The definition of "acquiring corporation" should be broadened to include the case where a corporation has acquired for its stock or securities a mine or plant unit as a going concern from two or more owners, which is not permitted under the now specified technical conditions.

XIV. *Carry-forward and backward of credit.*—The provisions of section 710 (b) (3) for an unused excess-profits credit carry-over

for 2 years should be extended to 5 years and provision should also be made for a carry-backward allowance. The present net loss carry-over should be extended to at least 5 years.

XV. *Daily computations.*—Section 715 of the law limits the cases in which daily computations of invested capital may be waived by the Commissioner to those where the difference will amount to not more than $1,000 of invested capital. The taxpayer should not be required to make hundreds or thousands of computations to get within a $50 margin of accuracy in amount of tax. The $1,000 limitation should be stricken from the law.

XVI. *Strategic metals.*—The bill in section 206 proposes to repeal the present section 731 which exempts from excess profits tax certain so-called strategic metals. This subject has been or will be presented to the committee by others. It seems unnecessary for me here to repeat the reasons why section 731 should be retained. We join with others who urge a continuation of this exemption.

XVII. *Capital stock taxes.*—We urge that provision should be made for annual declaration of capital stock value. We have urged this on prior occasions but the present situation makes it even more imperative.

The essence of the capital stock tax is the declaration of a value and the payment of a tax thereon which will give an exemption from the declared value excess profits tax. It carries the implied assumption that the declared value should be based on estimated future earnings of the succeeding 3-year period. Under stable conditions corporations might perhaps be expected to make some reasonable estimate of prospective earnings over a 3-year period. However, no corporation can hope to do that today. It is bad enough for the corporation, under present conditions, to try to estimate earnings 6 months in advance. If it fails to estimate high enough, it will have to pay a relatively high declared value excess-profits tax; if it overestimates the amount of probable earnings it will pay an unnecessarily large capital stock tax. It is simply impossible for businessmen to try to estimate what will be a fair declared value for capital stock which will give adequate allowance for the declared value excess profits tax for the next 3 years.

Under these conditions corporations should be given the right to make annual declarations, unless the capital stock tax is repealed.

The bill proposes to increase the capital stock tax rate to $1.25 per thousand dollars of declared value capital stock. To this we enter no protest. We do urge that, unless the tax is repealed, the increased rate carry with it the specification of the right to make annual declarations of capital stock value.

XVIII. *Section 734, Adjustment for inconsistencies.*—It is the duty of the Commissioner, under section 57 of the code to "determine the correct amount of tax." The new section 734, of the excess-profits-tax amendments of 1941, requires that the amount of the excess-profits tax shall take into account the amount of any adjustment in case of a position inconsistent with prior income-tax liability.

Speaking broadly, you have made it the duty of the Commissioner to determine whether any item affecting the determination of the excess-profits credit is treated in a manner inconsistent with the treatment accorded such item in the determination of the income or

excess-profits-tax liability of such taxpayer or a predecessor, in any prior year from 1913 to date, which is otherwise not open for redetermination; then to determine whether such prior inconsistent determination was or was not correct under the law applicable to such prior year. Since the invested capital credit involves the amount of accumulated earnings and profits, and the amount of distributions not out of earnings and profits, it is virtually made the duty of the Commissioner to reaudit all prior tax returns of the taxpayer to determine whether every item of income or deductions, every item of nonallowable losses or expenses, every distribution to stockholders, and even every income tax paid (which taken together will affect the amount of accumulated earnings and profits, or will determine the amount, if any, of distributions not out of earnings and profits), was correctly treated or computed as to law and amounts in prior tax settlements. Added to this reaudit of the taxpayer's returns will be the supplemental examination of any "predecessor's" returns.

This is quite apart from the reconsideration which must be given to every reorganization or exchange to determine its correct status under the law as now interpreted, and the amount, if any, of gain or loss which should have been recognized. The "adjusted basis" for every property item, as it is concerned in determining admissible and inadmissible assets, must be reexamined and traced back to see if it involves any "inconsistencies" as to prior years of taxpayer or predecessor. Certainly Congress did not intend this when it enacted section 734; yet this seems to be the requirement of the section as it stands in the law. It is unbelievable that Congress should allow the section to continue in the law. There can be no expectation that the Commissioner will not enforce this section to the full extent of the authority it gives and the duty it imposes.

Actually there is no real reason for section 734 in the excess-profits tax law. The question of whether or not prior years' tax liabilities were correctly determined has no bearing upon the question of the reasonable normal earnings of the current year, which is the determination now to be made for excess-profits tax purposes.

Section ought to be promptly repealed, with retroactive effect.

XIX. *Consolidated returns.*—Consolidated returns should be allowed for income-tax purposes. Congress has rightly recognized that for computing excess-profits tax it is fair that consolidated income of an affiliated group should be the basis. This same principle should be applied to income subject to normal tax.

This was recognized in 1918 when the income tax was only 12 percent and in subsequent years when the income tax was between 10 and 15 percent. It should certainly be recognized when we are to have an income tax of 30 percent. This high rate serves to magnify all the artificialities of the separate corporate returns, where the real net income of an affiliated group is that shown by the consolidated return.

XX. *Depletion.*—The Secretary of the Treasury has suggested possible revision of the depletion provisions. We naturally urge that no change in existing provisions should be made without opportunity for a full hearing thereon. We are confident we can at that time satisfy the committee, as we have on previous occasions, that the present provisions are no more than mines are fairly entitled to. If any change is to be made it should be to remedy some of the present provisions of law

and regulations which fail to grant, in some instances at least, the full depletion allowance which mines should really have to compensate for capital exhaustion.

XXI. *Government expenditures.*—We urge that nondefense expenditures be reduced to the minimum, and waste and extravagance in defense expenditures be avoided. The essential objectives of defense expenditures are not helped by waste and extravagance; nor by including in the name of "defense" expenditures which are not essential for that purpose.

In an "all-out" defense effort we should cut nondefense expenditures by $2,000,000,000, rather than raise this by present or future taxes from the people. We should not ask this generation or the next to pay for unnecessary costs of these years.

We can more easily and equitably cut $2,000,000,000 from our nondefense expenditures than we can raise that much in additional taxes.

Certainly we should not use the pressure for funds for avoidable expenditures as a reason for denying relief from inequitable provisions of our present tax laws or for imposing unfair provisions in the pending bill.

The best estimates we have indicate $90,000,000,000 or more of national income for the present calendar year. At that income level it is estimated that the present law would yield over $11,000,000,000 of revenue. The proposed increases of rates in this bill, even after making all the amendments we have urged, should still give an adequate yield.

We must not wreck the businesses whose profits are counted upon to yield these revenues. This is true as to revenues during the emergency and as to the revenues which we shall still need in the post-emergency years. We believe the recommendations we have made will serve not merely to deal fairly and justly with taxpayers, but will contribute to the stream of revenue which we need continually flowing into the Treasury.

Accordingly we urge that the amendments here recommended be made in the pending bill.

I again call attention to the provision regarding daily computations in section 715, where, through some mistake, the limitation of $1,000 of invested capital, which would mean a difference of less than $50 in tax, was inserted. It ought to be cut out, because you cannot ask people to make hundreds and thousands of computations in order to try to get within $50 of what would be a theoretically correct tax.

Thank you very much.

The CHAIRMAN. Thank you.

Mr. E. E. Raymond, Saginaw, Mich.

STATEMENT OF EARL E. RAYMOND, PRESIDENT, RAYMOND PRODUCTS CORPORATION, SAGINAW, MICH., AND PRESIDENT, TRAILER COACH MANUFACTURERS ASSOCIATION

The CHAIRMAN. Mr. Raymond, will you give your name to the reporter?

Mr. RAYMOND. I am E. E. Raymond, president of the Raymond Products Corporation, Saginaw, Mich., and also president of the Trailer Coach Manufacturers Association.

The Trailer Coach Manufacturers Association, by the way, represents about 70 percent of the units produced by the manufacturers in the trailer industry.

The CHAIRMAN. About 70 percent?

Mr. RAYMOND. About 70 percent; yes, sir.

The CHAIRMAN. All right, you may proceed with your statement.

Mr. RAYMOND. After having both read and listened to the testimony of representatives of several other industries who have appeared before your committee to register objections to provisions proposed in the revenue bill of 1941 for their industries, we are rather hopeful that what we will have to say in the few minutes accorded us will prove refreshing.

We are here to suggest an alternative arrangement under which substantially more revenue can be realized from our little industry than can be obtained from the proposed 7 percent excise tax.

And, incidentally, to call to your attention the extremely desirable advantage which this alternative proposal will have in spreading this tax burden over the many rather than on the few at an almost prohibitive rate.

May I digress to say that when I left Saginaw Sunday evening I was under the impression that the only purpose of the current revenue bill was to raise needed revenue, and it was on that basis that I came prepared to make my statements and offer our suggestions to you.

Yesterday, however, in reading the report of Secretary Morgenthau's testimony before your committee on August 8 I was somewhat surprised to learn that other considerations appear to be involved—at least, to the extent of bearing down rather heavily in the tax program on industries producing products not generally regarded as essential and which use raw materials vital for defense needs.

When I tell you that approximately 95 percent of the trailer coaches being produced today are going directly into use for the temporary housing of defense-project workers we trust that you will agree with us in our position that trailer coaches cannot be considered, by any stretch of the imagination, as a luxury type of product nor one which should be called upon to carry an extra tax burden.

As a matter of fact, it seems to us that just the opposite position should be taken. Since the first of this year, in addition to the 15 percent of our output which has been taken by the Government, upward of 80 percent of all trailer coaches manufactured have gone directly to defense workers, who have taken the initiative in providing for themselves, at their own expense, temporary housing facilities at no cost to the Government.

You, of course, are aware that the Coordinator of Housing already has recognized both the economy and desirability of trailer coaches for mobile emergency-defense housing. Our industry has supplied over 4,000 trailer coaches so far this year in his temporary-shelter program—and this, by the way, at a cost of less than $300 per person, including furniture—everything needed except bed linen, dishes, and cooking utensils. We cite this figure in comparison of the per capita cost of housing our soldiers in training camps as well as in comparison with what is being spent on a per capita basis on housing-defense projects throughout the country.

From a strictly housing angle—mobile housing though it is—we perhaps should be here appealing to you to accord to the trailer-coach

owners of the country the same consideration you expect to give the individual home owner, who, without hesitancy, provides shelter for himself and his dependents, at his own expense and at no cost to the Government.

If the alert and independent defense workers who will purchase trailer homes for themselves this next year were organized and in position to send a spokesman to present their views to you, we are sure their earnest plea would be: "Give us the same treatment you give to the other householders—no better and no worse."

Now, from our own angle as manufacturers of trailer coaches, may I say this: If revenue is the sole object of the new tax bill, the proposed 7-percent excise tax on trailers, as conditions now stand, scarcely warrants consideration. Due to impending restrictions on materials and the proposed restrictions on installment sales, the total output of factory-built jobs during 1942 may drop to a mere fraction of our present production. The withdrawal of credit in 1937 cut us down from around 12,000 to less than 3,000 units.

Under the most favorable conditions, namely, a high priority rating, a favorable financing set-up along with further orders from the Government itself, we doubt if to exceed 25,000 units could be expected during 1942. By eliminating 5,000 that the Government could use to advantage, this leaves around 20,000, at the most, on which the proposed tax could be levied. The average manufacturer's net price is now around $600. You have, therefore, a possible minimum sales volume, based on 3,000 units, of $1,800,000, which would produce a tax revenue of only $126,000 under restricted operating conditions, and a maximum of $12,000,000 in sales volume on which the maximum tax revenue would be $840,000.

The full burden, in either event, will fall on those who purchase trailer coaches in 1942, practically every one of whom will be making his investment to provide a roof over his head. When it is remembered that there are now in use as regularly occupied mobile homes upward of 200,000 trailer coaches—the bulk of them in defense or other areas where housing shortages exist—it's not easy to cite sound reasons why the comparative few who will buy trailer homes during 1942 should be asked to provide the $126,000 to $840,000 in taxes projected for the trailer-coach industry.

By entirely eliminating the proposed 7-percent exise tax from trailer coaches and substituting, for instance, a use tax of $5, such as is proposed for motor vehicles and boats, you not only would obtain materially more revenue under the most favorable conditions we now can envision—far more than we believe will come to pass—but also would spread the levy so broadly that no one could suffer from it.

In our endeavor to condense our statement to comply with the time limit given us, we have been forced to omit mention of several important points which properly should be developed, such as—

1. The proper clasification of trailer coaches as distinguished from other types of trailers used in connection with passenger automobiles;
2. The erroneous data on which the Treasury Department based its estimates;
3. The factual data in the form of statistics showing the rapid growth of this, a new depression-born industry; and
4. Sociological aspects.

We therefore request that the proposed exise tax be eliminated from trailer coaches and recommend in its stead a use tax such as is proposed in section 3540 on the use of motor vehicles.

The CHAIRMAN. Are there any questions?

Senator DANAHER. One question, Mr. Chairman.

Suppose, as you remark on the first page here of your prepared statement, that there are other considerations than merely raising the revenue involved in this proposed excise tax, what defense production could you engage in if you were driven out of the motor-trailer business and into some defense production?

Mr. RAYMOND. The majority of the trailer plants are plants that have been organized particularly for the construction of trailers; their equipment is rather light, because the materials of which they build trailers is light material—plywood, masonite, and such materials. There are none of the trailer manufacturers that I can recall offhand that actually build the heavy units going into their production, such as axles and wheels, and things of that sort; they manufacture only the lighter parts, so that their equipment is, therefore, very light. Their buildings are quite roomy, because their product is a large product requiring room. The type of work that they go into is rather difficut to think of right at this time. I cannot think of any, at least.

Senator DANAHER. They could not make trucks for the Signal Corps, or anything like that?

Mr. RAYMOND. Their room would be sufficient to do so in some cases, but their equipment would not in any way, shape, or manner.

Senator CONNALLY. May I ask a question?

Mr. RAYMOND. Yes.

Senator CONNALLY. If a passenger automobile pays a 7-percent tax, why should not a trailer pay it?

Mr. RAYMOND. Why should not it?

Senator CONNALLY. Yes.

Mr. RAYMOND. That is what we propose.

Senator CONNALLY. You mean the excise tax or the use tax?

Senator BROWN. He is for the $5 use tax instead of the 7-percent trailer tax.

Senator CONNALLY. I am talking about the 7-percent excise tax. If the automobile pays 7 percent, why should not the trailer pay 7 percent?

Mr. RAYMOND. We think that the automobile, in a good many cases, at least, beyond the proportion of the trailer coaches, is used for pleasure purposes. Trailer coaches, according to our statistics on it, are used, particularly in this last year, 95 percent as homes.

Senator CONNALLY. All right. You want to treat it as a home? That kind of a home has a big advantage over my home, or over the ordinary home, because you can move it around; you can take it anywhere. It is a fine privilege, and you ought to pay something for it. I have got a home, and I cannot move it; I cannot budge it; it stays where it is; and this other fellow has got a trailer—he can go wherever he wants to and set up his home.

Mr. RAYMOND. That is right.

Senator CONNALLY. That is an advantage over the ordinary home. Why should not he pay a tax for that privilege?

Mr. RAYMOND. We suggest that he pay $5—that all trailer owners do that.

Senator CONNALY. Oh, $5. He will probably pay that, too, in this bill.

Senator BROWN. As I get it, Mr. Raymond, your idea is you will get somewhere around $800,000 tax, perhaps, for the Treasury?

Mr. RAYMOND. That would be the maximum.

Senator BROWN. And $120,000 is the minimum?

Mr. RAYMOND. That is right.

Senator BROWN. That tax will come entirely from buyers of new trailers?

Mr. RAYMOND. Yes.

Senator BROWN. Your idea is if we go back and reach those who bought the trailers through the years, the trailers that are still in existence, and charge them $5, you figure that would bring in more money?

Mr. RAYMOND. Yes.

Senator BROWN. I think you say $1,000,000.

Mr. RAYMOND. Yes.

Senator BROWN. That is more than the estimate on the 7-percent excise tax?

Mr. RAYMOND. Yes.

Senator BROWN. I think your idea is a very sensible one.

Mr. RAYMOND. If I might add, we realize the owner of the coach has advantages in economies due to the fact that he is living in his coach, but he does not only pay the $5 for the 1 year, by the way, he possibly will have to pay that as a use tax for some time. He may eventually pay even more than the 7-percent excise tax, so possibly it will be more of a burden, but it will be distributed in such a way that it would not affect his initial purchase.

Senator BROWN. Of course, he is paying taxes in various States in the form of a license.

Mr. RAYMOND. A license tax; yes, sir.

I thank you.

The CHAIRMAN. Thank you, Mr. Raymond.

Mr. Thomas S. Hammond is not here.

Next is Mr. O. L. Weber.

STATEMENT OF OSCAR L. WEBER, PRESIDENT, WEBER LIFELIKE FLY CO., STEVENS POINT, WIS., REPRESENTING ASSOCIATED FISHING TACKLE MANUFACTURERS

The CHAIRMAN. Mr. Weber, you may proceed.

Mr. WEBER. Mr. Chairman and members of the committee: My name is Oscar L. Weber, president of the Weber Lifelike Fly Co., Stevens Point, Wis. I represent the fly and bait division of the Associated Fishing Tackle Manufacturers and hundreds of other small companies. I am here to request a change in H. R. 5417, section 3406, page 72, lines 2 and 3. This change would call for the elimination of "artificial lures, baits, and flies," as taxable items in this bill. In addition to my oral testimony, I should like to file a written statement.

The CHAIRMAN. Yes, sir; you will have that privilege, Mr. Weber.

Mr. WEBER. I wish to call your attention to the thousands of individuals producing flies and baits as a home or spare-time industry, selling to other individuals or to one or two stores in their com-

munity, from whom it would be practically impossible to collect an excise tax. This imposes an unfair burden on organized tackle manufacturers.

Senator CLARK. Do you know what that tax is estimated to raise?

Mr. WEBER. A million and a half sales.

Senator CLARK. I say, do you know how much revenue it is estimated to raise?

Mr. WEBER. Yes; I figure a million and half sales, and at 10-percent tax would be a million and a half.

Senator CONNALLY. $1.50 on each sale?

Mr. WEBER. Probably I do not get your question.

Senator BROWN. The question is, what would the tax raise in money?

Mr. WEBER. I figure that the tax that we are objecting to would bring a million and a half sales.

Senator CONNALLY. He wants to know how much money the Treasury would get.

Mr. WEBER. They would get 10 percent.

Senator CONNALLY. How much would the sale be for? You might sell a fly for a nickel.

Mr. WEBER. Yes; flies do sell for a nickel, from 5 cents up.

Senator CONNALLY. In my opinion, they sell for too much, all of them.

Mr. WEBER. For too much? What part of the country do you come from? You come from the South, where they sell bass flies.

Senator CONNALLY. I was on the Chesapeake, and a fisherman had a whole trunk full of flies, and yet the fish did not bite any better.

Mr. WEBER. The chances are they were all homemade flies, too.

Senator CONNALLY. No; they were not. They were the fancy reels and rods, and all these fancy flies, a whole trunk full of them; they were folded in the lockers, 4 or 5 drawers. That is a luxury. Why should not we tax those flies?

I would be in favor of taxing all kinds of flies.

Mr. WEBER. The trouble, Senator, is you have a trunk full of fishing tackle, but the investment in cash was all in the rods and reels, you did not have the investment in the flies.

The CHAIRMAN. You were asking to strike out what particular words?

Mr. WEBER. I did not want anything struck out.

The CHAIRMAN. I mean, out of the bill.

Mr. WEBER. Oh; page 72, lines 2 and 3. This change would call for the elimination of "artificial lures and flies."

The CHAIRMAN. Page 63 in this present bill here. I simply want to get your language. You are not asking that anything else be stricken out in that sporting-goods section?

Mr. WEBER. No.

The CHAIRMAN. Except the artificial lures, bait, and flies?

Mr. WEBER. That is all.

The CHAIRMAN. Yes, sir.

Mr. WEBER. There is no opposition to the excise tax on rods, reels, and creels which represent the large volume in fishing-tackle sales, but we are opposed to taxing artificial lures, flies, and baits because the small volume of sales does not justify the expense involved in collecting the tax.

In the Revenue Act of 1932, a 10-percent tax was imposed on rods and reels and all similar articles commonly or commercially known as sporting goods. Realizing the difficulties in the collection of a tax a ruling was made that the tax be confined to rods and reels only.

In the Report of the Subcommittee of the Committee on Ways and Means of the House of Representatives, proposing revision of the revenue laws of 1938, there is a statement on page 63 as follows: "The tax on sporting goods has caused administrative difficulties out of proportion to the revenue received." Gentlemen, if this has been true of sporting goods as a whole the difficulties will be multiplied many times in the collection of a tax on flies and baits.

Gentlemen, as this bill now reads it taxes the barefoot boy and the commercial fisherman as well as the sportsman. A lure may be anything attached to the end of a fishing line. This would include spinners and spoon hooks which are used as widely as natural bait.

The imposition of this tax will advance the price of artificial lures, flies, and baits. This will increase the use of live bait such as frogs, minnows, crawfish, and helgramites. The traffic in live bait is the most serious cause for the depletion of our game fish as it robs these fish of their natural food.

We do not wish to shirk our duties in the support of an adequate tax plan but we believe the elimination of artificial lures, baits, and flies in this tax bill will be of mutual benefit.

Senator LA FOLLETTE. Mr. Weber, have you any estimate on what proportion of the artificial lures and flies that are used are produced as a home industry?

Mr. WEBER. I would think more than 50 percent.

The CHAIRMAN. All right, Mr. Weber. Thank you.

(The statement referred to by Mr. Weber is as follows:)

STATEMENT OF THE FLY AND BAIT DIVISION OF THE ASSOCIATED FISHING TACKLE MANUFACTURERS

Realizing the critical need for a tremendous increase in tax revenue at this time, when the country is dedicated to a gigantic national-defense program, the Fly and Bait Division of the Associated Fishing Tackle Manufacturers desires, through this statement, to go on record as supporting the President of the United States in all defense measures. At the same time, pursuant to the testimony offered by Mr. Oscar L. Weber, our representative, who appeared before the Senate Finance Committee, we feel it incumbent upon us to state in detail our objections to an excise tax on artificial lures, baits, and flies.

In H. R. 5417, now under consideration by the Senate Finance Committee, lines 2 and 3 on page 72, fishing rods, creels, reels, and artificial lures, baits, and flies are listed as taxable items under the general heading of "Sporting goods," which is included in section 3406, excise taxes imposed by the Revenue Act of 1941. Rods and reels have been taxed on two previous occasions, but artificial lures, baits, and flies never have been included in previous tax bills. One of the reasons for not taxing these latter items is the difficulty of collecting revenue, inasmuch as thousands of small manufacturers—in many cases families—impose upon the Federal revenue-collecting agency a task which is far more costly than the income derived, even if they could be located, and that is an impossibility.

We quote from the 1938 report of the subcommittee of the Committee on Ways and Means of the House of Representatives on the proposed revision of the revenue laws, in which it was stated:

"The tax on sporting goods has caused administrative difficulties out of proportion to the revenue received."

In requesting the committee to eliminate, on page 72, lines 2 and 3, H. R. 5417, "artificial lures, baits, and flies," we should like to list the following points for consideration:

1. Fishing tackle mainly is divided into three classes: (*a*) Rods and reels; (*b*) lines; and (*c*) artificial lures, baits, and flies.

2. Sales of artificial lures, baits, and flies are one-third in dollar volume of the sales of rods and reels and about one-half in dollar volume of fishing-line sales. Bait-casting lures are primarily the poor man's lures and are more widely used for the poorer class of commercial fishermen.

3. Thousands of small, insignificant manufacturers and sellers of artificial lures, baits, and flies cannot be reached by the Commissioner of Internal Revenue for the collection of such a tax as H. R. 5417 imposes. Consequently the collection of such a tax will strike only the larger and more widely recognized producers of such items, a condition which sets up an unfair tax burden. The back-room producers of artificial lures, baits, and flies have been able to spring up because the manufacture of these items on a small scale requires almost no capital investment.

4. Imposition of any tax on "artificial lures, baits, and flies" is certain to create a tendency toward price advances for these items. This being true, fishermen will use more live bait, i. e., frogs, minnows, and crawfish, which constitute the natural food of fish. Widespread use of live bait is opposed to the recognized principles of conservation and the fly and bait division of the Associated Fishing Tackle Manufacturers is opposed to a violation of any sound principle of conservation.

5. Since no opposition to the proposed tax on rods and reels is on record, it is suggested that the committee give consideration to a higher tax on these items—let us say 12 percent instead of 10 percent, which would produce a greater tax revenue than would be lost by removing the tax on "artificial lures, baits, and flies." Rods and reels are produced by recognized manufacturers whose identity and places of manufacture are well known and by producers who keep complete statistics on their daily production and daily sales.

6. In addition to the above, the industry is threatened with a proposed 10-percent tax on all fishing tackle for conservation purposes under H. R. 3301 and S. 1614, companion bills.

This committee cannot help but be aware of the fact that any tax imposition, even in a period of dire emergency burdens the fishing-tackle industry with extra duties, additional expense, and loss of time. It is our desire and wish to cooperate with the Federal Government to the very fullest extent, but, since we have presumed to make these suggestions to the Senate Finance Committee in a hope that "artificial lures, baits, and flies" will be eliminated from the text of the tax bill as passed by the House. We believe that our reasons are cogent, particularly since they point out that the revenue-collecting process on these items will involve such a high cost that the imposition of any tax will, in final analysis, nullify itself and fail to produce the return the Government expects.

(Signed) OSCAR L. WEBER,
President, Weber Lifelike Fly Co., Stevens Point, Wis.
(Signed) L. J. WOOSTER,
Vice President, James Heddons' Sons, Dowagiac, Mich.

The CHAIRMAN. Mr. Dahmen.

STATEMENT OF L. C. DAHMEN, OLEAN, N. Y., REPRESENTING THE DAYSTROM CORPORATION

Mr. DAHMEN. Mr. Chairman and gentlemen, I speak for the Daystrom Corporation, what might be called a medium-sized corporation, and I suspect there are thousands of corporations in this country in the same position in which we find ourselves.

The CHAIRMAN. What do you produce?

Mr. DAHMEN. Metal furniture, some plastics, steel tubing for furniture, dinettes, and furniture of that type.

The CHAIRMAN. What is the particular thing you are going to speak to?

Mr. DAHMEN. The general effect of the tax bill on the medium-sized corporations.

The CHAIRMAN. I see; not with respect to any specific excise tax?

Mr. DAHMEN. No; just the general provisions of the bill.

Senator BARKLEY. Excess profits?

Mr. DAHMEN. Excess profits; everything that is included in it.

The CHAIRMAN. All right. Go ahead.

Mr. DAHMEN. A small or medium-sized corporation has three general sources where it can get capital. As it grows it requires more capital. The more successful a corporation the more capital it requires. If it is unsuccessful, it goes into liquidation, and dies; but our corporation, and thousands of others like it, are what you might call successful. Starting out 10 years ago with 5 employees, today it employs 500, and it is still growing.

Now, we have three sources from which we can get capital. First, we can sell stock, but we fall into that unfortunate classification as do hundreds of others where S. E. C. restrictions on the sale of stock make that method cumbersome and inadvisable. We tried it many times and each time gave it up because of the cost and expense, and the fact that we do not fit in that classification of small corporations where a few thousands of dollars of local money will help us; on the other hand, we do not fit into the classification where we can go into the larger money markets, in Wall Street, to be financed. We have a second source of obtaining money, and that is borrowing, and, of course, you are all familiar with the limitations on capital borrowing. You can borrow for short-term needs, bue not for expansion and growth. That leaves one source for obtaining capital for growth, and that is earnings, and that has been the source that our company and thousands of others like us have obtained our money.

Now, we find ourselves in this position: Under this proposed tax law that source is being rapidly depleted and dried up. Net income, as pointed out many times today, does not necessarily mean that it is cash. It goes into brick, mortar, machines, and that type of thing, and at the present time we find ourselves in the position, gentlemen, where although highly successful for 10 years, we are actually borrowing money to anticipate and meet tax payments as well as to meet the increased demands of the requirements of our business.

Now, it seems to me, and I am not a tax expert, that the following of this procedure is going to ultimately result in weakened, sick corporations of this class. We are not going to be strong, and instead of being able to collect taxes from us on a reasonable basis your tax collections are going to be smaller and smaller. In other words, the old fable "The goose is being killed" by this type of taxation is pertinent.

Senator CONNALLY. Let me ask you this: You say you are borrowing money to pay taxes. What do you do with the money you make; what do you do, buy these supplies? Why don't you borrow the money to pay the bill for the brick, mortar, and machinery and pay the taxes with the cash?

Mr. DAHMEN. We would be very glad to borrow the money to buy those things, but it is not feasible to do so.

Senator BARKLEY. Do you have any more difficulty borrowing money for tax purposes than for the purchase of materials?

Mr. DAHMEN. I should say that borrowing money for taxes, unless you can show an immediate method of liquidation, is pretty nearly impossible.

Senator BARKLEY. Yet you say you borrow money to anticipate and meet tax payments. I asked you whether it was more difficult to do that than it would to borrow money for the purchase of the supplies.

Mr. DAHMEN. Well, if you wish me to go into it, I might say that the Daystrom Corporation has a hundred thousand dollar indebtedness against it.

Senator BARKLEY. I don't want to go into that. I am not trying to pry into your private finances, but I don't see where it would be any more difficult to borrow for your capital purposes than for your taxes.

Senator GERRY. One is short term, the other long term.

Mr. DAHMEN. That is true on many items of value such as buildings, equipment, and so on, but——

Senator BARKLEY. Then it ought to be easier to borrow for capital purposes than for tax purposes?

Mr. DAHMEN. No; it is not.

Senator BARKLEY. In other words, it is easier to borrow where you have no security than where you have?

Mr. DAHMEN. Of course, banks are limited naturally in the making of these loans.

Senator BARKLEY. It has no relationship to this bill, but you said you borrowed for tax purposes and that you could not borrow to provide capital funds.

Mr. DAHMEN. We borrowed for machinery and taxes. Giving you an honest answer to your question, some of the borrowing has been occasioned by the larger requirements of inventory, by the necessity of making purchases due to the condition of the market.

Senator BARKLEY. That has been made necessary by your larger business?

Mr. DAHMEN. Yes; and also by the uneven flow of material. A couple of years ago you could buy piecemeal; today you cannot do that.

Senator TAFT. The main point is, you haven't any means of financing your expansion?

Mr. DAHMEN. That is true, and if a corporation doesn't expand and grow it stands still and goes backward, and from your point of view, if you do not keep alive and strong these businesses, you are not going to be able to tax them, even on a lower basis. The amount on which you can successfully tax is going to be less than if you allow corporations to reinvest. Taking our corporation in particular, in 10 years there has never been a cash dividend paid which stockholders could put in their pockets. He has to put it back in the business. And that is true to a large extent of our executive salaries.

Finally, a method of taxation is coming along which gives us apprehension for the future. I am not disputing the need for the money but rather pointing out the result of getting it in this fashion where the corporations in this class, and there are thousands like ours, instead of being strong are going to be weak, and that is not mentioning the fact that thousands of businesses are in a very precarious condition already. We have had fair earnings this year but as the year progresses the availability of material is becoming less and less and the immediate prospects for profits, or even break-even operations, are becoming more restricted.

Senator VANDENBERG. Are not priorities a greater threat than taxation?

Mr. DAHMEN. I think you cannot isolate one thing and say it is that one thing; it is a multiplicity of things acting simultaneously to create a result, and this tax problem is one of them.

Senator BARKLEY. Of course, the question of priority is frequently brought into this matter here and undoubtedly the restriction of necessary material to industries not engaged in national-defense production is a hardship.

Mr. DAHMEN. Yes.

Senator BARKLEY. But is not that all due to the lack of foresight on the part of the American people as a whole in that they have not laid sufficient warehouses of such materials in the years past, and we have now to decide between some of our industries and the defense program, which, I suppose, most people feel is entitled to priority?

Mr. DAHMEN. Yes. I don't think that business generally is objecting to these priorities because we know after all we have a big stake in this thing.

Senator CLARK. Of course, priorities do enter into the tax situation in that the ability to pay taxes may be completely frustrated by inability to get materials.

Mr. DAHMEN. Yes; and further than that, during these periods of shifting, changing conditions, where one day we have one material and the next day another material is available, we must shift our equipment facilities in order to use available materials, and each time we make that change we have to invest more capital money to make that shift, with the net result that if I, as a manager of this company, wanted to limit my capital expenditures in order to pay taxes, I would be faced with the choice of either liquidating and closing down because I wouldn't have materials or doing the next best thing, attempting to meet another front.

Senator BARKLEY. What do you make?

Mr. DAHMEN. Steel tubing for furniture, dinettes, plastic, various parts of such things. The difficulty with our type of business is that we are not big enough in any one thing to be sufficient on that alone.

Senator CONNALLY. You are a hundred times bigger than when you started?

Mr. DAHMEN. Yes; we are going along pretty well.

Senator CONNALLY. And expanding regardless of how you are getting the money?

Mr. DAHMEN. Yes; we have been, but the question is whether you want us to grow; whether you want us to continue to be something you can tax or put us under such a burden that we cannot do so.

Senator BARKLEY. Where is your plant?

Mr. DAHMEN. Olean, N. Y.

Senator GUFFEY. Do you feel that this inability to get finances is due to conditions inherent in your business or are you basing your contention entirely on general conditions?

Mr. DAHMEN. I think it is general. I have no criticism with the S. E. C. program; it is necessary and is a very fine thing, but it has an effect and there is no loophole for a business which is not big enough to be able to afford to pay 30 percent to get some money.

Senator TAFT. I suppose you find difficulty in getting individual investors interested?

Mr. DAHMEN. Yes. Very frankly, the man with real investment capital today can invest in a large corporation, many of whose stocks are selling at liquidating prices. His inducement to invest in that type of business is far greater than is his inducement to invest in our

type of business, which is so personal. The death of myself, or my partner, or certain key men in our organization might destroy his investment; therefore, that type of individual is seeking the larger corporations. The small corporations are engaged in fabricating basic materials which are created by the larger corporations. The larger corporations do not go generally into producing the consumer goods. They produce the raw materials and it is a better investment for an investor.

Senator GUFFEY. How many employees have you now?

Mr. DAHMEN. About 500.

Senator GUFFEY. And you have been in business 10 years?

Mr. DAHMEN. Yes.

Senator GUFFEY. What was your capital originally?

Mr. DAHMEN. Just a very few dollars.

Senator GUFFEY. And how many men were there originally?

Mr. DAHMEN. Just myself and two others.

Senator GUFFEY. And now you have 500?

Mr. DAHMEN. Yes.

Senator GUFFEY. Then you cannot complain at the tax laws?

Mr. DAHMEN. I am not complaining at what the taxes have been; I am addressing myself to the projected taxes for the effect I fear they will have on the future well-being of corporations such as ours.

Senator GUFFEY. You don't see the ghosts before you reach the graveyard, do you?

Mr. DAHMEN. Unfortunately, if we don't see some of the ghosts, we are going to be in the graveyard.

The CHAIRMAN. That is the thought: You are trying to convey that thought. In other words, your credit position under this proposed tax is so circumscribed that you cannot any longer go into the money market and get the money for your expansion with hope of paying it back, and therefore you cannot get the money?

Mr. DAHMEN. That is the situation we are in.

The CHAIRMAN. Mr. Charles F. Willis.

STATEMENT OF CHARLES F. WILLIS, PHOENIX, ARIZ., STATE SECRETARY, ARIZONA SMALL MINE OPERATORS ASSOCIATION, AND CHAIRMAN, ARIZONA MINERAL RESOURCES BOARD

Senator HAYDEN. Mr. Chairman, while Mr. Willis is taking the stand, I should like to say that in addition to being the secretary of the Arizona Small Mine Operators Association and chairman of the Arizona Mineral Resources Board, Mr. Willis is also the publisher of the leading mining journal of the Rocky Mountain region. I am sure that any representations he may make should be given serious consideration.

Mr. WILLIS. My name is Charles F. Willis, of Phoenix, Ariz., and I am State secretary of the Arizona Small Mine Operators Association and chairman of the board of governors of the Arizona Department of Mineral Resources.

The Arizona Small Mine Operators Association is an organization of approximately 4,300 members, most of them operating small marginal or submarginal mines; many of them engaged in the development or production of the strategic and critical minerals which are so urgently being sought by the Government for defense pur-

poses. They are willing and anxious to do their part in providing raw material for the defense program and the mining of minerals and metals is the one place in which Arizona can fit, in a substantial way and do a splendid part.

I am speaking primarily on that amendment to the revenue bill—repealing section 731—which exempted the corporate producers of strategic and critical minerals from the provisions of the excess-profits taxes, although I will comment briefly upon certain other phases of the excess-profits taxes as they affect the mining industry and apply to other metals and minerals as well as those specified as strategic.

We in Arizona are fully in accord with the principles and objectives of the excess-profits taxes and the fact that an attempt is being honestly made to prevent profiteering on the defense program. We feel, however, that great care should be taken to make certain that the taxes being imposed are on true excess profits rather than upon profits that are actually normal or subnormal. Under the limitations as stated in this proposed law much of the possible strategic mineral production would be abnormally and unfairly taxed and be put out of business by burdens that could not be carried and therefore would not be assumed.

While Arizona is best known for its production of copper, it has large resources of many other metals, notably manganese, quicksilver, tungsten, vanadium, asbestos, and others. We have a deposit that has been stated on good authority to be one of the largest deposits of manganese ore in the United States, yet it is idle today, and the country badly needs manganese. I am reliably informed that the owners are awaiting your action, as that will determine whether it is to be a possible success or a certain failure.

The years 1936 to 1939 selected as the base period for a measure of normal earnings were not true normal earning periods even for the mines that were fortunate enough to be able to work during those years. Metal prices generally were far below average, and the small demand for metals caused the working at reduced capacity, and this meant higher per-ton or per-pound costs. The year 1937 was the only one of the base period that even approached normal. Many mines were shut down during substantial parts of that period.

During this base period many other mines were operated at a loss much of the time simply because it was less expensive to continue operation than to assume a shut-down expense. Mines that are shut down often require a large expenditure to maintain the property for future use, and if this is not done the available ore may be lost forever.

Most of the mines to which I refer are those on which there are no base-period earnings, as they were not producing or were only making preparations to produce during the period from 1936 to 1939. Therefore they would be forced to select the provision for basing profits on invested capital.

Mines are not made ordinarily through direct invested capital in the form of money, but by long periods of hard work, sacrifice, and stick-to-it-ive-ness. In many cases the invested capital of any individual mine, as ordinarily interpreted, is relatively small compared to its value.

The history of the development of a mine that ultimately becomes profitable is one of investment, operation, failure, reorganization with additional new capital, with the former owners retaining a part inter-

est; then further development, expenditure of the new capital raised, refinancing again, and it is frequent that this cycle may be repeated many times before the mine ultimately gets to profitable production. Each reorganization and refinancing buys in the results of the work of previous holders at a small fraction of the cost of the work done. Thus, the final invested capital, when it reaches the production stage, is relatively small as compared with the total that has been invested in different forms in the property.

There are many properties in which investments are made that never do reach the period of ultimate profitable production but stop forever at points along the route. The risks are great, the failures and losses frequent and it is only by normal profits being permitted on those that are lucky enough to make a success that the losses on the unsuccessful can be recovered.

Since the passage of the Second Revenue Act of 1940, there has been much search for and development of properties of strategic minerals in Arizona and production is now beginning to show in a substantial way, particularly in manganese, quicksilver, tungsten, and asbestos. The recent investments in these properties were primarily made because of the recognition by the Government of the critical need of stimulating production of these particular minerals and metals. The Second Revenue Act of 1940 exempted from the provisions of the excess-profits tax law these minerals and metals and, on the basis of that recognition, mines were prepared for production, plants were started and substantial investments made.

Many of the strategic mineral operations now under way were based upon contracts with the Metals Reserve Company or R. F. C. and, in making those contracts and setting prices thereon, consideration was given to the fact that the Second Revenue Act of 1940 exempted them from the excess-profits taxes. The removal of these exemptions will require that new contracts be made and the increased costs due to the larger taxes will have to be added to the prices. Thus, the revenue from them that might be obtained from this provision of the law would be consumed by the higher prices of the commodity and even more if they were on a cost-plus basis.

It is distinctly unfair and might be considered to be a lack of good faith on the part of the Government, to eliminate that clause in the Second Revenue Act of 1940 upon which these investments were encouraged. Those mines would have no alternative but to determine whether they are in sufficiently deep to keep on, assume additional risks and attempt to recover a portion of the investments made or to quit and take their loss now. Except in the rare cases of bonanza discoveries a loss will be taken and the question is as to which route means the lesser loss.

In some cases companies planning to mine strategic minerals have held up plants to be erected for production because of the fact that the proposal this year was not to exempt them from the provisions of the excess-profits taxes. They feel that they cannot afford to make the substantial capital outlay necessary until they know where they are going and what they have to look forward to. They are waiting your action and yet the country sadly needs manganese, quicksilver, asbestos, tungsten, and other metals and minerals which they might be producing.

It must be recognized that it would require a most adventurous mining organization to make investments in strategic anud critical minerals on any basis of paying a normal corporation tax of 80 percent and then an excess-profits tax, from which the normal tax is not deductible, and have the excess-profits tax based upon 8 percent of the invested capital—knowing very definitely that, except in a very few isolated cases, the entire investment will be useless and unrecoverable when the defense period is over. It simply cannot be expected to be done.

Mining, and particularly the strategic mineral production, is an industry of great risks and financial hazards. Under the Second Revenue Act of 1940, the Government said "You take the risk as we badly need that which you propose to produce. If you are successful in producing it we will grant you certain preferential treatment in the form of excess-profits-tax exemption." And now it is proposed that the preferential treatment, upon which they confidently made their investment and based their operations, be withdrawn.

It is probably true that, out of the many mining properties which will be developed as a result of the defense-program demands, there will be a few that will be able to operate after the defense program is over. Continued operation may get costs down to a point where they can survive the post-war domestic competition and that which will come from the low-cost production of foreign countries, but those cases will be few and far between.

The normal development procedure for any mine, and this applies to all mining as well as those of the strategic materials, is to work on a small scale and plow operating income back into the ground for additional development work, thereby opening the mine gradually for ultimate larger-scale operation and the handling of greater tonnage. They depend upon the future larger-tonnage operation, when the mine is ready for regular production, for the return of the capital and the profits, if any. They may, at any time, find that they have reached their economic production limit and have to stop there.

Under the proposed excess-profits-tax provisions, as I understand them, this is not recognized. When any mine increases its production capacity during the latter part of the base-period years or since and does not make any greater profit per ton of ore mined or per pound of metal produced, it is not making excess profits, but it is only putting into the current year those profits which would normally be made in later years as the ore was taken out in a more orderly and leisurely manner, and it is probable that even less profit would result from more rapid extraction.

A mining property has within its borders very definite limitations of its ore bodies. If that ore body is mined within 5 years, simply because of the extraordinary demands of the defense program and the urgency of the Government requirements, the net income during the 5-year period would naturally be greater, yet it would be far less than if the same ore body were extended in production to a period which coincided with the life of the plants and equipment necessary to extract it or the allowable period of amortization. Instead of being excess profits it would not be up to normal profits, and yet under the provisions of this law the excess-profits tax would be imposed.

Therefore, it could hardly be expected that mines could afford to increase their capacity and make the investments necessary thereto

and pay the penalties imposed under these provisions of the revenue bill under consideration. They are quite willing to patriotically deplete their ore bodies and shorten their life but could not be expected to pay a premium for doing it.

A manufacturing enterprise is very different than a mining company because of the fact that a mine depletes, and ultimately exhausts, its assets; has definite limitations as to life and during its life must obtain a full recovery of the capital investment before a penny of actual profit is made. If the life is shortened, because of the emergency demands, the opportunity for recovery of capital and an adequate return is lessened.

An excess-profits tax on mine products without consideration of the conditions set forth will produce an inevitable waste of the Nation's resources because increased costs will make it necessary to seek and mine only the higher-grade ores, those which can stand the increased load. Thus, lower-grade ores must be passed by and, when this happens, they are frequently irrecoverable. The lower-grade ores, and there are many different grades in most mines, can only be worked during a period of increased demand and higher prices or lower costs. The present proposal forces upon the mine operators, the taking of the cream, and the leaving of only the skimmed milk for the future—a program which may prove disastrous.

There very definitely should be written into this law a provision applying to mining that bases excess profits upon the additional financial recovery per ton of ore mined or per pound of metal produced. It obviously is inequitable in mining to base it upon the aggregate income of the producing company.

The excess-profits tax as written and as applied to mining discriminates against corporate development. The tax applies only to corporations. Yet corporate development is the only way we can possibly get the quantity production of strategic and critical minerals required.

Mines ordinarily start as individual enterprises. The individual carries them to a point of promise and need of greater capital requirements. The risks of mining can be lessened by capital spreading itself thinly over many units anticipating that the profits of one will overtake the losses of many. The risks are too great for a concentration of capital on single units. Therefore corporate development may serve to minimize the risks by spreading the load.

By penalizing and discriminating against corporate development you restrict new mining activities, which are very necessary if the defense-program requirements are to be fulfilled, to small and individual producers which ordinarily have far higher unit costs than larger-scale operations. Thus the prices on the metals and minerals necessarily must be higher in order to bring out the production required.

The amount of revenue that will be raised by the excess-profits tax coming from those engaged in strategic mineral production is an inconsequential part of the revenue to be obtained under this bill, because it must come entirely from the going mines of today which cannot, under the proposed law, expand their operations because of the confiscatory penalties imposed. They will curtail expansion of production from old mines; they will stop a search for new mines; they will decrease production of much-needed materials and, unless

relief is granted, they will seriously handicap the defense program because the strategic minerals are those which are absolutely necessary to the defense program yet have not been opened to produce an amount sufficient for the Nation's needs.

Senator JOHNSON. Mr. Willis, will you permit an interjection right there?

Mr. WILLIS. Yes.

Senator JOHNSON. This committee has heard with regularity complaints about priorities and the effect priorities will have on businesses to be taxed. I think we are all convinced that priorities are a very serious threat to many industries in this country. Now, you are proposing that the very things that cause these priorities—shortage of these essential minerals—that production be encouraged so that the blow of such priorities will not be so severe.

Mr. WILLIS. We are proposing a method by which the strategic metals, so necessary for national defense, may be brought out. You must remember it is a new industry in this country because we have an insufficient production of them.

Senator JOHNSON. And the encouragement you are giving to the production of these strategic minerals is the only answer that can be given to the problem of priorities?

Mr WILLIS. I cannot say the only answer but insofar as they are used in the manufacture of machinery that is true.

Senator JOHNSON. Well at is why we are having priorities, the shortage in the essential metals.

Mr. WILLIS. Yes; it is; because of that shortage, and yet under the proposal in this law of eliminating the exemption of excess profits from them it will cut down the strategic minerals supply.

Senator JOHNSON. I think that is a fine case of killing the goose that lays the golden egg.

Senator TAFT. Can you estimate the amount involved in this provision?

Mr. WILLIS. No; we cannot; there is no possible way to. I don't think it was ever segregated in any of the reports. I doubt very much whether it would amount to a million dollars; it is extremely small.

Senator TAFT. It couldn't exceed a million dollars; it is limited to seven minerals, of which three or four are most essential.

Mr. WILLIS. No; there are others but those are the chief ones.

Senator TAFT. Is tin being produced?

Mr. WILLIS. No; but there are several possibilities that are being looked into now. The Government is spending a world of money to bring out these minerals and yet with the knowledge that they have to go through a period of basing their profits as provided in the act, and with the knowledge that after the emergency is over their investment is useless, operators just can't see their way clear to do it.

Senator JOHNSON. The revenue to the Treasury isn't great, but the effect upon industry is——

Mr. WILLIS. Tremendous. Although there is no possible way of proving the statement, it is believed that the revenue to be obtained by the 30-percent normal taxes on new mining units of strategic minerals would be far greater than that which could be obtained from the few who are now producing insufficient quantities for de-

fense and, at the same time, the requirements of the Government would be much nearer fulfillment. In other words, if there was this exemption applied you would have new mines and new production. They would, of course, pay the normal tax, and the 30-percent tax to be obtained from them would in my estimation far exceed the amount of exemption from excess-profits tax from those now producing for the Nation's needs.

The CHAIRMAN. Your time has expired, but you may proceed if you will only take a few more minutes.

Mr. WILLIS. As a matter of fact, there are very little, if any, true excess profits in mining as the prices of the metals have largely been "pegged," whereas costs have not been similarly limited. That small margin between costs and selling price is becoming smaller and smaller as the costs increase and the additional normal taxes are being imposed.

It is inequitable to limit prices without limiting the factors that go to make up those prices. In mining approximately 40 percent of the costs are in wages and it is felt that we very definitely cannot expect them to be "pegged." Mine wages are bound to increase and, while mining was once considered to be a high-wage industry, it has been so far outstripped by those working on direct defense projects that the mines of Arizona are rapidly losing their labor to the defense industries in the Pacific Coast States.

While this is the situation relating primarily to the large copper mines and will, in time adversely affect copper production, it has its very direct bearing upon the mines producing strategic minerals in that the mining wage scale of the State is regulated to a very considerable extent by the wages paid at the larger copper mines. They must all pay the prevailing scale or they cannot get labor. Thus new production of strategic minerals has additional cost burdens piled upon it with more to come.

The shortage of metals is critical. This shortage does not only apply to those listed as critical or strategic metals and minerals but likewise applies to many of those in which there are ample resources in this country but which have not been made ready for production beyond peace-time demands.

Ore in the ground is worth nothing. It only has value when the necessary capital, labor, engineering and management are applied to bringing it out in a form of a useful commodity. The Western States have great potential resources of these minerals and metals. They are desirous of contributing them to the defense program with no thought or desire of abnormal or unusual profits. Capital is required to do so yet, under the present conditions, capital cannot possibly afford to assume the risks involved under such conditions as are proposed.

We are not isolationists in the currently accepted meaning of that word but we do believe that we should be ready for such isolation as may be forced upon us. There are many directions from which it may come. We must develop and make ready our resources to fulfill the national needs. We must have an inventory of our mineral resources and know to what extent those resources can be counted upon to serve useful purposes but it can never be done if prospecting and new mine development is penalized. If these strategic metals are not

produced by individual initiative and private capital they will have to be brought out by the Government at an immeasurably greater expense than the revenues which will be obtained from this bill and it is very certain that they must be produced.

The Arizona Small Mine Operators Association therefore appeal to you to make it possible for us to contribute our part to the defense program and urge upon you the continuation of the exemption of the excess profits taxes for production of the strategic and critical minerals and that the milling and preparation for the market be included.

We further urge that consideration be given to a method of recognizing that true excess profits from mines comes only from increased prices or decreased costs and not from a larger number of units produced as this merely anticipates later normal profits.

The CHAIRMAN. Thank you, Mr. Willis. Are there any other questions of Mr. Willis?

(No response.)

The CHAIRMAN. I understand there will be no business transacted in the Senate. Senator Barkley advises that there may be a confirmation of one or two nominations; beyond that there will be nothing of a controversial nature. I think we might run until about 12:30 if that is agreeable to the committee.

Mr. Martin Popper, Washington, D. C.

(No response.)

The CHAIRMAN. Mr. Richard B. Barker.

STATEMENT OF RICHARD B. BARKER, WASHINGTON, D. C., REPRESENTING CHINA GROVE COTTON MILL, CHINA GROVE, N. C., AND GASTONIA FULL-FASHIONED HOSIERY MILL, GASTONIA, N. C.

Mr. BARKER. My name is Richard B. Barker, Washington, D. C. I am here representing the China Grove Cotton Mills, of China Grove, N. C., and the Gastonia Full-Fashioned Hosiery Mill, Gastonia, N. C.

I wish to speak to the committee on the declared value excess-profits tax. This is not the excess-profits tax enacted last year and should not be confused with it. This is the tax enacted in 1933 wherein corporations were required to declare a value on their capital stock and allowed 10 percent of such value against income; any amount in excess of that was taxed at the 6 and 12 percent income tax rates. My suggested amendment to this is that corporations be allowed to declare their capital stock annually rather than for a 3-year period. Historically the amendment I am asking is nothing more than the Senate and Congress has done in practical effect in the last 8 years, or since 1933. The Congress has recognized that it is unfair and impracticable to make a coporation guess as to what its future profits will be, and if it makes a bad guess to exact a penalty tax from it. It has been stressed to this committee time and time again that taxes should be based on ability to pay, especially when you have high rates of taxation, and I cannot emphasize enough to this committee that the present declared value capital stock excess profits tax law which requires the corporation to declare capital stock for 3 years in advance is not in any way based on ability to pay, but is based entirely, 100 percent, on ability to guess.

Let me illustrate: Suppose two corporations, corporations A and B, each over a period of 3 years earn $3,000,000. Corporation A earns $1,000,000 a year for 3 years and corporation B loses money the first and second years and makes money the third year, $3,000,000 the third year. Both corporations have the same amount of income at the end of that period. Corporation A will only pay $30,000 of capital-stock tax during those 3 years; corporation B, in order to protect itself from the penalty, and assuming that corporation B can make a perfect guess, will have to pay $90,000 under the present rate.

In other words, corporation B will have to pay three times as much tax on the same income as corporation A if it is to avoid the penalty tax, and, of course, under those circumstances it would be very unlikely that corporation B could make a perfect guess; so we say it is only fair when you have those high rates to distribute the burden among all corporations. Nevertheless, some corporations cannot make as good a guess as others; that is why you will notice from the charts before you—the first chart, the textile industry net income—you will notice that it is an extremely volatile industry, with profits jumping up and down. It is the kind of corporation, the kind of industry, that enjoys what is known as a short feast and long famine.

Skip the next set of figures and look at the next chart. That chart applies to the cotton-goods manufacturers, and again you will note that rather than being steady income, it is really the opposite situation, an extremely volatile situation.

Now, on the third chart, which I think is the most important one for comparative purposes, I have set forth the percent of net income to net worth of the tobacco industry, the utilities industry, and the textile industry. You will note that whereas tobacco and utilities have fairly steady profits and can forecast with a reasonable degree of accuracy their profits, the textile industry cannot, and it must make, in the nature of things, far worse guesses than the other industries.

In other words, you are taxing the volatile at the expense of the steady industries. The T. N. E. C. report shows practically all the excess-profits tax, penalty tax—or a large proportion of it—is collected from corporations whose income is under $50,000 a year, and gradually progresses downward until on very large corporations practically no such tax is collected.

That same report shows that in these volatile industries most of the taxes are collected, whereas on the tobacco and utilities industries, the steady ones, no excess-profits tax is collected. Under those circumstances we feel it is only fair not necessarily to repeal the tax, as Secretary of the Treasury Morgenthau recommended a few years ago—you need the revenue—but do as you have in the past; give us an annual declaration each year. I emphasize this and ask that it be done at the present time, because the Commissioner of Internal Revenue has extended the time within which to file our capital-stock returns until September 29, but by September 29 we must know whether we are going to have to guess again with reference to our profits for the next 3 years.

Gentlemen, you won't lose any revenue over what you have collected in the past but you will cut out this vicious penalty tax and especially in those industries where you have priorities.

Let me repeat: The fact is that where you have a situation such as we have in Gastonia at the Full-Fashioned Hosiery Mill, it seems unfair

to say on the one hand "You must guess what your profits will be for the next 3 years, and if you guess badly we are going to put a terrific penalty on you," and on the other hand say, "We are going to have the right to shut down your plant and make you guess badly."

Under those circumstances, we cannot make a decent guess. We are pilloried on this priority problem and there are hundreds of otherwise likewise. Base your tax, base your rate on ability to pay, please cut out penalty taxation. I can advise the committee that we have discussed this matter with the Treasury; that while the Treasury officials say they are not in a position to recommend the change we ask, they do say that they do not oppose it.

Now I ask permission to have a memorandum setting forth the technical language that would effect this change filed—this memorandum and the historical approach to it—and inserted in the record.

Senator BAILEY. What would you say as to the substitution of a capital investment base for it?

Mr. BARKER. We already have that in this last year's excess profits tax.

Senator BAILEY. The capital investment base could be carried——

Mr. BARKER. The trouble with that is that the reason they put in this declared capital stock value tax in 1933 was in order to avoid the bitter disputes that arose under the old provision. Now, of course, you have to make the determination.

Senator BAILEY. You don't think that substitution would work?

Mr. BARKER. There is no logic to this thing whatsoever.

Senator BAILEY. I agree with you as to that.

Mr. BARKER. We believe that what we are here proposing would be much fairer than this penalty situation that exists today. That is true because if we make a bad guess, which we are bound to do, it is going to result in terrific hardship. It may be the proverbial straw that can well break the camel's back.

The CHAIRMAN. You may insert anything further that you wish in the record.

Mr. BARKER. I have here a memorandum in support of the amendment which we propose to the capital stock tax law, together with some charts and figures relevant to the textile industry from 1920 to 1938. I should like to have the memorandum incorporated in the record.

The CHAIRMAN. Yes; it will be put in the record.

(The memorandum referred to follows:)

MEMORANDUM IN RE CAPITAL STOCK TAX AMENDMENT

In Monograph No. 9, entitled "Taxation of Corporate Enterprise," published by the Temporary National Economic Committee, at page 118, the following remark is made with respect to the capital stock and declared value excess-profits taxes:

"CAPITAL STOCK AND EXCESS-PROFITS TAXES

"The Federal capital stock tax is based upon an evaluation of capital in terms of corporate earning power rather than in terms of the capital actually invested or tangible net worth. The present 'excess-profits' tax is nothing more than a penalty tax on those corporations which guess badly in declaring their capital stock for tax purposes. Despite its name the tax has nothing to do with 'monopoly' profits.

"The compound capital stock-excess-profits taxes discriminate markedly against corporate enterprises with fluctuating profits, including small corporations and

corporations in particular industries, the profits of which cannot be accurately forecast. The excess-profits tax is substantially nonexistent on most large corporations."

See also pages 67-69, where the following remarks are made:

"The present excess-profits tax, which was initially enacted by the National Industrial Recovery Act of 1933, is an excess-profits tax in name only, thoroughly unlike its namesake of the war period. Essentially the present excess-profits tax is the lesser of a pair of Siamese twins, the better half of which is the capital-stock tax enacted at the same time, and functions as a whipping boy for the latter" (p. 67).

"The selection of favorable capitalization figures depends obviously on the accuracy with which earnings may be forecasted, a factor which varies with the economic skill of the corporate managers, the stability or fluctuation of corporate profits in different industries, and the chances of a particular corporation to make profits in any given year" (p. 68).

"From this chart it appears that the excess-profits tax shows a very marked tendency to vary inversely with corporate size, while the capital-stock-tax pattern characteristically exhibits only slight size variations" (p. 69).

(Mr. Barker also submitted the following memorandum, charts, and tables:)

MEMORANDUM IN SUPPORT OF AMENDMENT TO CAPITAL STOCK TAX LAW

This memorandum is submitted in support of a proposed amendment to section 1202 of the Internal Revenue Code under which corporations would be permitted, in computing their liability for capital-stock taxes, to redeclare the value of their capital stock each year, rather than every third year, as required under the present law.

Section 1202 of the Internal Revenue Code now provides as follows:

"SEC. 1202. *Adjusted declared value*—(a) *Declaration year.*—(1) The adjusted declared value shall be determined with respect to three-year periods beginning with the year ending June 30, 1938, and each third year thereafter. The first year of each such three-year period, or, in case of a corporation not subject to the tax imposed for such year, the first year of such three-year period for which the corporation is subject to such tax, shall constitute a 'declaration year.'

"(2) For the declaration year of the first three-year period the adjusted declared value shall be the value as declared by the corporation in its return under section 601 of the Revenue Act of 1938, 52 Stat. 565, for the year ended June 30, 1938, or in the case of a corporation not subject to the tax imposed for such year, the value as declared in its return filed under this chapter for the first year with respect to which it is subject to the tax. For each subsequent three-year period, the adjusted declared value for a declaration year shall be the value as declared by the corporation in its return for such declaration year. The value declared by a corporation in its return for a declaration year (which declaration of value cannot be amended) shall be as of the close of its last income-tax taxable year ending with or prior to the close of such declaration year (or as of the date of organization in the case of a corporation having no income-tax taxable year ending with or prior to the close of such declaration year).

"(b) *Subsequent years.*—(1) *Domestic corporations.*—For each year of any three-year period subsequent to the declaration year, the adjusted declared value in the case of a domestic corporation shall be the value declared in the return for the declaration year plus—

"(A) the cash, and the fair market value of property, paid in for stock or shares,

"(B) paid-in surplus and contributions to capital,

"(C) its net income,

"(D) its income wholly exempt from Federal income tax, and

"(E) the amount, if any, by which the deduction for depletion exceeds the amount which would be allowable if computed without regard to discovery value or to percentage depletion, under section 114 (b) (2), (3), or (4) of chapter 1 or a corresponding section of a later Revenue Act; and minus—

"(i) the cash, and the fair market value of property, distributed to shareholders,

"(ii) the amount disallowed as a deduction by section 24 (a) (5) of chapter 1 or a corresponding provision of a later Revenue Act, and

"(iii) the excess of the deductions allowable for income-tax purposes over its gross income.

"The adjustments provided in this paragraph shall be made for each income-tax taxable year included in the three-year period from the date as of which the value was declared in the return for the declaration year to the close of the last income-tax taxable year ending with or prior to the close of the year for which the tax is imposed by this section. The amount of such adjustment for each such year shall be computed (on the basis of a separate return) according to the income-tax law applicable to such year.

"(2) *Foreign corporations.*—For each year of any three-year period subsequent to the declaration year, the adjusted declared value in the case of a foreign corporation shall be the value declared in the return for the declaration year adjusted (for the same income-tax taxable years as in the case of a domestic corporation), in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, to reflect increases or decreases in the capital employed in the transaction of its business in the United States.

"(c) *Corporations in bankruptcy or receivership.*—The capital-stock tax year beginning with or within an income-tax taxable year within which bankruptcy or receivership, due to insolvency of a domestic corporation, is terminated shall constitute a declaration year. In such case the adjusted declared value for any subsequent year of the three-year period shall be determined on the basis of the value declared in the return for such declaration year.

"(d) *Credit for China Trade Act corporations.*—For the purpose of the tax imposed by section 1200 there shall be allowed in the case of a corporation organized under the China Trade Act, 1922, 42 Stat. 849 (U. S. C., Title 15, c. 4), as a credit against the adjusted declared value of its capital stock, an amount equal to the proportion of such adjusted declared value which the par value of the shares of stock of the corporation, owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date. For the purposes of this subsection shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested; and as used in this subsection, the term "China" shall have the same meaning as when used in the China Trade Act, 1922.

"(e) *Additional declaration years.*—In the case of any domestic corporation, the year ending June 30, 1939, and the year ending June 30, 1940, shall each, if not otherwise a declaration year, constitute an additional declaration year if with respect to such year (1) the taxpayer so elects (which election cannot be changed) in its return filed before the expiration of the statutory filing period or any authorized extension thereof, and (2) the value declared by the taxpayer is in excess of the adjusted declared value computed under paragraph (1) of subsection (b). If, under this subsection, the year ending June 30, 1939, is a declaration year, the computation, under paragraph (1) of subsection (b), of the adjusted declared value for the year ending June 30, 1940, shall be made on the basis of the value declared for the year ending June 30, 1939."

It is suggested that this section be amended by striking out sections 1202 (a), 1202 (b), 1202 (c), 1202 (e) and substituting the following language:

SEC. 1202. (a) The declared value of the capital stock of a corporation shall be the value as declared by the corporation in its return for each year. The value declared by a corporation in its return each year shall be as of the close of its last income-tax taxable year ending with or prior to the close of the year for which such return is filed (or as of the date of organization in the case of corporations having no income-tax taxable year ending with or prior to the close of such year).[1]

The sole effect of the adoption of the above amendment would be to allow corporations to declare the value of their capital stock each year instead of every third year. This would not only simplify the computation of the capital stock and/or the declared value excess profits tax but would also eliminate a great deal of the uncertainty which is forced on taxpayers by the provisions of the present law. It would not seriously reduce the revenue.

The present capital stock tax, together with its complement, the declared value excess-profits tax, originated in the National Industrial Recovery Act of 1933 (secs. 215 and 216). Under the provisions of that act, a tax of $1 for each $1,000 was imposed upon the value of the capital stock as declared by the corporation. An

[1] As a result of this amendment it would become necessary to substitute the phrase "declared value" for the phrase "adjusted declared value" in secs. 1200 and 1202 (d) as well as in secs. 600 and 601 (where such phrase is used in connection with the declared value excess-profits tax). It would also be necessary to change the present number of sec. 1202 (d) to sec. 1202 (b).

excess-profits tax was imposed on all income in excess of 12½ percent of the declared value in order to prevent a corporation from undervaluing its stock. The Senate Finance Committee report (77d Cong., 1st sess., S. Rept. 114) stated the taxing scheme in these words:

"In order to avoid controversy as to the value of the capital stock, the tax is imposed on the value declared by the corporation. A reasonable value, is, however, assured by means of an excess-profits tax imposed by section 215 and based on the relation of the net income of the corporation to such declared value."

Under the act of 1933 no provision was made for redeclaring the value of the capital stock. After the first declaration year the taxable value was to be determined by adding to or subtracting from the original declared value any additions to or withdrawals from the capital of the corporation. As sated in the Senate Finance Committee report (*supra*):

"A value once having been declared, such value may not be subsequently changed except for bona fide changes in the capital structure."

The capital stock and excess-profits taxes were reimposed in the Revenue Act of 1934 (sec. 701 and 702), and a new declaration of value was permitted for the first year under the new statute. However, under the terms of the 1934 act the value of the capital stock as declared in the first year under that act could not be changed in later years except for specific changes in the capital structure of the corporation.

In the Revenue Act of 1935 the House proposed to increase the rate of the excess-profits tax and reduce the exemption from 12½ percent of the adjusted declared value of the capital stock to 8 percent of such declared value without allowing a new declaration of value. The Senate refused to agree to this, however, and the statute as passed permitted a new declaration of value.

Although three new declaration years were allowed during the first 5 years of the capital stock tax, it was not until the 1938 act that Congress incorporated into the statute a provision permitting a periodic redeclaration of value. In the Revenue Act of 1938 (sec. 601) Congress provided that every third year (beginning with the year ending June 30, 1938) should be a declaration year in which a corporation could declare a new value for its capital stock. The Senate bill provided for a redeclaration every 2 years, but the Senate receded in conference and approved the three year period. The reason for allowing periodic redeclarations of value was stated by the Ways and Means Committee in its report (75th Cong., 3d sess., H. Rept. 1860).

"Under the 1935 act, as amended, the valuation fixed by the corporation may not be changed for later years except that adjustments for later years are to be made as increase or decrease of corporate property occurs. In view of the changing business conditions to which business is subject, it seems that some opportunity for revaluation of the capital stock at reasonable intervals should be afforded."

It was found, however, that the "changing business conditions" referred to in the committee report changed faster than anticipated, so that the 3-year interval between declarations was too long. In the Revenue Act of 1939 Congress recognized this fact and allowed corporations to redeclare upwards in both 1939 and 1940, which were nondeclaration years according to the Revenue Act of 1938. The Secretary of the Treasury appeared before the Ways and Means Committee on May 27, 1939, and advocated the repeal of the capital stock excess profits tax on the ground that it was a "tax irritant." He said:

"Under the present law the capital-stock tax is based upon a declared capital stock value which the taxpayer may revise every 3 years. The declared value may be any figure that the taxpayer desires to submit, regardless of the actual value of the stock. The excess-profits tax applies to profits in excess of 10 percent of such a declared value. The taxes are thus not really taxes on the value of capital stock or on excessive profits. Their major defect is that they operate very erratically. The tax liability they impose depends on the taxpayer's ability to forecast profits for the next 3 years as well as upon the amount of profits actually realized during each of the 3 years. Forecasts of earnings are particularly difficult to make in the case of new businesses and these with unstable incomes such as the capital-goods industries, with the result that taxes imposed on such businesses are at times inordinately high."

Although the committee decided to retain the tax, the statute was amended to allow a redeclaration upwards in 1939 and 1940. This action is explained in the committee report (76th Cong., 1st sess., H. Rept. 855) in the following words:

"As the main hardship arising from this feature of the tax law is due to the fact that a corporation is unable to forecast its profits accurately over a 3-year

period, it is believed that the situation can be remedied by permitting these corporations which declared a too low value for capital-stock tax purposes to increase such value for the capital-stock tax years ending June 30, 1939, and June 30, 1940. This will permit corporations that have been unable to forecast their profits accurately to be relieved of a large excess-profits-tax liability for the excess-profits-tax years ending after June 30, 1939, and June 30, 1940, respectively. Since corporations are entitled to a new declaration for the capital-stock-tax year ending June 30, 1941, this declaration will afford them relief from any hardship arising from an underestimate of profits for at least a 3-year period."

From this review of the legislative history of the capital stock-excess profits tax, it is seen that, as a practical matter, during the 9 years of this tax, there have been 7 declaration years. These new declarations have been permitted from year to year, not according to any intelligent, well-considered plan, but because of economic factors which could not be ignored without creating an injustice. Congress has recognized the necessity of permitting frequent redeclarations of value, but the hand-to-mouth character of its recognition has subjected taxpayers to great uncertainty. Why would it not be more sensible to recognize openly and deliberately the actual situation and the true purpose of the tax by making a specific statutory provision for yearly declarations?

As the Secretary of the Treasury stated in his appearance before the Ways and Means Committee on May 27, 1939, the capital stock-excess profits tax is neither a tax on the value of capital stock nor a tax on excess profits. In effect, the tax is imposed on the capitalization of a taxpayer's guess as to his future income. Because of international conditions and the defense program, business at the present time is faced with uncertainty to a degree unparalleled in recent years. Under these conditions, even large and well-established corporations are wholly unable to make an accurate forecast of their earnings 3 years hence. And for a new corporation or for the small or medium sized corporation which is called upon to embark on a new enterprise, a forecast even approaching accuracy is utterly impossible. Such a corporation has no way of knowing the extent to which it will be called upon to participate in the defense program. It has no way of anticipating the effect on its earnings of priorities which are now being put into operation in the interests of national defense. Nor does it have any way of knowing what will happen to its business in the event of a sudden cessation of hostilities abroad; a declaration of war by or against the United States; or even the effect of future taxing statutes, Federal or State. All these factors combine to make it difficult for a well-established business, and impossible for a new business, to make an intelligent forecast of its earnings 2 or 3 years hence.

In the Senate Finance Committee report on the Revenue Act of 1934 (73d Cong., 2d sess., S. Rept. 558) the purpose of the declared value excess-profits tax was described as follows:

"The primary purpose of this tax is to induce corporations automatically to declare a fair value for their corporate stock under section 701. The rate is 5 percent on the portion of the net income in excess of 12½ percent of the adjusted declared value of the stock of the corporation. The secondary object of the tax is to subject to a somewhat higher rate of tax abnormal profits which are out of proportion to the capital of the corporation."

It is seen, therefore, that even at its inception, the declared value excess-profits tax was not so much a tax on excess profits as it was an inducement to a fair declaration of value for capital-stock-tax purposes. If it is anything except a penalty for undervaluation, the declared excess-profits tax was and is a tax on unexpected profits rather than excess profits. A corporation can earn any rate of return upon its actual capital without being subject to the declared value excess-profits tax if it can anticipate this profit and declare the value of its capital stock accordingly. It is only the unexpected profits which are reached.

Whatever necessity there was in 1934 for a tax to reach excess profits, there is surely no such necessity at the present time. There is now a real excess-profits tax, imposing a tax on an excessive return on invested capital. Consequently, at the present time, the only conceivable purpose of the declared value excess-profits tax is to prevent a corporation from undervaluing its stock. If the only problem is one of insuring a fair declaration of value it would appear that this could be accomplished more fairly and more precisely by allowing a corporation to reexamine its business situation each year and place a value on its capital stock. If the business conditions in 1939 were so uncertain

as to prompt Congress to allow redeclarations in 1939 and 1940, surely they are sufficiently uncertain now to make it imperative that the statute provide specifically and definitely for annual redeclarations of value.

The only possible objection to the allowance of annual redeclarations of value is that a small loss of revenue might result. It is indeed true that some part of the revenue now obtained from the capital stock and declared value excess-profits tax results from bad guesses by taxpayers as to future earnings. If taxpayers could redeclare every year there would be fewer bad guesses and hence less revenue. However, considering the Federal tax policy as a whole, the very slight loss in revenue which might result from allowing yearly redeclarations of value would be more than offset by the elimination of the irritating uncertainty to which taxpayers are subject under the present law and the inequities of taxation which result.[2] All successful taxing statutes represent a reasonable compromise between revenue for the Government on the one hand and fairness to taxpayers on the other. The intolerable uncertainty to which corporations, particularly new corporations, are subjected under the present law is all out of proportion to the revenue produced under the law. Corporations which are alike in their capitalization and earnings are subjected to greatly varying taxes depending upon the luck of their officials in forecasting future conditions. If annual redeclarations were permitted, most of the uncertainty and inequities would disappear, with only a slight decrease in revenue.

It should not be overlooked, moreover, that the adoption of annual declarations of value would greatly simplify the collection of the capital-stock tax both from the point of view of the Government and from the point of view of the taxpayer. Under the present law, the "adjusted declared value" in nondeclaration years is computed by adjusting the declared value for reductions from or additions to invested capital. These changes in capital structure are often complicated, and consequently present questions for litigation and dispute between the taxpayer and the Bureau of Internal Revenue. The necessity of making this involved computation of tax liability places just another burden on taxpayers who already must spend a great deal of time and money computing their tax liability under other taxing statutes. Many taxpayers complain more about the difficulty of computing their proper tax liability than about the amount of the tax. The adoption of the proposed amendment to the capital stock tax law would not only eliminate all controversy as to the adjusted declared value but would release for more productive work the time and energy of corporation executives who now spend too much effort merely computing the tax liability of their corporations.

Many of the inequities of the present law apply to all corporations alike. However, as mentioned previously, the present law is particularly hard on new corporations and old corporations branching off into new lines of business. The large and well-established corporation has a long experience from which to draw in forecasting future earnings for purposes of valuing its capital stock. While it may be very difficult even for a well-established corporation, in view of the rapidly changing economic conditions, at least there is some basis for making an intelligent guess. In the case of a new business, however, there is not even a basis for a guess. And the penalties for a bad guess are great enough to impair seriously the limited working capital of a new business. It is submitted, therefore, that this penalty on new corporations should be removed by amending the present capital stock tax law so as to allow annual declarations of value.

There is a further consideration which is probably of less weight. Many businesses and businessmen are being called upon to expand their operations or enter upon new and untried fields. There is a natural reluctance on the part of corporate directors to risk the capital entrusted to them by their stockholders in new ventures. The uncertainty or burden of this tax may well be a factor which will weigh against changes or expansion, especially after June 30, 1941, when the capital-stock value will have been declared and cannot again be declared for 3 years. There should be, at the very least, the opportunity to increase the value each year, and to redeclare the value at 3-year intervals.

RICHARD B. BARKER.

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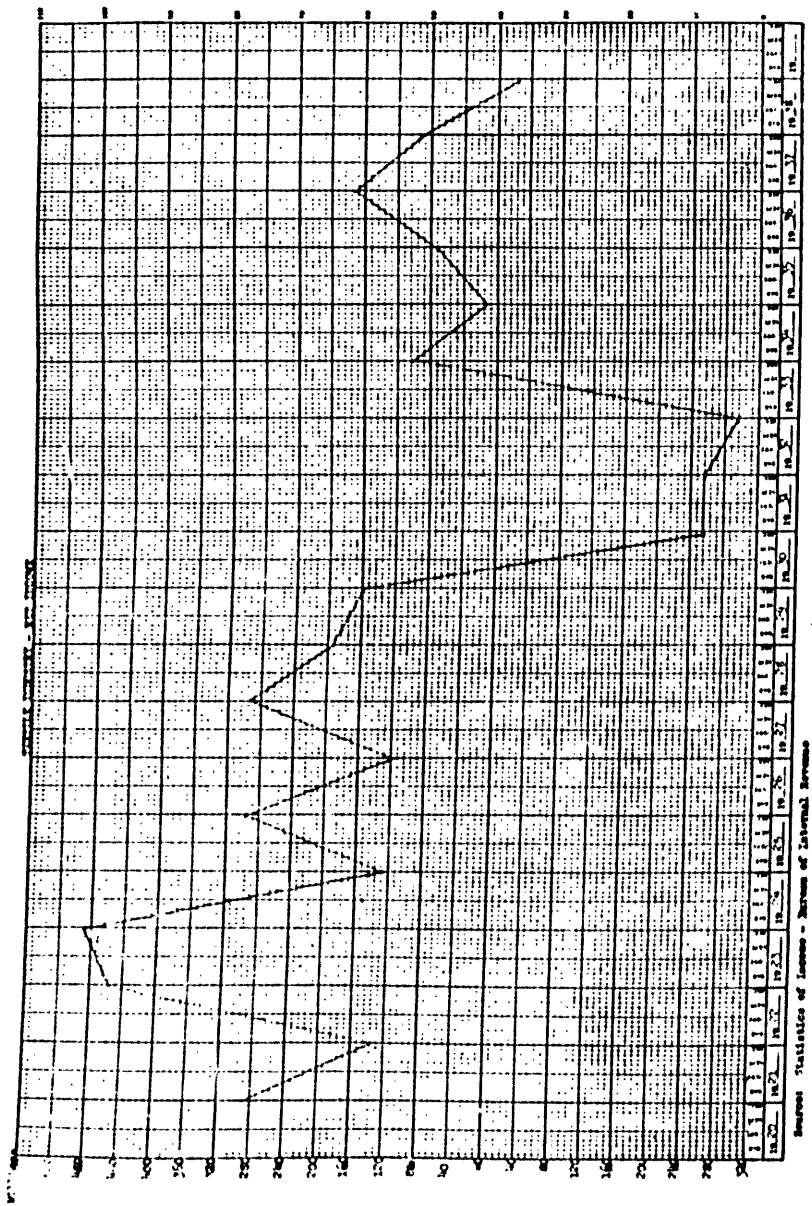
[2] That penalties for bad guesses have no place in tax laws was recognized by Congress in passing the excess-profits tax amendments of 1941. Under the prior law a corporation was bound by its first election as to the method of computing its excess-profits tax credit. The provision was amended so that the tax is based on the method which shows the lesser amount of tax, thus eliminating the penalty imposed on corporations making unwise elections.



Textile industry—net income

Year:	Net income (000 omitted)	Year:	Net income (000 omitted)
1920	$291,066	1930	[1] $264,080
1921	137,016	1931	[1] 264,707
1922	456,705	1932	[1] 201,197
1923	491,567	1933	100,895
1924	128,824	1934	16,788
1925	208,342	1935	71,167
1926	119,485	1936	177,849
1927	200,068	1937	96,952
1928	196,121	1938	[1] 22,007
1929	160,005		

[1] Red figures.

Source: Statistics of Income, Bureau of Internal Revenue.

Cotton-goods manufacturers—net income

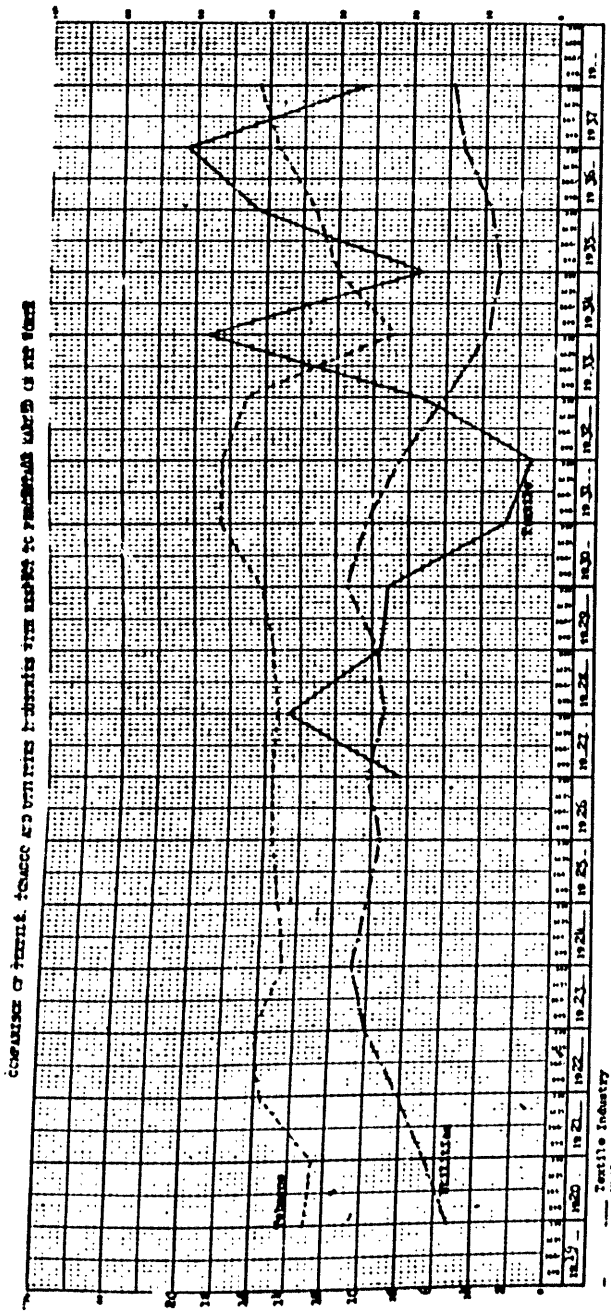
Year:	Net income (000 omitted)	Year:	Net income (000 omitted)
1916	$104,813	1927	$75,842
1917	No data	1928	10,882
1918	203,747	1929	22,017
1919	303,995	1930	[1] 91,507
1920	146,456	1931	[1] 63,509
1921	52,246	1932	[1] 53,663
1922	92,063	1933	31,828
1923	103,910	1934	8,414
1924	[1] 39,835	1935	[1] 10,261
1925	No data	1936	37,503
1926	9,051	1937	40,463

[1] Red figures.

Source: Statistics of Income, Bureau of Internal Revenue.

* No Data

Source: Statistics of Income - Bureau of Internal Revenue


Textile Industry
Tobacco Industry
Source: Investigraphs, Inc.

The CHAIRMAN. Mr. R. C. Rolfing.

STATEMENT OF R. C. ROLFING, REPRESENTING THE NATIONAL PIANO MANUFACTURERS ASSOCIATION OF AMERICA, INC.

Mr. ROLFING. My name is R. C. Rolfing; I am president of the Rudolph Wurlitzer Co., of Cincinnati, Ohio, and president of the National Piano Manufacturers Association of America. I have a brief statement, Mr. Chairman, that I would like to read.

The CHAIRMAN. Yes. Can you do it in 10 minutes?

Mr. ROLFING. Yes; it will take about 4 minutes.

Mr. Chairman and gentlemen, 1. I wish to say at the very outset of my brief statement to your committee that the piano manufacturers of America, for whom I am speaking today, are conscious of the state of emergency which exists in our country and that these manufacturers are desirous of carrying their fair share of the burden which the people of this country must bear. Although I represent the piano manufacturers of America, what I have to say applies generally to the entire musical-instrument industry.

2. Our industry, as you gentlemen no doubt know, is small but important to the Nation as a whole. Music is as old as the hills, and people through the generations have learned that they cannot live without it. Music and musical instruments are not luxuries but important necessities to any nation at peace or at war.

3. It probably is not necessary for me to plead the cause of music and its effect on the lives of any free, intelligent people. Our national, State, and local governments have never been blind to this fact. On the contrary, they have sought throughout the entire history of our country to encourage music and musical education in a variety of ways. Educational institutions have always been encouraged by relief from taxation in its various forms, and no one denies that music is a part of our general educational program. Likewise, it is an important part of the religious life of a free people.

4. Furthermore, you and I know that the appeal of music is universal. It is not merely for those people who can afford it or who have time for it or who have special aptitude for it. It is estimated that in 1939 in the United States alone 4,000,000 children in public, parochial, and private schools, and 9,000,000 children and adults outside of these schools, were playing and learning to play the piano. The existence of thousands of music schools or music departments in public and parochial schools, choral societies, community groups, symphony, concert, and band or orchestras certainly lends much force to what I am saying to you today.

5. In appraising the broad subject of music, it must be remembered that a large proportion of the buyers of musical instruments and pianos come from the lower income groups. Many thousands of these people who work in the shops and factories and on the farms of this country deny themselves comforts, and even what we might agree are necessities, so that their children may have the educational and cultural advantages of music. In doing so they are not and they do not regard themselves as indulging in luxury.

6. There is evidence to show that the Federal Government, through the War Department, considers music essential. The mimeographed

forms of advice given to selectees by the draft boards name those articles which may be taken to camp and those which are prohibited. These forms state that "musical instruments such as guitars, banjos, and so forth, should be taken." Likewise, there are in the Army camps of the Nation today literally hundreds of pianos, most of which have been purchased by the service men themselves in order that they may enjoy music, which is so essential in building up and maintaining the morale of any armed force.

7. According to the Department of Commerce (Census of Manufacturing, 1940), the total value of musical instruments, including pianos, produced in 1939 was $31,000,000, of which, roughly, $20,000,000 represented the value of pianos. The 1940 figures are not available, but would probably be slightly higher. The proposed 10-percent manufacturers excise tax on musical instruments and piano sales is estimated by the Treasury to yield no more than $3,600,000 annually in taxes for the Federal Government, or about one-tenth of 1 percent of the total amount of the revenue-raising program of the Treasury.

8. Much has been said and written recently about the phenomenal growth of the piano industry during the past few years. True, there has been a substantial increase in production due largely to the increase in employment during the past few years, which has permitted thousands of people of moderate means to acquire a piano so that their children may have the advantage of a musical education. This increase in production was also due to the ingenuity of piano manufacturers in making smaller and better pianos at lower prices, but even in 1939 the industry produced only one-third the number of pianos it produced in 1923, when 343,000 pianos were made.

9. Please do not misunderstand me. I am not suggesting that the imposition of a 10-percent excise tax would completely ruin the piano and musical-instrument business, but I do say that it would be a step in the wrong direction, and one that certainly should not be taken at this time. The amount of revenue a 10-percent excise tax would raise is only a small fraction of 1 percent of the total amount of the revenue-raising program of the Treasury; but if in the final analysis Congress should conclude that pianos must be taxed, then I would urge upon you the desirability of imposing an excise tax of not more than 5 percent, the same as was imposed by Congress on February 15, 1919, after the first World War.

10. In conclusion, gentlemen, let me say that in my judgment the proposed 10 percent manufacturers excise is undesirable (1) because it probably will not produce the desired revenue, (2) because it will do serious damage to an industry which has its part to play in the life of this country, and (3) because it will impede the progress of musical education and culture so necessary to the people in times of great emergency.

11. Music in Great Britain has had a magnificent part to play and its practical value in times of great emergency is considered almost priceless. Let us not forget that national defense demands music. The support of strong public morale at this time is as vital as the maintenance of national-defense measures.

The CHAIRMAN. Any questions?

Mr. ROLFING. Mr. Chairman, I have just one short matter.

The CHAIRMAN. Yes; all right. I thought you had concluded.

Mr. ROLFING. I have with that part of it.

As president of the Rudolf Wurlitzer Co., an individual manufacturer, I would also like to offer an objection to the retroactive and discriminatory features of section 549 of the act, which taxes installment sales entered into after July 1, 1941, and before the effective date of the act. I have prepared a very brief memorandum on this subject which I ask permission to file with the clerk of the committee. I request that this memorandum be made a part of the record of these proceedings.

(The prepared statement of Mr. Rolfing is as follows:)

STATEMENT OF R. C. ROLFING, PRESIDENT, THE RUDOLF WURLITZER CO.

RETROACTIVE EFFECT OF INSTALLMENT SALES PROVISION

Section 549 of the pending revenue bill (see p. 56 of Senate print) imposes a manufacturers' sales tax in respect of articles sold under installment-sales contracts entered into prior to the effective date of the act. In the case of articles not taxable under the law in existence on July 1, 1941, the tax is imposed on such articles sold under installment sales contracts where delivery of the article was made on or after July 1, 1941. But such tax is imposed only in respect of installments paid after the effective date of the act. (See subparagraph (3) on p. 57.)

The practical effect of this provision is to impose retroactively an excise tax upon sales made by manufacturers under contracts entered into in the ordinary course of business on or after July 1, 1941, and before the effective date of the act.

To apply the tax retroactively is directly at variance with the policy expressed by the Secretary of the Treasury in his statement before the Finance Committee. (See p. 1 of unrevised print, part 1, of Finance Committee hearings on H. R. 5417.)

Manufacturers who have their own retail outlets have, in the regular course of business, entered into many binding sales contracts since July 1, 1941. Those contracts have been made at a fixed sales price that cannot now be changed. Yet, under the provisions of section 549, which never was publicly disclosed until the bill was reported to the House, the few manufacturers thus affected now find themselves faced with the imposition of a tax on contracts already entered into in respect of merchandise already delivered months before the effective date of the act. And they cannot collect that tax from the vendees.

The inequity of the situation can be demonstrated by pointing out that where sales have been made by a manufacturer to a retailer—say on July 15, 1941—and the retailer then sold the article under an installment sales contract to the consumer, no tax is imposed in respect to the installments paid by the consumer after the effective date of the act, even though the contract was entered into prior to the effective date of the act and after July 1, 1941. But if the manufacturer who happens to operate his own retail outlet makes a similar sale to the consumer on the same day (before the effective date of the act) all installments paid by the consumer after the effective date of the act bear their proportionate share of the tax. The tax is, therefore, not only retroactive but also highly discriminatory. The few manufacturers who sell direct to the consumer are heavily penalized, the large proportion of manufacturers who sell to distributors or retail dealers are not.

It would be no solution to the problem to impose a tax liability on the vendee in such circumstances, because the burden of the discriminatory levy would be shifted merely to another class of taxpayers who are entitled equally to protection against retroactive taxation.

Moreover, complex questions would arise in the case of successive and multiple purchases, some taxable and some not, but all incorporated into a single running account. The problems of administration would multiply out of all proportion to the tax involved.

If the intent of the act is to reach contracts for future delivery in order to prevent anticipatory buying, then the date of delivery, not the passage of title under a conditional sales contract (which is purely a security device), should

be the test of taxability. Something of a parallel situation was presented under the 1932 act, wherein it was provided, in a section directed at executory contracts, that if the vendor could not pass on the tax under the sales contract entered into prior to the effective date of the act, then the tax should be imposed upon the vendee. (See sec. 625, Revenue Act of 1932.) In order to further clarify this provision and to prevent any inequitable burden on the vendee, Congress, on June 13, 1932, 7 days after the passage of the act, by joint resolution of June 13, 1932, provided that if delivery were made prior to the effective date of the act (June 21, 1932) the tax should not be collected. This still permitted collection of the tax in respect of deliveries made after the effective date of the act, such tax to be paid by the vendor if, under his contract, he could add it to his sale price, or if not, then from the vendee.[1]

We believe that neither Congress nor the Treasury Department has any desire to impose a retroactive, unjust, or discriminatory tax upon either the manufacturers or the consumers of products upon which excise taxes are levied, and we therefore earnestly request that section 519 be amended so as to tax bona fide sales entered into in the ordinary course of business only where deliveries are made on or after the effective date of the act.

The CHAIRMAN. Mr. Martin Popper. Come around, Mr. Popper. You weren't here when you were called.

Mr. POPPER. I wish to beg the committee's pardon for being late, but my plane was grounded.

The CHAIRMAN. That is all right; we are glad you got here.

Mr. POPPER. Thank you.

STATEMENT OF MARTIN POPPER, WASHINGTON, D. C., SECRETARY, NATIONAL LAWYERS GUILD

Mr. POPPER. I am Martin Popper of Washington, D. C., and am secretary of the National Lawyers Guild.

We are in complete accord with the statement of the Assistant Secretary of the Treasury, John L. Sullivan, that our tax system must be designed to enhance our national unity in this critical period of world history when our very national existence is imperiled. National unity can be enhanced by extending and preserving in our tax system the democratic principles of taxation according to ability to pay. Taxation in a democracy should aim to "promote the general welfare, and secure the blessings of our economy and of our resources to ourselves and our posterity," to paraphrase the Constitution.

We agree with the objective declared by Secretary Morgenthau that the needed revenue "should come from all sources where there is ability to pay." But the determination of "sources with ability to pay" requires careful and realistic analysis of the economic and fiscal situation. We fully concur that five of the six proposals of Secretary Morgenthau would tax sources with ability to pay, which are now escaping their fair share of taxes. These five sources which should be fully tapped are:

1. An effective excess-profits tax on excess profits now exempt.
2. Mandatory joint returns to eliminate a highly important tax avoidance device and to terminate discrimination favoring married persons in community-property States.
3. Elimination of tax-exemption privilege from governmental securities.
4. Increased estate and gift taxation.

[1] The last sentence in sec. 3447 of the Internal Revenue Code is the portion added by the joint resolution of June 13, 1932. The balance of the section is the original sec. 625 of the 1932 Revenue Act.

5. Reduction in depletion allowances.

1. Personal income-tax exemptions.—However, we are unalterably opposed to any lowering of the personal income-tax exemptions in the face of the increasing cost of living, for such a change would depress further the standard of living of the American people which is, in fact, direly in need of improvement. How can one justify the lowering of personal exemptions when, in the words of Secretary Morgenthau, "prices and the cost of living have increased at an accelerated rate"? Manifestly, a family requires greater income, not reduced income, to maintain its standard of living with prices rising. The report of the House Ways and Means Committee, in rejecting efforts to lower personal exemptions, courageously declared:

> Your committee feels that a further reduction in these exemptions is not warranted at this time especially in view of the rising cost of living.

According to studies made in prior years by Dr. Mordecai Ezekiel, Department of Agriculture economist, $2,500 was needed to maintain an average worker's family at the barest level of health and decency; $2,200 according to the Heller committee of the University of Southern California. The United States Bureau of Labor Statistics fixed the sum of $2,015 as the necessary minimum annually for maintaining an American standard of living. In view of the rising cost of living and the substantial increase in the tax burden on the low-income groups, it is obvious that the American family will need substantially more than these amounts to maintain a decent standard of living. The proposal to lower exemptions to $1,500 would cut into the standard of living of the American people—a standard far too low already.

Taxes in the brackets below $2,000 will mean less food, clothing, and shelter for the great majority of the American people.

The advocates of broadening the tax base forget that the lower income groups represent the cornerstone of our economy. There are 33,000,000 consumer units in the United States, each earning less than $2,000 annually. They purchase 60 percent of the Nation's goods. Impose more taxes on them and you dry up the well that feeds the industrial machine. Those who think that defense orders may keep industry moving at top speed, regardless of the extent to which the buying of the consumers is cut, will soon discover their error—to the detriment of our economy. Taxing the lower income groups will dislocate the existing consumer industries. It will intensify the post-war depression for it should not be forgotten that 80 percent of the consumer units are represented in the group with incomes under $2,000.

There are those who have the idea that the lower income groups do not pay taxes. The fact is that those who earn as little as $500 a year pay 20 percent of their incomes to the city, State, and Federal Governments in the form of taxes. Thus, it appears that the poor pay out 1 cent in taxes every time they spend a nickel. This is also true of those who earn up to $2,000 a year.

We cannot over emphasize the significant statement made by the House Ways and Means Committee in its report, which declared:

> It should be remembered that because an individual is exempt from the individual income tax does not mean that he is free from taxation. The revenue system includes many taxes which directly and indirectly burden these lower income classes. In this connection it is important to consider, not the

Federal taxes alone, but also the State and local taxes which on the whole are less progressive than the taxes imposed by the Federal Government. Furthermore, several of the excise taxes will in substantial part fall upon individuals not reached by the income tax. Moreover, the proposed use tax on automobiles will result in collecting at least $5 from many individuals who are not subject to the income tax. Statistics indicate that over 50 percent of the passenger automobiles are owned by individuals with incomes of $2,000 or less and over 18 percent are owned by individuals with incomes of $1,000 or less.

As pointed out by the House committee:

The additional revenue resulting from reduced exemptions comes almost entirely, not from new taxpayers, but from individuals already subject to the income tax.

Assistant Secretary of the Treasury, John L. Sullivan, in his testimony before the Senate committee, stated that:

Of the $303,000,000 we anticipate we will gain, as a result of lowering the exemptions, the overwhelming portion comes from the people who today, last year, for the last few years have already been on the tax roll.

Senator Brown has pointed out that when the exemptions were cut in 1940 from $2,500 to $2,000 for married persons and from $1,000 to $800 for single individuals, the new group of lower bracket taxpayers provided only $19,000,000 in revenue and that it will cost $15,000,000 to collect that revenue. As Senator Brown has so wisely stated:

The additional revenue we would gain from a further cut wouldn't amount to anything and we would merely be harassing a group of already distressed people (New York Times, August 10, 1941).

The fact is, as Mr. Sullivan pointed out, the bulk of the revenues derived from the lowering of exemptions, comes from existing taxpayers:

When you lower the personal exemption for married people $500 as you did last year, one of the results of that is that the married person who is already paying a tax has $500 removed from his exemption and put on his income at the very top bracket.

But this additional income could be secured by a more equitable method, rather than reducing exemptions. Instead of allowing personal exemptions as a credit against net income, which reduces the income in the highest bracket, the personal exemptions should be allowed as a deduction in the lowest surtax bracket—or as a credit against the tax, rather than against net income.

Thus, under existing law, the $2,000 personal exemption results in a tax saving only $80 (4 percent of $2,000) to a married man with an income of $2,500. However, to a man in the top bracket, it results in a tax saving of $1,580 (79 percent of $2,000). The wealthy taxpayers, possessing ability to pay, thus accrue from the exemption a decidedly greater reduction in actual taxes than the low-income taxpayers. Surely, this inequity in the income-tax structure favoring the wealthier taxpayer should be removed in the Revenue Act of 1941.

The principle here proposed has been strongly endorsed by Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue Taxation, in his testimony before the House committee, and it has also been recommended by Dr. Magill, representing the Treasury Department, in his testimony before the House committee in 1934,

as well as Dr. Dewey Anderson, executive secretary of of the T. N. E. C., in his monograph, Taxation, Recovery, and Defense (p. 263).

By adopting this change we would add greater equity to the income-tax structure and at the same time derive very substantial revenues from a source possessing ability to pay. A reduction of $500 would subject only $500 to the top-bracket rates—while the proposal here made would subject $2,000 to the difference in rates between the top bracket and the lowest brackets.

Since the surtax under the revised schedule applies to the first dollar of surtax net income, whereas under existing law the first $4,000 of surtax net income is free from surtax, the lower income groups would be subject to very substantial income tax increases. In fact, a single person earning $1,000 a year and a married person earning $2,500 a year will pay 3½ times the income tax he now pays.

A sound tax program, concerned with the welfare of the American people and the maintaining of morale in this period of world crisis, would restore the $1,000, $2,500 personal exemptions and reject proposals to lower the existing exemptions. The impact of the proposed surtaxes would thereby be cushioned so as not to depress further the standard of living of the low-income groups.

If the personal exemptions were reduced in the face of the rapidly rising cost of living, it would constitute a pincer movement against the standard of living of the American people.

The argument is advanced that added taxation would decrease purchasing power and thereby tend to counteract inflationary price rises. But surely the pending price-and-rent-control bill is a more effective and democratic instrumentality to prevent inflationary price rises. What is more, the low income groups, whose purchasing power has already been reduced by the higher cost of living, would have their standard of living further jeopardized by added tax burdens. The new tax burdens would surely not nullify the price rises already borne by the low-income groups.

According to the July 1941 issue of the Labor Information Bulletin, published by the Department of Labor, the cost of living in 20 large cities increased 6.1 percent during the period from August 15, 1939, to June 15, 1941—in Buffalo the increase was as high as 8.9 percent, in Detroit 8 percent.

Since the cost of living consumes, in most if not all cases, the earnings of families with incomes under $2,000, the increase in the cost of living in this period has already taken $120 on the average from such families. Shall we aggravate the situation further by lowering exemptions?

The Senate committee should reject, as courageously as did the House committee, the proposals made to lower personal exemptions.

For the same reasons suggestions that the social security old-age benefits tax be increased must be rejected. If the 1-percent tax were increased to 2 percent, about a billion and a half dollars would be taken in largest measure from the lower-income groups. This provision is particularly retrogressive since the ceiling is fixed at $3,000 per year, so that earnings beyond this figure are free from social security taxation.

Despite the heavy tax burden on the lower-income groups, there are those who are clamoring for a general Federal sales tax. Studies of the sales-tax burden show that it rests hardest on the "ill fed, ill

clad, and ill housed." According to the Tax Policy League, a 2-percent sales tax will take $12 from a man earning $1,000 a year, but will only take $0.25 a $1,000 from a man with $1,000,000 a year (Where the Sales Tax Falls, 1934). David Cushman Coyle in his enlightening booklet, Why Pay Taxes, vigorously condemns sales taxation as "a graduated income tax in reverse."

To achieve a defensible tax program proposals to lower exemptions, excise taxes on consumer necessities, sales taxes, taxes on salaries and wages which would increase the tax burdens on persons whose present incomes do not permit a minimum standard of living, must be rejected and repudiated. Instead, increased taxation should be placed on the shoulders of those best able to carry it.

2. *Mandatory joint returns.*—Although the mandatory joint-return provision constituted the greatest contribution of the House committee's tax bill to a sound, progressive tax system, arguments without real foundation led to its defeat. It has been repeatedly pointed out that wealthy taxpayers escape the higher surtaxes by transferring their properties to their wives. Thus a wealthy stockholder receiving annually $200,000 from his stocks would pay a surtax of $108,320 under the pending bill. But if he transfers half his stocks to his wife, he will pay only $45,820 surtax on his $100,000, and his wife, by filing a separate return, would pay the same, thus avoiding $16,680 in surtaxes (excluding the 10-percent supertax). The splitting of incomes in community-property States is a serious discrimination against the rest of the population—a discrimination which should be terminated without delay. Considering that the mandatory joint-return requirement would affect only 153,000 couples, or 175,000 at most (excluding community-property returns) and that the expected yield is about $300,000,000, it is obvious how glaring is the loophole now existing—and how lucrative the fruit. This tax-avoidance device should be eliminated in this bill. The argument that mandatory joint returns will destroy the institution of marriage, lead to immorality, and send women back to marital slavery is sheer poppycock.

The CHAIRMAN. Your time is up. We don't want to cut you off, but don't extend your remarks more than necessary; you can file your brief if you so desire.

Mr. POPPER. I will leave out substantial portions of the statement.

Despite the utter necessity for the mandatory joint requirement, opponents of this progressive measure have suggested a proposal the very reverse thereof. This retrogressive suggestion would permit all married persons, in every State in the Union, to split their income 50–50 for tax purposes. Under the banner of "tax equalization," all the evils and inequities arising from the privilege of filing separate returns and the splitting of incomes by taxpayers in the eight or nine community-property States would be made universal.

The mandatory joint-return requirement should be restored in the 1941 Revenue Act, with or without the liberalization requested by the President and the Secretary of the Treasury, where both husband and wife work outside the home. The provision as adopted by the House committee was estimated to yield $287,200,000 net as compared with the $252,000,000 net estimated to be raised by the Treasury proposal. The difference in yield is not of very great consequence—the important thing is to incorporate the mandatory joint return requirement into the tax measure.

3. *An effective excess-profits tax.*—The principal feature of a democratically conceived Federal tax program, in an era in which billions of dollars of public funds are pouring into defense and other industries profiting by the war boom, should be a stringent and effective excess-profits tax. An effective excess-profits tax should be the keystone of a sound tax program based on ability to pay. We cannot afford to forget the reports of the Nye committee, which investigated the munitions industry and which revealed the exorbitant profits earned by the armament manufacturers in the first World War.

Current financial reports indicate that industry is duplicating if not bettering these tremendous profits. The National City Bank letter for August 1941 shows that 360 leading companies engaged in manufacturing, mining, trade, service, and construction showed combined net profits, less deficits, of approximately $785,000,000 after taxes in the first 6 months of 1941, which compares with $652,000,000 for the same companies in the first half of 1940, representing an increase of 20 percent. This tabulation also showed that 26 iron and steel companies more than doubled their profits in this period—from $61,915,000 in the first half of 1940 to $126,111,000 for the first half of 1941. And this tabulation shows that 9 automobile companies with profits of $125,860,000 are earning an annual rate of return of 21.1 percent (after taxes) on their net worth. These figures, representing profits after taxes, are the clearest evidence that the existing excess-profits tax is failing to recapture for the Government the abundant profits now being harvested by the large corporations.

In the formulation of a real excess-profits tax, there should be a ceiling based on a fair return of capital, above which all profits should be subject to excess-profits taxation. One of the most important loopholes in the existing excess-profits tax is that it exempts tremendous profits by corporations which had very prosperous earnings during the period 1936–39, while corporations which were making only modest earnings during that period are subject to excess-profits taxation. The highly prosperous, well-established corporations which have been making 30, 40, 50 percent or more on their invested capital in the 1935–39 period escape excess-profits taxation.

Secretary Morgenthau, in his memorandum of July 31, 1941, to the President, cited the case of an automobile company whose earnings in 1940, after the payment of taxes, will be approximately 26 percent of its invested capital. And Assistant Secretary of the Treasury John L. Sullivan testified before the House committee that—

> One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess-profits tax whatever on 1940 earnings and yet this is a company which has thus far received over $70,000,000 of defense contracts.

The first step in achieving an excess-profits tax worthy of the name is the elimination of the average-earnings option. Senator La Follette has aptly declared that the existing excess-profits tax gives corporations a heads-they-win, tails-the-Treasury-loses alternative.

The excess-profits tax should apply to profits in excess of a reasonable return on invested capital. The Treasury has consistently adhered to this position.

The CHAIRMAN. Do you know how many corporations you would put out of business if you abolished that; if the average-earnings choice were eliminated?

Mr. POPPER. No, sir; I am not aware of how many would be put out of business.

The CHAIRMAN. Utilizing that as a base?

Mr. POPPER. Utilizing that as a base makes it impossible to collect the excess tax and at the same time elimination of it will bring into the Treasury a huge revenue which it is losing.

What rate of return on invested capital should be allowed before taxing profits as excess? A reasonable rate of return on capital, today, cannot be determined in the light of customary notions of either the financial or legal community. It must be determined in the light of the fact that close to a million men annually are giving, as their patriotic contribution, up to 2½ years of their lives to military training. The cost to them is leaving jobs, careers, and homes—their return is $1 a day. Surely it is hardly an unequal sacrifice, on the part of industry, to require profits of industry to become excess at a return of 4 or 5 percent. A rate of 4 percent would be more than twice the average 1.7 percent return on capital earned by corporations during the years 1926–37. A rate of 5 percent would be equal to industry's 1929 return on capital.

At what rate should such excess profits be taxed? In determining a proper rate, we must consider which corporations are reaping the bulk of excess profits.

For 1937, which is the latest year for which a comprehensive analysis is available, the total net income of the 479,000 American corporations was $7,306,000,000. Slightly less than one-half of these companies having assets of less than $50,000 each showed a total deficit of $132,000,000. The other 250,000 companies earned nearly $7,500,000,000 and paid income taxes of $1,250,000,000.

The most striking feature of corporate net income is that, whereas the small corporation suffered losses, the largest corporations—2 percent of them—accounted for nearly two-thirds of the entire $7,307,000,000 of corporate net income. This reflects not only the now generally recognized fact of enormous concentration of wealth in a handful of companies, but the equally significant fact of the heavy concentration of profitable enterprises in the few large companies. It is these corporations, therefore, which will presumably receive two-thirds of the entire profits arising from the defense program and the war boom. Indeed, their proportion of current profits is likely to be even greater than two-thirds, in view of the fact that the largest companies are receiving the lion's share of the billions in defense contracts being negotiated.

In determining a proper rate schedule of excess-profits tax, we are thus confronted with economic problems which transcend questions of pure and simple tax policy. We are dealing with the entire gamut of problems created by the concentration of corporate wealth—monopolies, the wide powers wielded by managers of industrial empires, corporate mismanagement of undistributed surpluses, and so forth. It is precisely because the concentration of wealth and the concentration of profits go hand-in-hand that the excess-profits tax is a particularly effective instrument for curbing the power of large corporate industry, for redistributing the surpluses of these vast aggregates of wealth, and at the same time for forcing large-scale industry to make its just contribution to national defense.

The tax rate imposed upon excess profits by the 1918 War and Excess Profits Tax Acts was 80 percent. A rate of 80 percent imposed upon excess profits, defined as suggested above, would reflect the beginnings of a rejection of the current philosophy of "regressive sacrifice" for national defense—to borrow a tax term—which asks of men military service at $1 a day and allows industry a minimum 8-percent return or their 1936-39 profits, if higher, before taxing its profits as excess.

To those who fear that industry will refuse to accept defense contracts or will sabotage the defense program if profits are limited to 5 percent and the type of excess-profits tax here being advocated is adopted, it should be pointed out that there are two effective weapons—conscription of industry and Government operation of defense plants—which it is already in a very large measure financing. We venture the suggestion that it would hardly be necessary to conscript industry or take over defense plants in order to obtain speedy acceptance of defense orders; it would only be necessary to call industry's bluff, with conscription and Government operation as the unused trump cards. The line of industry's representatives clamoring for Government contracts would form quickly outside the offices of the Office of Production Management and War and Navy Departments.

The CHAIRMAN. Your time is up. We will be glad to have you include your statement in the record.

Mr. POPPER. I will only take 2 or 3 minutes more to conclude.

The CHAIRMAN. We are indulging you considerably already and if we do it with one it is difficult to avoid it with others.

Mr. POPPER. It will take a minute and a half for me to summarize.

The CHAIRMAN. Well, if you can do it in a minute and a half, you may.

Mr. POPPER. 4. *Elimination of amortization privilege.*—The amortization privilege was granted to industry because industry had waged a sit-down strike and had refused to give workers the signal to start the wheels of production for rearmament until Congress yielded to its demands for the amortization privilege and the suspension of the profit limitations on naval and aircraft contracts. (Aviation's Sit-down Strike, 86th Congressional Record; 76th Cong., 3d sess., p. 16372 et seq.)

The amortization privilege is nothing more or less than a tax subsidy to industry—a tax subsidy which has no justification in this era of colossal profits.

The amortization privilege, granting a flat, arbitrary deduction of 20 percent (instead of the ordinary depreciation) of the cost of property should therefore be repealed.

5. *Profit limitation on defense contracts.*—Industry's second demand as its price for cooperating in national preparedness was the suspension of the limitations on profits imposed by the Vinson-Trammell Act. Originally enacted in 1934, it was last amended in June 1940, so that any profit in excess of 8 percent on competitively bid contracts for ships or plans (7 percent on negotiated contracts) must be repaid in the Treasury. The loud clamors of industry's representatives for generous profits received the strong sympathy of War and Navy Department officials.

The First World War experience is a striking testimonial to the need for limitations on profits on Government contracts in order to recapture profits attributable to excessively high prices and to corrupt practices. The Wall Street Journal (July 3, 1940) estimated that, notwithstanding a 7-percent contract price limitation, aircraft plants would still earn 9.4 to 28 percent on their capital investments.

While workers are conscripted with no guaranty of wages previously paid, no Government financing of the obligations left behind which the draftees will face on their return, capital is being assured soaring profits and the elimination of even existing profits limitations.

A democratic defense program would require capital to make sacrifices at least equal to those exacted from labor—would require the extension of profit limitations. It is ironical that the profit-limitations mechanism, steadfastly operating in predefense days, should have been abandoned at the very start of the gigantic defense program—when it is most needed to reduce the cost of defense to the Government—to the people. And the irony is climaxed by the fact that the profit-limitations mechanism was scrapped on the alleged ground that the enactment of a general excess-profits tax rendered unnecessary the profit-limitation apparatus. Experience has shown that the existing excess-profits tax is decrepid and sorely in need of overhauling. The profit-limitation provisions of the Vinson-Trammell Act (suspended October 1940) should be revived and extended to cover all defense contracts, with profits limited to 8 percent of the invested capital employed in the performance of the contract.

6. *Restoration of corporate undistributed-profits tax.*—The undistributed-profits tax is one of the most effective instruments to make effective the graduated surtax rates of the personal-income tax. Corporate directors often choose to withhold earnings and accumulate surplus rather than increase dividends to the stockholders. Thus, by paying out earnings only as those in control of the corporation elect, stockholders may avoid the personal-income surtax rates—thus dividends paid to stockholders with net incomes over a million dollars would be subject to a tax of 76 percent, which may be avoided by the nondeclaration of such dividends. This results in unfairness to the small stockholders, and it reduces the yield of the income tax.

In Lincoln's administration the principles of the undistributed-profits tax were incorporated in our first income-tax law (1861) which provided that the gains and profits of corporations should be included in the annual taxable income of any person entitled to them, whether distributed or undistributed.

The immediate restoration of the undistributed-profits tax is all the more important in a war-boom period, for it would reduce the opportunities for tax avoidance and tax evasion, would grant greater protection to the interests of the small stockholders, would tend to stabilize revenues and further the democratic principle of levying taxes in accordance with ability to pay.

Either the corporate undistributed-profits tax should be restored or stockholders should be required to include as taxable income these undivided profits.

7. *Taxation of governmental securities.*—Dewey Anderson, executive secretary of T. N. E. C., in his monograph Taxation, Recovery, and Defense (p. 189), has declared:

A most reprehensible form of tax favoritism benefiting the wealthy, who need such favors least of any group in the population, is the issuance of tax-exempt Government securities.

Paul Studenski, tax consultant for various State and Federal Government agencies and professor of public finance at New York University, appearing before the Senate Committee on Taxation of Governmental Securities and Salaries in 1939, said:

We cannot profess to be taxing in accordance with ability to pay while we are offering a wide loophole to our wealthy citizens to avoid the application of this principle by investing some of their wealth in wholly exempt securities. (Hearings before the Special Committee on Taxation of Governmental Securities and Salaries, Senate, 76th Con., 1st sess., 1939, p. 553.)

Several months ago Congress eliminated the tax-exemption privilege from new issues of Federal securities. The first step has thus been taken in the elimination of one of the most flagrant and unwarranted loopholes in the tax laws.

The loopholes should be completely closed through the taxation of the income of all presently outstanding Federal securities and of all presently outstanding and future issues of State and local securities.

8. *An integrated estate-and-gift-tax system with a single exemption of $10,000, plus a $10,000 life-insurance exemption.*—The estate-and-gift-tax changes in the pending bill, estimated to yield $151,900,000, are limited to rate increases. The Treasury's recommendations that the $40,000 insurance exclusion under the estate tax and the $40,000 specific exemption under the estate and gift taxes be reduced to $25,000 each, were not incorporated in the bill. As the bill now stands an estate of $100,000 can completely escape estate-gift taxation ($40,000 gift exemption, $40,000 insurance exclusion, $40,000 estate exemption). The rates fixed in the pending bill are, moreover, very substantially less than the rates proposed by the Treasury.

Estate and gifts constitute the most desirable sources possessing greatest ability to pay. What is vitally needed is an integrated estate and tax system with a single exemption of $10,000 (plus a $10,000 life-insurance exclusion) with a single set of rates, drastically increased above the rates in the pending bill. Thereunder, gifts made during the life of the donor would be included in the taxable estate, assessing the tax against the total estate, and permitting credit for taxes paid previously on the gifts. Thus, under existing law, a gift of $10,000 from an estate which, at the death of the donor, will amount to somewhat more than $1,000,000 avoids a prospective estates tax of $3,200 while paying a gift of only $150. The integrated estate-and-gift-tax system would close this loophole.

Considering that the Treasury estate-and-gift tax recommendations would yield about $200,000,000 more than the estate-and-gift-tax changes made in the pending bill, an integrated gift-and-estate-tax system with a single exemption of $10,000 plus a $10,000 life-insurance exclusion would yield revenues far in excess of this additional $200,000,000.

Democracy in taxation.—Democracy in taxation and the maintenance of a stable economy through increases in the purchasing power of workers and farmers require that taxes be collected from those able to pay, and especially from those corporations which are reaping swollen profits from the armament program. Taxation which lowers the standard of living of our people—and the very great majority of our

people have incomes below $2,500—is repugnant to the basic concept of democracy.

To achieve a defensible tax program, proposals such as consumption taxes, excise taxes on consumer necessities, sales taxes, taxes on salaries and wages, lowered personal income-tax exemptions which would increase the burdens on persons whose present incomes do not permit a minimum standard of living must be repudiated and defeated. Instead the increased tax burdens should be placed on the shoulders of those best able to carry them.

An effective excess-profits tax should be enacted. The amortization privilege should be repealed and stringent profits limitations on Government contracts should be adopted. The undistributed profits tax should be restored to reduce opportunities for tax avoidance or stockholders should be required to include undivided profits as taxable income. The income from Federal, State, and local securities (outstanding and future issues) should be taxed.

The $2,500 and $1,000 personal exemptions should be restored. Capital gains should be taxed at full rates and capital loss deductions against ordinary income should be disallowed. The Federal estate tax and gift tax should be integrated into a single tax system with a single exemption and a single set of graduated rates, drastically increased for all brackets, so as to prevent estate-tax reductions through gifts. Finally, no increase can be tolerated in the tax burden imposed on the millions of people who are "ill-fed, ill-clad, and ill-housed" until corporate industry and persons with "comfortable and large" incomes have been taxed to the very limit of their capacity to pay. Such would be the direction of a democratic tax program.

The National Lawyers Guild has presented a program for the equitable distribution of the financial burden of defense to enhance our national unity. In the words of Leon Henderson, Administrator of O. P. A. C. S., taken from his testimony before the House committee:

> This claim for equitable distribution of the financial burden of defense is not motivated only by an idealistic yearning for justice. It is an essential condition for the success of an all-out defense program. The battle of production can be won only if we all participate in it to the fullest. The people will willingly participate without reservations in that battle only if they are satisfied that the burdens are equitably distributed and that nobody is permitted to make excessive and unjustified profits out of the gravest emergency which we have faced in many generations.

The CHAIRMAN. Any questions?

Mr. POPPER. Do I understand that I have permission to include in the record the memorandum of the tax committee of the Guild, plus a definite proposal for legislation which I have not had time here to read?

The CHAIRMAN. Just give it to the stenographer. We will take a recess until 2 o'clock.

(Mr. Popper submitted the following memorandum and the pamphlet, entitled "A Democratic Tax Program for the American People.")

EIGHT POINT FEDERAL TAX PROGRAM ADVOCATED BY THE NATIONAL LAWYERS GUILD

1. *Personal income tax.*—The $1,000 personal exemption for single persons and the $2,500 personal exemption for married persons and family heads should be restored.

2. *Corporate taxes.*—An effective excess-profits tax of 80 percent on profits above 5 percent of invested capital should be adopted. The "average earnings" option of computing the excess-profits credit should be eliminated. Borrowed

capital should be excluded in determining the amount of invested capital. The 20-percent amortization privilege should be repealed; profit limitations on all defense contracts should be restored; the undistributed-profits tax should be reenacted or stockholders required to include undivided profits as taxable income.

3. *Estate and gift taxes.*—An integrated estate-and-gift-tax system with a single exemption of $10,000 (plus $10,000 life-insurance exemption) and a single set of graduated rates drastically increased for all brackets should be adopted.

4. *Government securities.*—Income from all outstanding and future governmental securities should be taxed.

5. *Capital gains.*—Capital gains should be taxed at full rates and capital loss deductions against ordinary income should be disallowed.

6. *Consumers' taxes.*—All proposals to increase or add excise or consumption taxes on consumers' necessities must be rejected and defeated. A general sales tax is indefensible.

7. *Reduction in depletion allowances.*—Concerns engaged in extracting certain of our natural resources, particularly oil, have been granted unjustifiable and excessive allowances for depletion. This unwarranted privilege of tax escape should be removed.

8. *Mandatory joint returns.*—Immediate adoption of mandatory joint-return requirement, thereby eliminating a highly important tax-avoidance device and ending the discrimination favoring married persons in community-property States.

A DEMOCRATIC TAX PROGRAM FOR THE AMERICAN PEOPLE

By NATIONAL COMMITTEE ON TAXATION

of the

NATIONAL LAWYERS GUILD

A DEMOCRATIC TAX PROGRAM

1. *Personal income tax.*—The $1,000 personal exemption for single persons and the $2,500 personal exemption for married persons and family heads should be restored.

2. *Corporate taxes.*—An effective excess-profits tax of 80 percent on profits above 5 percent of invested capital should be adopted. The "average-earnings" option of computing the excess-profits credit should be eliminated. Borrowed capital should be excluded in determining the amount of invested capital. The 20-percent amortization privilege should be repealed; profit limitations on all defense contracts should be restored; the undistributed-profits tax should be reenacted or stockholders required to include undivided profits as taxable income.

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THE REVENUE BILL OF 1941

After 3 months of deliberation, the House Committee on Ways and Means introduced the revenue bill of 1941, H. R. 5417, designed to raise $3,500,000,000 which has certain commendable features.

As introduced in the House, the committee's tax bill would have raised the revenue from the following sources:

1. One billion three hundred and twenty-two million nine hundred thousand dollars in increased taxes on corporations.

2. About $323,000,000 through the mandatory joint return requirement, thereby eliminating a highly important tax avoidance device, ending a serious discrimination against earned income, and terminating the discrimination favoring married persons in the eight community property States.

3. Eight hundred and twenty-nine million dollars in higher surtaxes on individuals.

4. About $900,000,000 in excise taxes which would not affect the lower income groups except for the lowering of exemptions on admissions, the tax on soft drinks and the added taxes on radios and mechanical refrigerators.

5. One hundred and fifty-two million dollars in additional estate and gift taxes.

The House committee resisted the attempts to impose a general sales tax, to add taxes to the poor man's table, and to lower personal income-tax exemptions. These should be marked down on the favorable side of the balance sheet of the House committee's tax bill.

The 1941 revenue bill, however, does not meet two major objectives which a tax measure based on the democratic principle of taxation according to ability to pay should in these times contain:

1. It does not propose an effective stringent excess-profits tax which will recapture the large profits being made by corporate industry as a result of the billions pouring out of the Treasury and by foreign governments to meet war and defense needs. The committee rejected the sound proposal that the average-earnings basis of computing excess-profits credits be eliminated. The bill allows a 7–8 percent return on invested capital or 95 percent of the average-earnings during 1936–39 as an excess profits credit.

2. The bill retains the $800 and $2,000 personal income tax exemptions which were lowered in the First Revenue Act of 1940, and repeals the existing exemption of $4,000 against surtaxes. The result would be that surtaxes, until now paid only by the well-to-do, would fall on those in the lower income brackets who now file returns.

A single person earning $1,000 or a married person earning $2,500 a year would pay three and one-half times the income tax he now pays, so steep is the increase in the lower-income groups.

In the House, after a barrage of misleading and baseless propaganda as to the effects of mandatory joint returns upon the home, woman's status in society, the divorce rate, etc., the mandatory joint-return provision was defeated. This is one of the soundest features of the Ways and Means Committee's bill and deserves the support of every progressive-minded citizen. It is common knowledge that wealthy persons escape the higher surtaxes by transferring their properties to their wives. Thus a wealthy stockholder receiving annually $200,000 from his stocks would pay a surtax of $108,320 under the pending bill. But if he transfers half his stocks to his wife he will pay only $45,820 surtax on his $100,000, and his wife, by filing a separate return, would pay the same, thus avoiding $16,680 in surtaxes (excluding the 10 percent supertax thereon). The revenue which would be derived from the mandatory joint-return requirement would come from families possessing ability to pay, since only 158,000 persons would thereby be affected, and the tax of any family whose combined income is less than $4,000 would not be increased. The argument that joint tax returns will destroy the institute of marriage, lead to immorality, send women back to marital slavery, is sheer poppycock. As the House committee's report showed in Great Britain, where compulsory joint returns have been required since 1914, the number of divorces for each 1,000 marriages was, in 1935, 12 divorces for each 1,000 marriages, while in the United States 164 divorces for each 1,000 marriages.

Despite the need of a mandatory joint-return requirement, opponents of this progressive measure have suggested a proposal the very reverse thereof.

This retrogressive suggestion would permit all married persons to split their income 50–50 for tax purposes. Under the banner of "tax equalization" all the evils and inequities arising from the privilege of filing separate returns and splitting incomes by taxpayers in the eight community-property States would be made universal. If the ability to pay principle is to be advanced, the mandatory joint-return requirement must be included in the law.

We propose the following changes in the House committee's bill:

I. AN EFFECTIVE EXCESS PROFITS TAX

In these days of vast expenditures for defense and war preparation, an effective, stringent excess-profits tax, designed to recapture the unparalleled profits being made by industry as a result of the threat to our national safety, should be the cornerstone of the Federal tax program. Profits should be treated as excess when they exceed a reasonable return on the capital invested. Credit for borrowed capital should be disallowed, since the return on borrowed capital is adequately provided for by interest deductions.

The retention of the average-earnings method permits many corporations with very substantial defense contracts to escape entirely the payment of excess-profits taxes. Assistant Secretary of the Treasury John L. Sullivan, in his testimony before the House Ways and Means Committee, testified that an examination of actual tax returns filed in 1941 showed that—

"One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess-profits tax whatever on 1940 earnings, and yet this is a company which has thus far received over $70,000,000 of defense contracts.

"A large industrial company which has received over $250,000,000 of defense contracts and had earnings in 1940 of nearly 200 percent larger than in 1939 will pay no excess-profits tax."

Little wonder, then, that the Assistant Secretary of the Treasury concluded:

"We now have on the statute books a tax which is called an excess-profits tax, and which the country believes is an excess-profits tax. The truth of the matter is that the law we call an excess-profits tax does not tax excess profits at all."

Senator La Follette has aptly declared that existing excess-profits tax gives corporations a "heads-they-win-tails-the-Treasury-loses alternative."

Excess profits taxation should apply to profits in excess of a reasonable return on invested capital. A "reasonable" rate of return on capital cannot be determined in the light of customary notions of either the financial or legal community. It must be determined in the light of the fact that close to a million men annually are being asked, as their patriotic contribution, and are being required by conscription, to give a year or more of their lives to military training. The cost to them is leaving jobs, careers and homes, their "return" is $1 a day. It must be determined in the light of the fact that a large part of the increased profits will be "earned" by corporations without substantial capital risk—the risks in a large measure being taken by the Federal Government.

In these circumstances, we suggest that the profits of industry become excess at a return of 4 or 5 percent. A rate of 4 percent would be more than twice the average 1.7 percent return on invested capital earned by corporations during the years 1926–1937. A rate of 5 percent would be equal to industry's 1929 return on invested capital. For 1937, which is the latest year for which a comprehensive analysis is available, the total net income of the 479,000 American corporations was $7,300,000,000. Slightly less than one-half of these companies having assets of less than $50,000 each showed a total deficit of $132,000,000. The other 250,000 companies earned nearly $7,500,000,000 and paid income taxes of $1,250,000,000.

The most striking feature of corporate net income is that whereas the small corporation suffered losses, the largest corporations—2 percent of them—accounted for nearly two-thirds of the entire $7,300,000 000 of corporate net income. This reflects not only the now generally recognized fact of enormous concentration of wealth in a handful of companies, but the equally significant fact of the heavy concentration of profitable enterprises in the few large companies. It is these corporations, therefore, which will presumably receive two-thirds of the entire profits arising from the defense program and the war boom. Indeed, their proportion of current profits is likely to be even greater than two-thirds, in view of the fact that the largest companies are receiving the lion's share of the billions in defense contracts being negotiated.

In determining a proper rate schedule of excess-profits tax, we are thus confronted with economic problems which transcend questions of pure and simple tax policy. We are dealing with the entire gamut of problems created by the concentration of corporate wealth—monopolies, the wide powers wielded by managers of industrial empires, corporate mismanagement of undistributed surpluses, etc. It is precisely because the concentration of wealth and the concentration of profits go hand in hand that the excess-profits tax is a particularly effective instrument for curbing the power of large corporate industry, for redistributing the surpluses of these vast aggregates of wealth and at the same time for forcing large-scale industry to make its just contribution to national defense.

The tax rate imposed upon excess profits by the 1918 war- and excess-profits tax acts was 80 percent. A rate of 80 percent imposed upon excess profits, defined as suggested above, would reflect the beginnings of a rejection of the current philosophy of "regressive sacrifice" for national defense—to borrow a tax term which asks of men military service at $1 a day and allows industry a minimum 8 percent return or their 1936-39 profits, if higher, before taxing its profits as excess.

To those who fear that industry will refuse to accept defense contracts or will sabotage the defense program if profits are limited to 5 percent, and the type of excess-profits tax here being advocated is adopted, it should be pointed out that Congress has two effective weapons—conscription of industry and Government operation of defense plants, which it is already in a very large measure financing. We venture the suggestion that it would hardly be necessary to conscript industry or take over defense plants in order to obtain speedy acceptance of defense orders—it would only be necessary to call industry's bluff, with conscription and Government operation as the unused trump cards. The line of industry's representatives clamoring for Government contracts would form quickly outside the offices of the Office of Production Management and the War and Navy Departments.

II. THE RESTORATION OF PERSONAL EXEMPTIONS TO $1,000 AND $2,500

At the present time the low-income groups are paying very heavy taxes which are passed on to the consumer in higher prices for articles and services. Senator O'Mahoney, of the Temporary National Economic Committee, has pointed out that 26 percent of all taxes imposed by Federal, State, and local Governments were in 1939 paid by persons whose incomes were less than $1,000 a year. This means that a person with $800 annual income (the personal exemption now allowed single persons) paid out in 1939 and $208 in Federal, State, and local taxes. Persons with incomes under $500 a year paid out 21.9 percent of their incomes, or more than $100 in taxes in 1938-39 (Colm and Tarasov, Who Pays Taxes, Temporary National Economic Committee Monograph No. 3). These figures, based on 1939 tax payments do not take into account the increased tax burden levied under the Revenue Act of 1940, which was to raise an additional $375,000,000 in consumer taxes and another $375,000,000 in personal income taxes, much of which will come out of the pockets of the consumer and the low-bracket taxpayer since personal exemptions were reduced from $1,000 to $800 for the single person and from $2,500 to $2,000 for married persons in the same Revenue Act of 1940.

According to studies made in previous years by Dr. Mordecai Ezekiel, Department of Agriculture economist, $2,500 was needed to maintain an average worker's family at the barest level of health and decency; $2,200 according to the Heller committee of the University of Southern California. In view of the rising cost of living and the existing increased tax burden on the low-income groups, it is obvious that the American family will need substantially more than the $2,200 to $2,500 figure to maintain a decent standard of living.

Each dollar of tax placed upon such low incomes cuts into the standard of living of the American people—a standard far too low.

Thus taxes in the brackets below $2,200 to $2,500 do not mean less savings or fewer luxuries—they mean less food, clothing and shelter. The maintenance of morale in this present crucial time is hardly advanced by depressing the standard of living of the American people.

A sound tax program concerned with the welfare of the American people and the maintenance of morale in this period of unlimited national emergency would restore the $1,000 personal exemption for single persons and the $2,500 personal exemption for married couples. The impact of the proposed surtaxes would thereby be cushioned so as not to depress further the standard of living of the low-income groups. Restoration of the $1,000 to $2,500 personal exemptions would serve to reestablish the personal income tax as a progressive tax based on genuine ability to pay.

III. THE INTEGRATION OF ESTATE AND GIFT TAXES WITH A SINGLE EXEMPTION OF $10,000, PLUS A $10,000 LIFE-INSURANCE EXEMPTION

The Treasury had proposed to raise $347,000,000 in increased estate and gift taxes by increasing the estate-and-gift-tax rates, and by reducing from $40,000 to $25,000 the specific exemption under the estate tax and gift tax, and the insurance exemption under the estate tax.

The House Committee on Ways and Means increased the estate and gift rates to yield $152,000,000 additional revenue.

The House committee's decision would therefore yield about $200,000,000 less than the Treasury's proposals from a source very able to pay increased taxation. The House committee refused to reduce the existing $40,000 exemptions. As the bill now stands an estate of $120,000 completely escapes estate-gift taxation ($40,000 gift exemption, $40,000 insurance exclusion, $40,000 estate exemption). The rates fixed by the House committee are very substantially less than the rates proposed by the Treasury.

At a time when the low-income groups of all classes of society, including laborers and farmers, are called upon to bear an ever-increasing tax burden, when personal income tax exemptions are reduced to an $800 figure, they will hardly be convinced that burdens are being distributed according to ability to bear them when an estate of $120,000 is still permitted to escape estate-gift taxation. An integrated estate and gift-tax system with a single exemption of $10,000 (plus a $10,000 life insurance exclusion) should be adopted with drastically increased rates.

IV. TAXATION OF INTERGOVERNMENTAL SECURITIES

The first step in the elimination of one of the most flagrant and unwarranted loopholes in the tax laws, tax-exempt securities, has been taken through the provisions for taxing the income from future issues of Federal securities. The loophole should be completely closed through the taxation of the income of all presently outstanding Federal securities and of all presently outstanding and future issues of State and local securities.

V. ELIMINATION OF AMORTIZATION PRIVILEGE

The amortization privilege was granted to industry because industry had waged a sit-down strike and had refused to give workers the signal to start the wheels of production for rearmament until Congress yielded to its demands for the amortization privilege and the suspension of the profit limitations on naval and aircraft contracts. (Aviation's Sit-Down Strike, 86 Cong. Rec. (76th Cong., 3d sess.), pp. 16372 et seq.) Under the Federal income-tax laws, annual deductions may be taken for depreciation of plant, equipment, and other property used in business (6 percent depreciation rate for manufacturing plans represents a rough average).

The amortization privilege is nothing more nor less than a tax subsidy to industry—a tax subsidy which has no justification in this era of colossal profits.

The amortization privilege, granting a flat, arbitrary deduction of 20 percent (instead of the ordinary depreciation) of the cost of property should therefore be repealed.

VI. PROFIT LIMITATIONS ON DEFENSE CONTRACTS

Industry's second demand as its price for cooperating in national preparedness was the suspension of the limitations on profits imposed by the Vinson-Trammell Act. Originally enacted in 1934, it was last amended in June 1940 so that any profit in excess of 8 percent on competitively bid contracts for ships or planes (7 percent on negotiated contracts) must be repaid in the Treasury. The loud clamors of industry's representatives for generous profits received the strong sympathy of War and Navy Department officials.

The first World War experience is a striking testimonial to the need for limitations on profits on Government contracts in order to recapture profits attributable to excessively high prices and to corrupt practices. The Wall Street Journal (July 3, 1940) estimated that, notwithstanding a 7 percent contract price limitation, aircraft plants would still earn 9.4 to 28 percent on their capital investments.

While workers are conscripted with no guaranty of wages previously paid, no Government financing of the obligations left behind which the draftees will face on their return, capital is being assured soaring profits and the elimination of even existing profits limitations.

A democratic defense program would require capital to make sacrifices at least equal to those exacted from labor—would require the extension of profit limitations to all Government contracts, not the suspension of profit limitations.

The profit limitation provisions of the Vinson-Trammell Act (suspended October 1940) should be revived and extended to cover all defense contracts, with profits limited to 8 percent of the invested capital employed in the performance of the contract.

VII. RESTORATION OF CORPORATE UNDISTRIBUTED-PROFITS TAX

The undistributed-profits tax is one of the most effective instruments to make effective the graduated surtax rates of the personal income tax. Corporate directors often choose to withhold earnings and accumulate surplus rather than increase dividends to the stockholders. Thus, by paying out earnings only as those in control of the corporation elect, stockholders may avoid the personal income surtax rates—thus dividends paid to stockholders with net incomes over a million dollars would be subject to a tax of 76 percent, which may be avoided by the nondeclaration of such dividends. This results in unfairness to the small stockholders and it reduces the yield of the income tax.

In Lincoln's administration the principles of the undistributed-profits tax were incorporated in our first income-tax law (1861) which provided that the gains and profits of corporations should be included in the annual taxable income of any person entitled to them, whether distributed or undistributed.

The immediate restoration of the undistributed profits tax is all the more important in a war boom period, for it would reduce the opportunities for tax avoidance and tax evasion, would grant greater protection to the interests of the small stockholders, would tend to stabilize revenues and further the democratic principle of levying taxes in accordance with ability to pay.

Either the corporate undistributed profits tax should be restored, or stockholders should be required to include as taxable income these undivided profits.

VII. COMPUTATION OF PERSONAL EXEMPTIONS

Under existing law, personal exemptions are allowed as a credit against net income. They therefore apply not only for the purpose of the normal tax but also for surtax purposes. This makes the benefit of the exemption unequal with respect to different classes of taxpayers, since it operates to reduce the top bracket of the taxpayer's income.

Thus the $2,000 personal exemption results in a tax savings of only $80 (4 percent of $2,000) to a married man with an income of $2,500. However, to a man in the top bracket it results in a tax saving of $1,580 (79 percent of $2,000). The wealthy taxpayer thus secures a decidedly greater reduction in actual taxes paid than the small taxpayer.

This inequity in the income-tax structure should be removed in the Revenue Act of 1941. This discrimination in favor of the upper-bracket taxpayers can be eliminated by allowing personal exemptions (and credit for dependents) to be deducted in the lowest surtax brackets—or as a credit against the tax, rather than against net income.

The principle here proposed has been strongly endorsed by Colin F. Stam, chief of staff of the Joint Committee on Internal Revenue Taxation, in his testimony before the House Committee on Ways and Means in its hearings on the pending bill (hearings, pp. 84–85). It has also been recommended by Dr. Magill, representing the Treasury Department, in his testimony before the House committee in 1934, and also by Dr. Dewey Anderson, executive secretary of the Temporary National Economic Committee, in his monograph, Taxation, Recovery, and Defense (p. 263).

DEMOCRACY IN TAXATION

Democracy in taxation and the maintenance of a stable economy through increases in the purchasing power of workers and farmers require that taxes be collected from those able to pay, and especially from those corporations which are reaping swollen profits from the armament program. Taxation which lowers the standard of living of our people and the very great majority of our people have incomes below $2,500—is repugnant to the basic concept of democracy.

To achieve a defensible tax program, proposals such as "consumption" taxes, excise taxes on consumer necessities, sales taxes, taxes on salaries and wages, lowered personal income-tax exemption, which would increase the burdens on persons whose present incomes do not permit a minimum standard of living,

must be repudiated and defeated. Instead, the increased tax burdens should be placed on the shoulders of those best able to carry them.

An effective excess-profits tax should be enacted. The amortization privilege should be repealed and stringent profits limitations on Government contracts should be adopted. The undistributed profits tax should be restored to reduce opportunities for tax avoidance or stockholders should be required to include undivided profits as taxable income. The income from Federal, State, and local securities (outstanding and future issues) should be taxed.

The $2,500 and $1,000 personal exemptions should be restored. Capital gains should be taxed at full rates and capital loss deductions against ordinary income should be disallowed. The Federal estate tax and gift tax should be integrated into a single-tax system with a single exemption and a single set of graduated rates drastically increased for all brackets, so as to prevent estate tax reductions through gifts. Finally, no increase can be tolerated in the tax burden imposed on the millions of people who are "ill-fed, ill-clad, and ill-housed" until corporate industry and persons with "comfortable and large" incomes have been taxed to the very limit of their capacity to pay. Such would be the direction of a democratic tax program.

NATIONAL COMMITTEE ON TAXATION, NATIONAL LAWYERS GUILD.

(Mr. Popper subsequently submitted for the record the following proposed amendments:)

TITLE I

SECTION 1. PERSONAL EXEMPTION.

(a) Section 25 (b) (1) of the Internal Revenue Code is amended to read as follows:

"(1) PERSONAL EXEMPTION.—In the case of a single person or a married person not living with husband or wife, a personal exemption of $1,000; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them."

(b) Section 251 (f) of the Internal Revenue Code (relating to personal exemption of citizens entitled to benefits of Section 251) is amended by striking out "$806" and inserting in lieu thereof "$1,000."

SEC. 2. RETURNS OF INCOME TAX.

(a) INDIVIDUAL RETURNS.—Section 51 (a) of the Internal Revenue Code is amended to read as follows:

"(a) REQUIREMENT.—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe—

"(1) Every individual who is single or who is married but not living with husband or wife, if having a gross income for the taxable year of $1,000 or over.

"(2) Every individual who is married and living with husband or wife, if no joint return is made under subsection (b) and if—

"(A) Such individual has for the taxable year a gross income of $2,500 or over and the other spouse has no gross income; or

"(B) Such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,500 or over."

(b) INFORMATION RETURNS.—Section 147 (a) of the Internal Revenue Code (relating to information at the source) is amended by striking out "$800" wherever occurring therein and inserting in lieu thereof "$1,000."

SEC. 3. TAXABLE YEARS TO WHICH APPLICABLE.

The amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1940.

AN ACT To provide revenue, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * * * *

TITLE II.—EXCESS PROFITS TAX

SECTION 201. EXCESS PROFITS TAX.

"Subchapter E—Excess Profits Tax" of Chapter 2 of the Internal Revenue Code is amended to read as follows:

"SUBCHAPTER E—EXCESS PROFITS TAX

"SECTION 710. IMPOSITION OF TAX.

"(a) IMPOSITION.—There shall be levied, collected, and paid, for each taxable year, beginning after December 31, 1940, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax of 80 per centum of the adjusted excess-profits net income.

"(b) DEFINITION OF ADJUSTED EXCESS PROFITS NET INCOME.—As used in this section, the term 'adjusted excess profits net income' in the case of any taxable year means the excess profits net income (as defined in section 711) minus:

"(1) A specific exemption of $25,000, or

"(2) The amount of the excess profits credit

allowed under section 712, whichever is greater.

"SEC. 711. EXCESS PROFITS NET INCOME.

"TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1940.—The excess profits net income for any taxable year beginning after December 31, 1940, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

"(1) EXCESS PROFITS CREDIT COMPUTED UNDER INVESTED CAPITAL CREDIT.—

"(A) DIVIDENDS RECEIVED.—The credit for dividends received shall apply, without limitation, to all dividends on stock of all corporations, except dividends (actual or constructive) on stock of foreign personal holding companies, and except dividends (actual or constructive) on stock which is not a capital asset;

"(B) INCOME TAXES.—The deduction for taxes shall be increased by an amount equal to the tax (not including the tax under section 102) under Chapter 1 for such taxable year;

"(C) LONG-TERM GAINS AND LOSSES.—There shall be excluded long-term capital gains and losses. There shall be excluded the excess of gains from the sale or exchange of property held for more than eighteen months which is of a character which is subject to the allowance for depreciation provided in section 23 (l) over the losses from the sale or exchange of such property;

"(D) INCOME FROM RETIREMENT OR DISCHARGE OF BONDS, AND SO FORTH.—There shall be excluded, in the case of any taxpayer, income derived from the retirement or discharge by the taxpayer of any bond, debenture, note, or certificate or other evidence of indebtedness, if the obligation of the taxpayer has been outstanding for more than 18 months, including, in case the issuance was at a premium, the amount includible in income for such year solely because of such retirement or discharge;

"(E) REFUNDS AND INTEREST ON AGRICULTURAL ADJUSTMENT ACT TAXES.—There shall be excluded income attributable to refund of tax paid under the Agricultural Adjustment Act of 1933, as amended, and interest upon any such refund;

"(F) INTEREST ON CERTAIN GOVERNMENT OBLIGATIONS.—The normal-tax net income shall be increased by an amount equal to the amount of the interest on obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income, if the taxpayer has so elected under section 720 (d); and

"(G) RECOVERIES OF BAD DEBTS.—There shall be excluded income attributable to the recovery of a bad debt if a deduction with reference to such debt was allowable from gross income for any taxable year beginning prior to January 1, 1940.

"(2) TAXABLE YEAR LESS THAN TWELVE MONTHS.—If the taxable year is a period of less than twelve months, the excess-profits net income shall be placed on an

annual basis by multiplying the amount thereof by the number of days in the twelve months ending with the close of the taxable year and dividing by the number of days in the taxable year. The tax shall be such part of the tax computed on such annual basis as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

"SEC. 712. EXCESS-PROFITS CREDIT—BASED ON INVESTED CAPITAL.

"The excess-profits credit, for any taxable year, shall be an amount equal to 4 per centum of the taxpayer's invested capital for the taxable year, determined under section 713.

"SEC. 713. DEFINITION OF INVESTED CAPITAL.

"For the purposes of this subchapter the invested capital for any taxable year shall be the average invested capital for such year, determined under section 714, reduced by an amount computed under section 720 (relating to inadmissible assets). If the Commissioner finds that in any case the determination of invested capital, on a basis other than a daily basis, will produce an invested capital differing by not more than $1,000 from an invested capital determined on a daily basis, he may, under regulations prescribed by him with the approval of the Secretary, provide for such determination on such other basis. (For computation of invested capital in case of foreign corporations and corporations entitled to the benefits of section 251, see section 720.)

"SEC. 714. AVERAGE INVESTED CAPITAL.

"The average invested capital for any taxable year shall be the aggregate of the daily invested capital for each day of such taxable year, divided by the number of days in such taxable year.

"SEC. 715. DAILY INVESTED CAPITAL.

"The daily invested capital for any day of the taxable year shall be the equity invested capital for such day.

"SEC. 716. EQUITY INVESTED CAPITAL.

"(a) DEFINITION.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b):

"(1) MONEY PAID IN.—Money previously paid in for stock, or as paid-in surplus, or as a contribution to capital;

"(2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined in the same manner as if the property were still held at the beginning of such taxable year. If such unadjusted basis is a substituted basis, it shall be adjusted, with respect to the period before the property was paid in, in the manner provided in section 113 (b) (2);

"(3) DISTRIBUTIONS IN STOCK.—Distributions in stock.—

"(A) Made prior to such taxable year to the extent to which they are considered distributions of earnings and profits; and

"(B) Previously made during such taxable year to the extent to which they are considered distributions of earnings and profits other than earnings and profits of such taxable year;

"(4) EARNINGS AND PROFITS AT BEGINNING OF YEAR.—The accumulated earnings and profits as of the beginning of such taxable year; and

"(5) INCREASE ON ACCOUNT OF GAIN ON TAX-FREE LIQUIDATION.—In the case of the previous receipt of property (other than property described in the last sentence of section 113 (a) (15) by the taxpayer in complete liquidation of another corporation under section 112 (b) (6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received, exceeds the sum of—

"(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share

to be determined immediately prior to the receipt of any property in such liquidation with respect to such share; and

"(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received.

"(b) REDUCTION IN EQUITY INVESTED CAPITAL.—The amount by which the equity invested capital for any day shall be reduced as provided in subsection (a) shall be the sum of the following amounts:

"(1) DISTRIBUTIONS IN PREVIOUS YEARS.—Distributions made prior to such taxable year which were not out of accumulated earnings and profits;

"(2) DISTRIBUTIONS DURING THE YEAR.—Distributions previously made during such taxable year which are not out of the earnings and profits of such taxable year;

"(3) EARNINGS AND PROFITS OF ANOTHER CORPORATION.—The earnings and profits of another corporation which previously at any time were included in accumulated earnings and profits by reason of a transaction described in section 112 (b) to (e), both inclusive, or in the corresponding provision of a prior revenue law, or by reason of the transfer by such other corporation to the taxpayer of property the basis of which in the hands of the taxpayer is or was determined with reference to its basis in the hands of such other corporation, or would have been so determined if the property had been other than money; and

"(4) REDUCTION ON ACCOUNT OF LOSS ON TAX-FREE LIQUIDATION.—In the case of the previous receipt of property (other than property described in the last sentence of section 113 (a) (15) by the taxpayer in complete liquidation of another corporation under section 112 (b) (6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the sum of—

"(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

"(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received), given by the taxpayer for such property so received,

exceeds the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received. The amount of the reduction under this paragraph shall not exceed the accumulated earnings and profits as of the beginning of such taxable year.

"(c) RULES FOR APPLICATION OF SUBSECTIONS (A) AND (B).—For the purposes of subsections (a) and (b)—

"(1) DISTRIBUTIONS TO SHAREHOLDERS.—The term 'distribution' means a distribution by a corporation to its shareholders, and the term 'distribution in stock' means a distribution by a corporation in its stock or rights to acquire its stock. To the extent that a distribution in stock is not considered a distribution of earnings and profits it shall not be considered a distribution. A distribution in stock shall not be regarded as money or property paid in for stock, or as paid-in surplus, or as a contribution to capital.

"(2) DISTRIBUTIONS IN FIRST SIXTY DAYS OF TAXABLE YEAR.—In the application of such subsections to any taxable year beginning after December 31, 1940, so much of the distributions (taken in the order of time) made during the first sixty days thereof as does not exceed the accumulated earnings and profits as of the beginning thereof (computed without regard to this paragraph) shall be considered to have been made on the last day of the preceding taxable year.

"(3) COMPUTATION OF EARNINGS AND PROFITS OF TAXABLE YEAR.—For the purposes of subsections (a) (3) (B) and (b) (2) in determining whether a distribution is out of the earnings and profits of any taxable year, such earnings and profits shall be computed as of the close of such taxable year without diminution by reason of any distribution made during such taxable year or by reason of the

tax under this subchapter for such year and the determination shall be made without regard to the amount of earnings and profits at the time the distribution was made.

"(4) STOCK IN CASE OF MERGER OR CONSOLIDATION.—If a corporation owns stock in another corporation, and—

"(A) such corporations are merged or consolidated in a statutory merger or consolidation, or

"(B) such corporations are parties to a transaction which results in the elimination of such stock in a manner similar to that resulting from a statutory merger or consolidation,

then such stock shall not be considered as property paid in for stock of or as paid-in surplus of, or as a contribution to capital of, the corporation resulting from the transaction referred to in subparagraph (A) or (B).

"(d) For special rules affecting computation of property paid in for stock in connection with certain exchanges and liquidations, see section 751 (a).

"(e) For determination of equity invested capital in special cases, see section 719.

"SEC. 717. ADMISSIBLE AND INADMISSIBLE ASSETS.

"(a) DEFINITIONS.—For the purposes of this subchapter—

"(1) The term 'inadmissible assets' means—

"(A) Stock in corporations except stock in a foreign personal-holding company, and except stock which is not a capital asset; and

"(B) Except as provided in subsection (d), obligations described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income.

"(2) The term 'admissible assets' means all assets other than inadmissible assets.

"(b) RATIO OF INADMISSIBLE TO TOTAL ASSETS.—The amount by which the average invested capital for any taxable year shall be reduced as provided in section 713 shall be an amount which is the same percentage of such average invested capital as the percentage which the total of the inadmissible assets is of the total of admissible and inadmissible assets. For such purposes, the amount attributable to each asset held at any time during such taxable year shall be determined by ascertaining the adjusted basis thereof (or, in the case of money, the amount thereof) for each day of such taxable year so held and adding such daily amounts. The determination of such daily amounts shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. The adjusted basis shall be the adjusted basis for determining loss upon sale or exchange as determined under section 113.

"(c) COMPUTATION IF SHORT-TERM CAPITAL GAIN.—If during the taxable year there has been a short-term capital gain with respect to an inadmissible asset, then so much of the amount attributable to such inadmissible asset under subsection (b) as bears the same ratio thereto as such gain bears to the sum of such gain plus the dividends and interest on such asset for such year, shall, for the purpose of determining the ratio of inadmissible assets to the total of admissible and inadmissible assets, be added to the total of admissible assets and subtracted from the total of inadmissible assets.

"(d) TREATMENT OF GOVERNMENT OBLIGATIONS AS ADMISSIBLE ASSETS.—If the excess-profits credit for any taxable year is computed under section 714, the taxpayer may in its return for such year elect to increase its normal-tax net income for such taxable year by an amount equal to the amount of the interest on all obligations held during the taxable year which are described in section 22 (b) (4) any part of the interest from which is excludible from gross income or allowable as a credit against net income. In such case, for the purposes of this section, the term 'admissible assets' includes such obligations, and the term 'inadmissible assets' does not include such obligations.

"SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

"(a) DEFINITIONS.—For the purposes of this section—

"(1) ABNORMAL INCOME.—The term 'abnormal income' means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the

taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

"(2) SEPARATE CLASSES OF INCOME.—Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

"(B) Income constituting an amount payable under a contract the performance of which required more than 12 months; or

"(C) Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

"(E) In the case of a lessor of real property, income included in gross income for the taxable year by reason of the termination of the lease; or

"(F) Income consisting of dividends on stock of foreign corporations, except foreign personal holding companies.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (F), inclusive, shall be subject to regulations prescribed by the Commissioner with the approval of the Secretary.

"(3) NET ABNORMAL INCOME.—The term 'net abnormal income' means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1) and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

"(b) AMOUNT ATTRIBUTABLE TO OTHER YEARS.—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

"(c) COMPUTATION OF TAX FOR CURRENT TAXABLE YEAR.—The tax under this subchapter for the taxable year, in which the whole of such abnormal income would be without regard to this section be includible, shall not exceed the sum of—

"(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

"(2) The aggregate of the increase in the tax under this subchapter which would have resulted for each previous taxable year to which any portion of such net abnormal income is attributable, computed as if an amount equal to such portion had been included in the gross income for such previous taxable year.

"(d) COMPUTATION OF TAX FOR FUTURE TAXABLE YEAR.—The amount of the net abnormal income attributable to any future taxable year shall, for the purposes of this subchapter, be included in the gross income for such taxable year. The tax under this subchapter for such future taxable year shall not exceed the sum of—

"(1) the tax under this subchapter for such future taxable year computed without the inclusion in excess profits net income of the portion of such net abnormal income which is attributable to such year, and

"(2) the decrease in the tax under this subchapter for the previous taxable year in which the whole of such abnormal income would without regard to this section be includible, which resulted by reason of the exclusion of the whole or a part of the abnormal income from the gross income for such previous taxable year; but the amount of such decrease shall be diminished by the aggregate of the increases in the tax under this subchapter which have resulted for the taxable years intervening between such previous taxable year and such future taxable year because of the inclusion in the gross income of the portions of such net abnormal income attributable to such intervening years.

"SEC. 719. EQUITY INVESTED CAPITAL IN SPECIAL CASES.

"Where the Commissioner determines that the equity invested capital as of the beginning of the taxpayer's first taxable year under this subchapter cannot be determined in accordance with section 716, the equity invested capital as of the beginning of such year shall be an amount equal to the sum of (a) the money plus (b) the aggregate of the adjusted basis of the assets of the taxpayer held by the taxpayer at such time, such sum being reduced by the indebtedness outstanding at such time. The amount of the money, assets, and indebtedness at such time shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary. In such case, the equity invested capital for each day after the beginning of the taxpayer's first taxable year under this subchapter shall be determined, in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary, using as the basic figure the equity invested capital as so determined.

"SEC. 720. FOREIGN CORPORATIONS AND CORPORATIONS ENTITLED TO BENEFITS OF SECTION 251—INVESTED CAPITAL.

"Notwithstanding section 713, in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, and in the case of a corporation entitled to the benefits of section 251, the invested capital for any taxable year shall be determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary under which—

"(a) GENERAL RULE.—The daily invested capital for any day of the taxable year shall be the aggregate of the adjusted basis of each United States asset held by the taxpayer on the beginning of such day. In the application of section 717 in reduction of the average invested capital (determined on the basis of such daily invested capital), the terms 'admissible assets' and 'inadmissible assets' shall include only United States assets; or

"(b) EXCEPTION.—If the Commissioner determines that the United States assets of the taxpayer cannot satisfactorily be segregated from its other assets, the invested capital for the taxable year shall be an amount which is the same percentage of the aggregate of the adjusted basis of all assets held by the taxpayer as of the end of the last day of the taxable year which the net income for the taxable year from sources within the United States is of the total net income of the taxpayer for such year.

"(c) DEFINITION OF UNITED STATES ASSET.—As used in this subsection, the term 'United States asset' means an asset held by the taxpayer in the United States, determined in accordance with rules and regulations prescribed by the Commissioner with the approval of the Secretary.

"SEC. 721. PERSONAL SERVICE CORPORATIONS.

"(a) DEFINITION.—As used in this subchapter, the term 'personal service corporation' means a corporation whose income is to be ascribed primarily to the activities of shareholders who are regularly engaged in the active conduct of the affairs of the corporation and are the owners at all times during the taxable year of at least 70 per centum in value of each class of stock of the corporation, and in which capital is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists of gains, profits, or income derived from trading as a principal. For the purposes of this subsection, an individual shall be considered as owning, at any time, the stock owned at such time by his spouse or minor child or by any guardian or trustee representing them.

"(b) ELECTION AS TO TAXABILITY.—If a personal service corporation signifies, in its return under Chapter 1 for any taxable year, its desire not to be subject

to the tax imposed under this subchapter for such taxable year, it shall be exempt from such tax for such year, and the provisions of Supplement S of Chapter 1 shall apply to the shareholders in such corporation who were such shareholders on the last day of such taxable year of the corporation.

"SEC. 722. CORPORATIONS COMPLETING CONTRACTS UNDER MERCHANT MARINE ACT, 1936.

"(a) If the United States Maritime Commission certifies to the Commissioner that the taxpayer has completed within the taxable year any contracts or subcontracts which are subject to the provisions of section 505 (b) of the Merchant Marine Act of 1936, as mended, then the tax imposed by this subchapter for such taxable year shall be, in lieu of a tax computed under section 710, a tax computed under subsection (b) of this section, if, and only if, the tax computed under subsection (b) is less than the tax computed under section 710.

"(b) The tax computed under this subsection shall be the excess of—

"(1) A tentative tax computed under section 710 with the normal-tax net income increased by the amount of any payments made, or to be made, to the United States Maritime Commission with respect to such contracts or subcontracts, over

"(2) The amount of such payments.

"SEC. 723. EXEMPT CORPORATIONS.

"The following corporations shall be exempt from the tax imposed by this subchapter:

"(a) Corporations exempt under Section 101 from the tax imposed by Chapter 1.

"(b) Foreign personal-holding companies, as defined in section 331.

"(c) Mutual investment companies, as defined in section 361.

"(d) Investment companies which under the Investment Company Act of 1940 are registered as diversified companies at all times during the taxable year. For the purposes of this subsection, if a company is so registered before July 1, 1941, it shall be considered as so registered at all times prior to the date of such registration.

"(e) Personal-holding companies, as defined in section 501.

"(f) Foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein.

"(g) Domestic corporations satisfying the following conditions:

"(1) If 95 per centum or more of the gross income of such domestic corporation for the three-year period immediately preceding the close of the taxable year (or for such part of such period during which the corporation was in existence) was derived from sources other than sources within the United States; and

"(2) If 50 per centum or more of its gross income for such period or such part thereof was derived from the active conduct of a trade or business.

"(h) Any corporation subject to the provisions of Title IV of the Civil Aeronautics Act of 1938, in the gross income of which for any taxable year beginning after December 31, 1939, there is includible compensation received from the United States for the transportation of mail by aircraft, if, after excluding from its gross income such compensation, its adjusted excess profits net income for such year is zero or less.

"SEC. 724. MEANING OF TERMS USED.

"The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

"SEC. 725. LAWS APPLICABLE.

"(a) GENERAL RULE.—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

"(b) RETURNS.—Notwithstanding subsection (a), no return under section 52 (a) shall be required to be filed by any taxpayer under this subchapter for any taxable year for which its excess profits net income, computed with the adjustments provided in section 711 (a) (1) and placed on an annual basis as provided in section 711 (a) (2), is not greater than $5,000.

"(c) FOREIGN TAXES PAID.—In the application of section 131 for the purposes

of this subchapter the tax paid or accrued to any country shall be deemed to be the amount of such tax reduced by the amount of the credit allowed with respect to such tax against the tax imposed by Chapter 1.

"(d) LIMITATIONS ON AMOUNT OF FOREIGN TAX CREDIT.—The amount of the credit taken under this section shall be subject to each of the following limitations:

"(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources within such country bears to its entire excess profits net income for the same taxable year; and

"(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's excess profits net income from sources without the United States bears to its entire excess profits net income for the same taxable year."

SEC. 202. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The Amendments made by this title shall be applicable only with respect to taxable years beginning after December 31, 1940.

TITLE VII.—DISCONTINUANCE OF AMORTIZATION DEDUCTION

SEC. 701. DISCONTINUANCE OF AMORTIZATION DEDUCTION.

(a) Section 23 (t) and section 124 of the Internal Revenue Act, with respect to the allowance of amortization deduction, are hereby repealed.

(b) Subsection (a) shall be effective only with respect to taxable years beginning after December 31, 1940.

TITLE VIII.—RESTORATION OF PROFIT LIMITATIONS OF THE VINSON ACT AND CERTAIN PROVISIONS OF THE MERCHANT MARINE ACT, 1936

SEC. 801. RESTORATION OF PROFIT LIMITATIONS.

(a) Title IV of the Second Revenue Act of 1940, with respect to the "suspension of profit limitations of the Vinson Act and certain provisions of the Merchant Marine Act, 1936," is hereby repealed.

(b) Subsection (a) shall apply to contracts or subcontracts for the construction or manufacture of any complete naval vessel or any Army or Navy aircraft, or any portion thereof, which are entered into after the date of the enactment of this title.

(Thereupon, at 12:25 p. m., the hearing was recessed until 2 p. m.)

AFTERNOON SESSION

(Pursuant to the adjournment for the noon recess, the committee reconvened at 2 p. m.)

The CHAIRMAN. Mr. Vallee, you may proceed.

STATEMENT OF E. A. VALLEE, MILWAUKEE, WIS., PRESIDENT, REFRIGERATION EQUIPMENT MANUFACTURERS ASSOCIATION

Mr. VALLEE. My name is E. A. Vallee. I am vice president of the Automatic Products Co. of Milwaukee, Wis., and I am speaking as president of the Refrigeration Equipment Manufacturers Association. We represent about 56 manufacturers of refrigeration equipment as described in paragraph (b) of section 3405 of the bill, H. R. 5417. We also manufacture the majority of the parts, supplies, and controls used in the servicing and maintenance of existing refrigeration equipment. I have several of my associates with me who may be able to answer any questions that I may not be able to answer.

Our group is willing to share in the burden of the national defense program, but the purpose of this tax seems to include other factors than the raising of revenue.

Discrimination against mechanical commercial refrigeration.—It singles out mechanical refrigeration from all other kinds of commercial and industrial machinery such as is used by service stations—air compressors, gasoline pumps, automobile lifts, lubrication equipment, and so forth.

Apparently commercial refrigeration equipment is the only commercial or industrial equipment (excepting automobile trucks and laundry machinery) on which an excise tax is proposed.

No provision is made to tax ice refrigeration even though a good share of it is manufactured with mechanical equipment. Incidentally, this presents another inconsistency in the bill.

A butcher's walk-in cooler may be cooled either by ice or a mechanical unit. In either case the box is the same.

If mechanical refrigeration is used to cool the box the entire installation is subject to the full excise tax. If ice is used no tax is involved. The box itself may well represent two or three times the cost of the refrigerating unit.

Isn't this discrimination of a nature never intended by the committee, and a hardship to the user who does not have ice available?

The bulk of ice used today is manufactured ice. This calls for mechanical refrigerating equipment using parts manufactured by our group. True the ice manufacturer will pay the excise tax on his original equipment which he uses every day in making ice which is, so far, tax free.

This places the ice manufacturer in those sections where natural ice can be cut at a disadvantage in addition to placing the members of our group in a noncompetitive position.

Commercial refrigeration is not a luxury product.—If commercial refrigeration equipment has been included in this bill on the premise that it is in the luxury group of consumer goods requiring sales curbs as an inflation control, we doubt if the proposed application of the tax to our products will accomplish that purpose.

A tax on commercial refrigeration is a tax on food.—A tax on the butcher's walk-in box, the grocer's storage refrigerator for milk, butter, and other perishables, the ice-cream dispenser's cabinet, etc., will logically lead to higher consumer prices on the products dispensed from such equipment.

If the intent of the bill is directed toward air-conditioning equipment as a luxury item, we respectfully refer to the statement of John W. Hart, beginning with page 206 of your hearings on this bill, which shows a total value for air-conditioning items in the bill of approximately 5 percent of the total refrigeration equipment proposed for taxation.

Surely an entire industry should not be asked to carry an excise-tax burden on the strength of a desire to penalize so small a portion of it which may be regarded as nonessential.

If and when you have heard from the manufacturers of air-conditioning machinery, we venture that you will conclude that air-conditioning itself seems a far more vital function than mere comfort cooling.

Danger of possible pyramiding of this tax.—From the present wording of the bill, it is not clear to us whether this tax on components of refrigerating equipment can be administered without pyramiding the tax as our products move through resale channels. We do not feel that it is the intention to have the act work that way so hope that your committee will see to it that this point is clarified.

If it is deemed necessary to raise extra revenue through an excise tax on food-handling equipment, then we believe that a similar tax should be imposed on all other types of mechanical equipment as previously mentioned.

Instead of an excise tax on products of this nature we feel that a sales tax imposed on the finished product or installation in which components are involved would be eminently more equitable and more economical to administer.

Therefore, it is our recommendation that the proposed excise tax on components manufactured by our group be eliminated, and that, if it is regarded as necessary to raise a specified quota from the mechanical-refrigeration industry that the proposed percentage on the finished units be increased slightly to meet the quota.

Senator LA FOLLETTE. Have you any views as to whether this tax might be pyramided if it stays in the bill?

Mr. VALLEE. We think as it is written it might.

Senator LA FOLLETTE. What leads you to that conclusion?

Mr. VALLEE. In our group we make, for example, belts, controls, coils, and if the taxes apply on each item and then on the finished product it might pyramid three or four times. Do I make that clear?

Senator LA FOLLETTE. Yes, sir.

Is there anything else?

Mr. VALLEE. That is all I have.

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

Mr. Brown, do you have any questions?

Senator BROWN. No, Mr. Chairman.

The CHAIRMAN. Mr. FitzGerald.

STATEMENT OF CHARLES D. WOODRUFF, CHICAGO, ILL., NATIONAL RESTAURANT ASSOCIATION

Mr. WOODRUFF. I am appearing in place of Mr. FitzGerald. I am Charles D. Woodruff, general attorney for the National Restaurant Association.

The CHAIRMAN. Your address is in Washington?

Mr. WOODRUFF. In Chicago.

The National Restaurant Association is the one trade group, national trade group representing restaurants, and comprises in membership the operators of some 10,000 restaurants throughout the country of all kinds and types. Generally speaking, our members are the operators of the leading and larger restaurants. Nevertheless, we feel that we are representative of the industry and fairly well qualified to speak on behalf of the more than 600,000 employees and the more than 170,000 actively engaged proprietors.

It is not our purpose to complain about the new and higher taxes, nor is it our purpose to object to bearing our fair share or even a little more than our share of the tax burden. We recognize the need

for the revenue which the pending proposal is designed to raise, even the need for more than it is expected to bring in. We have sought this hearing in order to bring to your attention what seems to us to be inequalities in the proposed measure and to point out some ways in which we feel it would not operate as it appears it was intended it should.

Our objections are directed particularly to the various excise taxes. The restaurant industry has many peculiarities, and because of that fact it is affected by an unusually large number of these excise taxes which would be imposed. Of them, we would mention the taxes on refrigerators and air-conditioning equipment, matches, soft drinks, electrical appliances, electric signs, business and store machines, rubber articles, washing machines, jewelry, coin-operated gaming and amusement devices, cigarettes, liquors, wines and beer, electrical energy, admissions and radios, phonographs and records, all of these being things which are being used widely in restaurants. We wish to mention certain of them in particular.

The preceding speaker mentioned the 10-percent tax on refrigerators and air-conditioning equipment. There presently is a manufacturers' excise tax of 5½ percent on refrigerators of the household type. The proposed revenue act would impose a tax of 10 percent on all refrigerators, parts, and so on, and upon air conditioners and components. We understand that in early drafts of this measure the tax was simply increased to 10 percent. It was left applying only to household refrigerators. Then, because of the extent of the commercial uses of refrigerators and air conditioners, and the importance of air conditioning in its commercial uses to public comfort, welfare, health, and efficiency and of refrigeration in the storing and processing of food and so to the public health, we urge the removal of this tax on refrigerators and air conditioners. At least insofar as the tax has been made to apply to the commercial uses of such equipment.

Another tax which we will point to particularly is the proposed excise tax of 10 percent on electrical appliances as provided in section 3406 of the proposed measure.

Listed in the section are flatirons, heaters, heating pads, blankets, household-type vacuum cleaners, and so on. From this list we have been led to feel that these taxes were intended to reach electrical appliances intended for home use, but when they reach the many uses which we have for electrical appliances they discriminate against our business and add to the already large burden of taxes which we have. When these electrical appliances are used in restaurants they are in no sense luxuries, they are essential to the proper conduct of the business, the proper preparation of food.

Much the same thing can be said with regard to the new chapter 19 imposing a new retailers' excise tax on jewelry, and so forth, on furs and on toilet preparations, and so on. Buried in the list of items taxed is silver-plated ware. Very obviously this section was intended to reach luxury items. Yet the tax imposed on silverware is a tax on an item which is used in large quantities in restaurants and for which there seems to be no satisfactory substitute. Silverware is an item of which large purchases are continually necessary

because of wearing out and damage, and because of the quantities of silver which are taken away from restaurants by customers.

Finally, among the taxes we mentioned specifically, we join with the American Hotel Association in protesting the change in the tax on cabarets which imposes the tax on the owner of the cabaret instead of upon the customer as heretofore. This change simply makes it more difficult for the cabaret operator to pass the tax on, and in effect imposes a 5 percent gross receipts tax on food, beverages, and other merchandise sold, when the tax supposedly is one on persons who seek admission to places where entertainment is provided. That is true at a time when cabaret owners are having difficulty enough in raising their prices to take care of advancing costs of food and labor. All of the other admission taxes are specifically applicable to the person paying the admission, and, in fact, are required to be set forth on the ticket purchased. No other admission tax is imposed in this manner. We think it is apparent that restaurants of necessity must spend large sums for electric signs, business and store machines, rubber articles, matches, washing machines, electrical energy, radios, phonographs, records, and that many of them will be seriously affected by the increased taxes on cigarettes, liquors, wines, beer, and soft drinks, not to mention the effect which many of the new and increased taxes will have upon restaurants.

Thus we plead with you for your particular consideration of the tax on mechanical refrigeration and air conditioning, on electrical appliances, on silver-plated ware, and the new admissions tax, the cabaret tax, because we feel that the first three were not intended to apply to commercial uses, and that they single us out unduly, because we feel that the burden of taxes already being imposed on the industry is too great.

The restaurant industry at the present time is suffering very grave problems as the result of the national-defense efforts, food costs, and wage costs which have increased and are increasing very rapidly, as is true of the cost of equipment used in restaurants. For several months now the industry has been confronted with an acute shortage of workers. There probably is no restaurant employment office in the country—and I note specifically the office here in Washington and one in Chicago—which is able to supply the demands upon it for workers. Everywhere restaurants are being forced to operate short of help and with a terrific turn-over.

I have mentioned that the burden of taxes on restaurants is heavy. State taxes alone have increased more than 10 times in the space of 6 or 7 years, an increase of over twice as much as has taken place in other retail lines.

The restaurant industry leads all retail business in the percentage of sales income which is devoted to taxes. This is true because it is partly a manufacturing industry or processing industry and partly a selling industry. So that taxes come from both sides.

The mortality rate of restaurants is ordinarily very high. One Government study showed that 50 percent of all restaurants go out of business or change hands every year. That is the highest rate of any retail business, and probably of any business. Many new problems that are confronting them, including increased costs which this proposed tax measure will place upon them, will presumably make for an even higher mortality rate.

We feel, therefore, that no unequal or unfair tax burden should be imposed upon the restaurant industry, such as those we have pointed out. We think this being a time when everyone is becoming more and more concerned about unemployment in nondefense industries, it is a time when the interests of an industry such as the restaurant industry should be considered.

Therefore, in the interests of probably in excess of a million people that depend upon the restaurant industry for their livelihood, and in the interest of public health, we respectfully ask your consideration of these taxes. We beg that this committee make as many changes in the pending revenue measure as it can which will ease the burden on the restaurant industry of the taxes to be imposed.

The CHAIRMAN. Thank you very much. Are there any questions of this witness?

(No response.)

(The following supplemental statement was submitted for the record:)

SUPPLEMENTAL STATEMENT OF NATIONAL RESTAURANT ASSOCIATION ON REVENUE ACT OF 1941

To Committee on Finance, United States Senate:

In supplementing the statement made on behalf of the National Restaurant Association on August 19, 1941, we wish particularly to stress the effect which certain of the proposed excise taxes would have on the price of food to the general public. This effect we regard, and believe you will, as most important at a time when inflation threatens and when adequate food at lowest possible prices is desired in the interests of the general welfare and national defense.

The 10-percent manufacturers excise tax, which would be imposed by section 546 of H. R. 5417 on refrigerating apparatus and air conditioners and components, is in effect a tax on the storage and processing of food. Witnesses appearing on behalf of manufacturers and jobbers stated that the present wording of this section would work a compounding of the tax in many instances. Whether or not the language of the section does so, there would, as a practical matter be a compounding of the tax. Whatever the language of the section, the tax would be compounded many times, when applied to commercial refrigerators. This would be true because most food products before reaching the table for consumption have, in the course of transportation and processing, undergone refrigeration not once but many times. At each resting point and processing step between the field or the slaughteringhouse this proposed tax would again and again be added into the cost of the ultimate food product.

We submit that no such tax as that on refrigeration and air conditioning, singling out an item so essential to the feeding of the Nation, should be imposed at this time, be its effect on the price of food little or great. It appears that this tax would have a substantial effect on food prices.

The importance of food to national defense was emphasized when President Roosevelt called the national Conference on Nutrition for Defense. Proper food is an essential for defense workers and nondefense workers. At the same time milk for babies is indispensable, children must be adequately fed with food which has been properly preserved by refrigeration. Specifically, food such as meat, dairy products, vegetables, and some fruits must be refrigerated. The increased cost of food, which would result from the imposition of this tax on refrigeration and air conditioning, would fall most heavily on those in the lower income brackets with their large families.

Thus far we have spoken only of the one proposed tax which would effect food prices generally, but we believe the numerous other taxes which will effect prices of food in restaurants also merit the committee's consideration. The figure of 7,000,000,000 meals per year served in restaurants, cited in our original statement was based on the census figures for 170,000 "eating places" in the country, did not take into consideration the many meals served in the 136,217 places classified as "drinking places," although many of these are, in fact, restaurants with

liquor service, nor did it take into consideration the lunches served by the 33,257 drug stores having soda fountains. What menu prices are to be in all of these establishments serving meals or lunches is certainly of great importance. Taking all of them into consideration, the total number of meals served must certainly exceed 10,000,000,000 per year. In this connection it is to be remembered that a very large portion of these meals are served to working people, who eat all or a large part of their meals away from home. In turn, a large portion of these working people are engaged in defense production.

These many people who rely on restaurants to such a large extent will be faced with higher menu prices as food prices go up and operating costs increase. Restaurant operators have no choice in the matter. The tax on refrigeration and air conditioning will mean higher food costs to them. This tax and the other excise taxes on equipment used in restaurants will make for higher operating costs. Painful and disruptive as the raising of menu prices is, it will have to be done in order to stay in business.

We would add that these representations are made on behalf of an industry which is doing all it can in the interest of the health and general welfare of our people and for national defense. As recently as 2 weeks ago the Office of Price Administration and Civilian Supply called on the industry through the National Restaurant Association to see that adequate, inexpensive eating facilities for defense workers are provided in the vicinity of defense housing projects now being built. In addition to cooperating in this phase of national defense, the restaurant industry has been acting in an advisory capacity to the Army and Navy at Army camps and naval bases, has actually trained a large number of Navy cooks in private restaurants, has completed a first draft of a revised cook book for the Navy, is working with the Health and Welfare Division of the Federal Security Agency in carrying out the program launched at the National Conference on Nutrition for Defense, and is about to begin cooperation with the Treasury Department in the sale of defense savings stamps.

Thus, speaking on behalf of an exceedingly defense-conscious and active industry, we ask in the interest of good health through good food at minimum prices and national defense, for your reconsideration particularly of the tax imposed on refrigeration and air conditioning, but also of the other proposed excise taxes.

The CHAIRMAN. Mr. William B. Henderson, from Washington, D. C.

STATEMENT OF WILLIAM B. HENDERSON, WASHINGTON, D. C., EXECUTIVE VICE PRESIDENT, AIR CONDITIONING AND REFRIGERATING MACHINERY ASSOCIATION, INC.

The CHAIRMAN. Mr. Henderson, you are appearing on behalf of the Air Conditioning and Refrigerating Machinery Association?

Mr. HENDERSON. Yes, sir.

The CHAIRMAN. All right; you may proceed.

Mr. HENDERSON. The revenue bill of 1941, as passed by the House of Representatives, contains a substantial inequity and an obviously unfair discrimination against the users and manufacturers of refrigerating and air-conditioning machinery by proposing a 10-percent excise tax on the sale of all refrigerating and air conditioning machinery. The machinery of which I am speaking is typified by those pictures, Mr. Chairman [indicating]—and I would draw your attention particularly to them because there is so much misunderstanding, of refrigeration as applied to the household box, with which you are so familiar, and the commercial type of refrigerating machinery so largely used in restaurants and similar places, and heavy industrial types of refrigerating machinery such as are used in packing plants, terminal storage warehouses, fruit-packing plants, ice-making plants, and so forth.

As the members of the Finance Committee undoubtedly are aware, few items of mechanical equipment are as essential to the national

welfare and to the national economy as the refrigerating machinery used for commercial and industrial purposes. Controlled temperatures and humidity are required for the processing of hundreds of products in common daily use. To illustrate: Controlled temperatures and humidity are essential to the output of many chemical products; of most drugs, medicines, serums, and vaccines; of explosives; of petroleum products (particularly high octane aviation gasoline); of synthetic products such as nylon, rayon, and neoprene; or precisions instruments, range finders, bombsights, airplane instruments, optical goods, and many other products.

Important though refrigerating and air-conditioning machinery is to American industry, refrigeration is of indispensable importance in maintaining and protecting the health of the civilian population and the armed forces of the United States.

Without refrigeration, very little meat could be moved from the farm to the consumer. Each year more than 80,000,000 animals go from the farmers' pasture land to 1,500 meat-packing centers with their huge installations of refrigerating machinery. From those packing houses, refrigerated railroad cars and motor-trucks take the meat to over 200,000 meat stores and the thousands of cold-storage warehouses and locker-storage plants throughout the country. Each step of the way, from the farm to the consumer's table, the 17,000,000,000 pounds of meat consumed annually in the United States are protected by the operation of industrial and commercial refrigerating machinery.

Milk is the largest single source of cash income on 5,000,000 United States farms. Annually, 25,000,000 cows produce some 50,000,000,000 quarts of milk. The milk goes from the farm to 13,000 dairies, 6,700 ice-cream plants, and 11,000 manufacturers of other dairy products to be processed for the ultimate consumer. Each day 45,000,000 quarts of fluid milk alone are used in homes, restaurants, hotels, and schools Without refrigeration, the modern dairy industry could not exist.

Millions of tons of fresh fruits and vegetables move each year from farms and plantations to cities and towns throughout the Nation. It is commonplace for highly perishable fruits and vegetables to be moved thousands of miles from the point of origin to the markets where the housewife buys them in practically as fresh and nutritious a condition as the day they were picked. This miracle of distribution would be impossible without commercial and industrial refrigeration.

In the revenue bill of 1941, as passed by the House of Representatives, it is proposed to levy a 10-percent excise tax on all types of refrigerating and air-conditioning machinery, whether used in the home, in the meat-packing plant, in the dairy, or in the munitions factory. Refrigerating and air-conditioning machinery is the only type of industrial machinery singled out for taxation in H. R. 5417. Refrigerating and air-conditioning machinery for commercial and industrial purposes is the only industrial machinery on which it is proposed to level an excise tax in the House bill, and with only two exceptions it is the only commercial machinery on which it is proposed to levy an excise tax.

Senator DANAHER. You might include business machines.

Mr. HENDERSON. When I was speaking of the commercial machinery, Senator, it was of the automotive-truck type of equipment. I think of business machinery as appliances rather than machinery.

Senator BROWN. Well, we have been taxing automobiles, and things of that kind.

Mr. HENDERSON. Yes, it is proposed to tax a commercial truck. I say that that and commercial laundry machinery are the only types in addition to commercial refrigerating machinery on which it is proposed to levy a tax.

Now, the manufacturers of refrigerating and air-conditioning machinery cannot understand why their equipment, which is so indispensable, so vital to the national welfare and public health, should be singled out for this tax when there are hundreds of other types of machinery which are not so fundamentally essential to our national welfare which are not proposed to be taxed.

Senator BROWN. Did you include photographic apparatus also? That is taxed.

Mr. HENDERSON. No; I did not, Senator.

Again, that is more an appliance than a machinery item. My thought may be wrong.

Senator BROWN. Optical equipment is also taxed.

Mr. HENDERSON. Yes.

Senator LA FOLLETTE. Mr. Henderson, does the refrigerating industry use any more so-called strategic defense materials than any other machinery-manufacturing industry?

Mr. HENDERSON. We use a great deal, Senator La Follette. We do not use more than the general run of machinery industry.

Senator LA FOLLETTE. The only explanation I have heard anybody give—I am not sure it is an explanation—for singling out some of these things for taxing was that they interfere with the defense program. I cannot see how this particular industry has any more materials for defense, unless you know of some reason, than some other industry turning out machinery which is not taxed.

Mr. HENDERSON. That is perfectly right, Senator La Follette.

Senator LA FOLLETTE. You do not have to have any special kind of metals, do you?

Mr. HENDERSON. No; not any more than the general run of machinery, I would say.

Senator LA FOLLETTE. That is what I am driving at.

Mr. HENDERSON. Yes; that is what we cannot understand, Senator, why we should be singled out over all these other types of machinery to bear this tax.

Senator LA FOLLETTE. Maybe somebody used a method of taking a number from 1 to 10.

Mr. HENDERSON. It may be; yes. I might say a great deal of our production now, better than 40 percent, is going into defense. By that I mean the Army and Navy, the merchant marine, the munitions factories, and other direct and indirect defense users are the heaviest customers today.

Senator BARKLEY. Is it not a fact, too, that such metal as you do use in the commercial refrigerating plant is only a small percentage of the total used by refrigerating plants generally? I am including the household box.

Mr. HENDERSON. We would almost have to take a specific metal, Senator, to answer that exactly, because some manufacturers use a particular metal in their machine which another might not use. For example, one might use an aluminum-alloy piston and another a cast-iron piston.

Our industry is not objecting to this tax per se, because we are willing to pay our fair share. We do realize there are tremendous expenditures which have to be met in the defense program and that it does call for heavier taxation. We are willing to bear our fair share. We do think the gentlemen of the committee will agree that the singling out of this one industry above all others is manifestly unfair. We do ask that the 10-percent excise tax on the sale of commercial and industrial refrigerating and air-conditioning machinery be eliminated from the revenue bill of 1941.

I would be glad, Mr. Chairman, to answer any questions which the members of the committee might have.

The CHAIRMAN. Are there any questions?

Senator LA FOLLETTE. There is one other thing I would like to ask you. There is a tax here on household refrigerators, is there not?

Mr. HENDERSON. I believe there is, Senator; yes; in the revenue bill. That is something which I have not brought up particularly. My interest is in the commercial and industrial types of refrigerating machinery.

Senator LA FOLLETTE. You make the machinery with which the ice manufacturers will have to make the ice, do you not?

Mr. HENDERSON. That is true; yes.

The CHAIRMAN. Very well, Mr. Henderson. Thank you very much.

Senator BROWN. I was to ask him one question.

The CHAIRMAN. All right, Senator.

Senator BROWN. When you sell machinery under this present 5½-percent tax, the household-equipment tax under the old revenue law, you add that to the price, don't you, just as the automobile manufacturer adds it to the price of the automobile?

Mr. HENDERSON. It will be added, I should imagine.

Senator BROWN. I mean, you have been doing it in the past.

Mr. HENDERSON. I could not say, because the manufacturers which I represent do not make the domestic type of refrigerating machinery; it is more the heavier type.

Senator BROWN. You are not complaining about paying the tax because the consumers are going to pay the tax. You do feel it is going to diminish your business by making the equipment which you sell more expensive?

Mr. HENDERSON. It is not that, Senator Brown; no. It will be the farmers, the industrial people, and people like the gentlemen from the resaurant association, who has just spoken to you, who are going to be unfairly hit, whereas the users of the hundreds of other types of machinery are not going to be taxed.

Senator BROWN. That is discrimination; is it not?

Mr. HENDERSON. That is discrimination, sir.

Senator BROWN. But the consumers generally are going to pay the tax. You are not going to pay.

Mr. HENDERSON. That is right.

Senator TAFT. It really increases the cost of distribution of all the food products.

Mr. HENDERSON. That is right, Senator; yes.

The CHAIRMAN. Very well, Mr. Henderson, thank you.

Mr. Holcombe.

STATEMENT OF A. H. HOLCOMBE, JR., PHILADELPHIA, PA., REPRESENTING NATIONAL REFRIGERATION SUPPLY JOBBERS ASSOCIATION

The CHAIRMAN. Mr. Holcombe, you are appearing in the place of Mr. Borden?

Mr. HOLCOMBE. Yes, sir.

The CHAIRMAN. All right, sir.

Will you state to the stenographer there, your name and address and for whom you appear?

Mr. HOLCOMBE. My name is A. H. Holcombe, Jr. I am the proprietor of Victor Sales & Supply Co., and vice president of the National Refrigeration Supply Jobbers Association. We are interested in a change in section 3405 of the proposed Internal Revenue Code amendment.

Our position in the mechanical-refrigeration and air-conditioning industry is that we are a group of independent, privately owned wholesalers who carry the stocks of equipment and supplies needed to service the refrigeration requirements of the country. We buy from the independent manufacturers and sell to the local refrigeration mechanics who do the actual service and repair work. There are approximately 250 such independent wholesalers distributed as needed throughout the entire country. This group has developed from scratch within the last 5 years, and become useful, self-sustaining, small business organizations in their communities.

Because of the distribution structure of our industry some companies will be favored and others penalized. By this I mean that those who both manufacture and merchandise direct to the consumer will pay the tax but once. The manufacturers' sales through independent wholesalers will be taxed 2 and 3 times. The above-mentioned 250 independent wholesalers represent the lifeblood of the industry as they form the bulk of the distribution channels.

As has been mentioned in previous briefs this tax is inflationary in trend as affecting food costs. Mechanical refrigeration only is being taxed and not its competitor, ice refrigeration.

The cost of mechanical refrigeration equipment in many cases is approximately 50-percent material and 50-percent labor of installation and service.

Mechanical refrigeration is essential in modern industry. Many of the common articles used in our daily life depend on it for mass production at low prices. Soap, movie film, medical supplies, chemicals, all of these and many others would be affected by increased costs. None of these items could be considered luxuries as could comfort cooling of offices and stores. Even this has been proved medically helpful as well as an aid to efficiency.

Mechanical refrigeration equipment as now scheduled will not compete with the national-defense program, but will supplement it.

Our industry is already feeling the impact of the defense program seriously and will need all of its resources in order to keep existing food preservation equipment in operation.

We favor a general manufacturers' sales tax to be collected at the source on all commodities, exempting certain foods. This will spread the effect evenly throughout all industry and bring in a more substantial revenue compared with the relatively small amount expected from this section of this bill.

Senator BROWN. I want to interrupt a moment. You say you fear this tax is going to be pyramided. The manufacturer will pay the taxes, then the wholesaler will also pay the taxes.

Mr. HOLCOMBE. Yes, sir.

Senator BROWN. That is not true in regard to paying the automobile tax. It is just paid once. This section 3406 says:

> There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate on the price for which sold, set forth in the following paragraphs.

Then, it includes sporting goods, luggage, and the electrical appliances that you are talking about. I do not think there is any double taxation there.

Mr. HOLCOMBE. We are thinking of the component parts that go to make up the servicing of this refrigeration equipment rather than the equipment itself. There would only be one tax on the complete unit, refrigerating unit, such as we had a picture of here a few minutes ago.

Senator BROWN. It seems to me that could pretty well be covered by regulation. I do not think it is the intent of this committee to pyramid that tax. I think it should be paid once and for all. I am glad you brought it up, because it ought to be clarified. It seems to me as it is now it is only one tax.

The CHAIRMAN. Is there something else you wish to put in?

Mr. HOLCOMBE. The previous speaker was asked about the amount of metal that had to do with national defense. We would like to enter into the record here some figures which have been collected showing the amount of the common metals that are used as compared to the amount of the same metals that are required for one battleship. Could we enter that into the record?

The CHAIRMAN. You mean that whole paper?

Mr. HOLCOMBE. Just this sheet, which illustrates the facts that are on there, not the diagrams.

Senator TAFT. I suggest he make a summary statement and put it in the record.

The CHAIRMAN. You may do that, if you wish to. You simply want to show the quantity of material used, do you not?

Mr. HOLCOMBE. That is right. The question came up about steel, for instance. The steel that is required by the commercial refrigerating machine manufacturers is the steel required for one-fifth of a battleship.

Senator BROWN. You mean that is all the steel that is used in one year?

Mr. HOLCOMBE. That is right. We will make such a table.

The CHAIRMAN. Yes.

Mr. HOLCOMBE. Thank you, sir.

(The table referred to by Mr. Holcombe is as follows:)

There were 361,000 commercial refrigerating machines sold in 1940. To make these requires:

28 tons of tin=that required in 7/10 of a battleship=3/10000 United States consumption.

153 tons of zinc=that required in 3/10 of a battleship=1/5000 United States consumption.

187 tons of aluminum=that required in 2/5 of a battleship=9/10000 United States consumption.

232 tons of rubber=that required in 2 9/10 battleships=2/5000 United States consumption.

1,072 tons of copper=that required in 1 battleship=1/1000 United States consumption.

5,729 tons of steel=that required in ⅕ of a battleship=1/5000 United States consumption.

The CHAIRMAN. Mr. Donald Callahan.

STATEMENT OF DONALD A. CALLAHAN, WALLACE, IDAHO, REPRESENTING THE IDAHO MINING ASSOCIATION

Mr. CALLAHAN. My name is Donald A. Callahan. I live at Wallace, Idaho, and I am representing here the Idaho Mining Association.

This association comprises several hundred mining operators in the State of Idaho, those who have producing mines and those who are still engaged in the ceaseless search for metals of commercial value.

Idaho is a State producing many metals—lead, zinc, copper among the base metals, and silver and gold among those of a more precious character. In addition to this, there is a great variety of what are known as strategic and critical minerals to be found in the forbidding mountains of the State.

I have read, or rather tried to read, section 204 of the House bill. It has to do with deduction of excess-profits tax and apparently reverses the procedure in the present law. As I read it, if this bill becomes law, the taxpayer must first deduct the excess-profits tax in computing net income. So, we find this confusing situation, as I see it. I cannot determine my excess-profits tax until I have determined my net income which tells me how much I have made that is subject to excess-profits tax. And I cannot determine my net income until I have deducted the excess-profits tax which cannot be determined until I have determined the net income which determines whether I have made any profits which are subject to the excess-profits tax. Can you imagine the bookkeeper of one of our isolated mining companies trying to make sense out of this section?

It reminds me of a statute passed by the legislature of one of our Western States a few years ago. The statute was a safety measure intending to do away with accidents where two railroads crossed one another. The provision was simple and highly effective. Upon the approach to the intersection of trains on each track, neither was to proceed until the other had passed.

In considering the bill which is before you, I am going to take a text. It is a quotation from Montesquieu's Spirit of the Laws, that

eighteenth century treatise on government which had such a tremendous influence upon the men who founded this Republic. I am going to quote an entire chapter of that book, chapter 13, which is subtitled "An Idea of Despotic Power." This is the shortest chapter in the book, consisting of but a few lines, but they are full of meaning. Here they are:

> When the savages of Louisiana are desirous of fruit, they cut the tree to the root, and gather the fruit. This is an emblem of despotic government.

I have chosen this text because I believe sincerely that the bill before you does that very thing. The object of the bill, of course, is revenue, and the framers of the bill have set themselves a goal, a very definite goal. They are seeking to gather for the use of the Government a large share of the fruits of the labor, the sacrifices, the genius and the perseverance of those who are engaged in business throughout this Nation. Our industry is willing to give its share of these fruits. It hopes, however, that in order to gather this fruit, they do not lay the ax to the roots of business itself.

In his statement before your committee the Assistant Secretary of the Treasury, Mr. Sullivan, set forth that of the total amount to be realized under the bill, 26.7 percent will be derived from increases in individual income taxes, 41.6 percent from increases in corporation taxes, 4.7 percent from increases in estate and gift taxes, and 27 percent from new excise and increases in existing excises. We can add together the percentage from increases in corporation taxes and that from excise taxes, and put down as the direct increase in taxes upon business under this bill 68.6 percent of the total amount to be realized under the bill. This is essentially a bill to tax business. While the excise taxes in many instances will be passed on to the ultimate consumers, the first impact is upon business, and business must adjust itself to it.

The Secretary of the Treasury is right when he says that people are willing to pay increased taxes to meet the cost of this defense program. I know that this is true among the people whom I represent. I am here not to protest against the amount of the revenue to be derived under this bill; I am here rather to call your attention to certain inescapable facts as to the effect of the method provided in this bill for levying these taxes upon the business which I represent. I am here to call your attention to the inequitable effects of the provisions of this bill as they are applied to the mining industry. I am here to tell you that the effect of this bill will be to seriously hamper and cripple an industry which is essential to defense and to the continued material welfare of the people of this Nation.

I do not set myself up as that superman who can truthfully say that he understands all the provisions of this bill. I most humbly take my hat off and bow before the genius who can put together words and figures in the manner in which they are combined in this piece of legislation. The men who framed this bill are not only clever, but they had a singleness of purpose, an objective, and that objective was to raise money for the support of Government, and particularly to pay a part of the cost of defending the institutions

of America. Within the spacious rooms of our beautiful Government buildings it was easy to sit down, far removed from the worry, the toil and sweat of producing those things so necessary to defense and common welfare, and exert their genius only upon the object of getting money into the public treasury. Now that they have finished their work, those of us who have tried to reach a conclusion as to the effect of such a bill, if it becomes law, come to you, the representatives not only of the Government but of the people and the business of the Nation, and ask you to give very careful consideration to certain interpretations which we give as to the effects of this legislation. We know the disadvantage under which we labor, but we also have firm faith and confidence in your desire to prevent the swivel-chair experts of the Government from seriously crippling the business of the Nation. We know that you do not want to have these expert marksmen kill the geese that lay the golden eggs of revenue. The Government is going to need revenue even after the emergency has passed.

Now, getting down to the particular business which I represent, the mining business. It differs, perhaps, from any other business in the Nation. First of all, it is an extractive industry, dealing with natural resources. It does not create the basic values of the mines. A wise Providence put the real values into the metals which we extract from the ground. Patient, toiling men found them in the most forbidding places. Trained engineers and geologists gave of their talents to extracting these metals from the earth. Brilliant, hard-working, patient metallurgists tested and tried until they found the best means of recovery of these metals in order that they might be placed in commerce.

In this age and under the conditions of modern warfare there is no industry so essential to our future safety and happiness as the mining industry. Every nation in the world is seeking the sources of metals with which to shape their engines of destruction. Our own Government has appropriated large sums of money to search for certain metals within our own domain, and to acquire stock piles of critical and strategic metals from abroad. We must not, through a measure such as this, destroy one single incentive to search for, to extract, to benefit, and to utilize the precious stores of metals with which this country of ours has been blessed. If we are to continue to be the arsenal of the democracies, our basic supplies of these metals must not be curtailed. We must have increased production.

A steady production of base metals depends upon exploration and development of additional ore bodies. This requires an unremitting program entailing the expenditure of vast sums of money which may never be returned, and an unceasing and expensive search for metallurgical processes which will make low-grade ore deposits commercially profitable. Accordingly, any tax bill which does not recognize the necessity for putting back into exploration and research a certain proportion of the amount realized from the extraction of ores is absolutely destructive.

Why is this policy so essential? It is because mining is a devastating industry. The nature of mine property differs from other forms of fixed property in that the mine property itself is reasonably consumed

in providing what we are accustomed to call operating profit. A mine is not a permanent property whereof the fruit only provides profit; on the contrary, in the mine the capital itself is necessarily consumed for the purpose of profit. No matter how extensive an ore body, it has its limits. Not man but nature formed the metals which are used in commerce. It has been given only to man to find the minerals in which these metals are contained, bring them to the surface of the earth, and extract the metal content from them. In this process the miner is necessarily using up his capital, that is, the units of metal which go to make it up. He cannot re-create them. It may be that there are more units of metal in the property than he anticipated. It may be that there are less. In either event they are limited. One day they will all be extracted and used up if his production program continues. A tax bill seeking not only revenue but to promote the effectiveness of a defense program must recognize this fact. This tax bill does not recognize this fact. It recognizes no difference between the business of mining and that of any other industry.

The mining industry is in a unique position. In the first place it is cooperating patriotically in the policy of the Government to maintain a ceiling on metal prices, thereby preventing a runaway market, and making it possible for the Government to secure its necessary metal supplies at a price which is practically the average price for base metals over a period of 40 years. There is no profiteering in the metal industry.

At the same time the Government is urging an increased production. There is a department in the Office of Production Management which has to do with the accumulation of strategic and critical metals and which is using every means within its power to bring about increased production from existing mines, and to encourage development and exploration of new ore bodies. So critical has the metal situation become that we find the Government contracting for the importation of large supplies of metals to be allocated to the various defense industries. We also find a very determined effort being made to suspend tariffs on metals until the passing of the emergency. In the meantime the Government itself is paying the tariffs upon the metals imported. All of these facts go to show that the metal situation in the United States is critical and deserves special consideration upon the part of this body before it finally determines just what treatment to accord the mining industry under the provisions of this bill.

Now let us consider the position of the prudent mine operator, caught between two fires. On the one hand his patriotic cooperation in maintaining a normal price level per unit of production; on the other, the demand of the Government for increased production and the expenditure of large sums of money in exploration and development and provision for additional plant facilities. This operator realizes that the production of additional units of metal in response to this urgent demand results in a using up of his capital. If he produces them now they are gone from him forever and cannot be replaced. Naturally, other things being equal, he will increase his production and extend his plant facilities, although he knows that when

the emergency passes those facilities will be useless to him. But there is a job to be done, and he is one of the essential factors in getting this job of defense accomplished in a thorough manner. Perhaps he thrills at the idea of being able to aid so materially in this all-out effort.

Now along comes this tax business. If he doubles or trebles the number of units produced in any year he will double or treble his income from the property for that year, even if he will receive no more per unit than the average over a long period of years. When he comes to make up his tax return he will find that this increased revenue has brought about what the Government calls excess profits. His patriotic willingness to take a risk in expending money for exploration, development and new plant facilities, his using up of the capital which can never be replaced, has resulted in putting him in a position where he must pay over to the Government, depending, of course, upon the tax credit which varies so greatly in individual mining enterprises, and the total amount of his income, a proportion of his earnings which can reach the staggering figure of more than 70 percent.

Now, if it were a business which does not consume its capital in its operation, the operator could very well say, "I will be as well off after the emergency passes as I was before, because I can continue my business, secure new raw material, and produce according to the demands of the market." But not so with the miner. His units have been used up; his capital has been exhausted. He finds a depleted mine and useless plant facilities.

This is inevitably having the effect of retarding the investment of money in mining enterprises. It is offering the temptation to hold down on production. It is offering such a barrier to the all-out production which the Office of Production Management desires that that branch of the Government is tremendously concerned. You members of this committee and the Congress of the United States have the answer to this problem, and you are the only ones who can remedy the situation presented by the program of the Treasury Department. You are standing here between this tax-collecting bureau and an essential industry of the Nation, and you must consider, in the decision which you finally make, the effect which that decision is going to have upon the defense program, which is the first consideration of our Government and its people at this moment.

I am going to offer a suggestion as to how you can correct the situation implicit in the bill before you. You have ample warrant for treating the mining industry as to the production of metals so necessary at this time in a manner different from that of any other industry. Your warrant is the necessity of production for our defense program, coupled with the fact that in providing the metals the mining industry is exhausting the units of metal which are its capital. Here is the proposal:

The mining industry should be asked to pay an excess-profits tax for additional production over its normal production during the past 4 years only upon the excess created by an increase in the profit per unit produced and sold. The profits resulting from an increased production should be subject only to normal tax, which, believe me, in the case of mines is very high.

It may be said that a formula to bring this about would be very difficult. I said in the beginning that I have utmost admiration for the ability of the experts who write these tax bills. If they can put words and figures together as they have to squeeze out of the taxpayer the last possible penny of revenue, they surely have genius enough to use the same words and figures to meet a peculiar situation which is so important to the welfare of our Nation. Tell them that your want such a formula written, and they will bring it back.

Secondly, it has been pointed out to you that because of the condition of the mining industry during the past several years the tax credit, before the imposition of excess-profits tax, works a distinct hardship upon individual mining properties and penalizes them to an extent which in many cases practically puts them out of business. Under previous excess-profits-tax laws machinery was provided for the treatment of special cases of this character. Suggestion has been made to you of a means by which this can be brought about, not only as affecting the mining industry but many other industries similarly placed. I do not like to call this special relief. The word "relief" in a situation such as we have confronting us in this Nation has a sinister sound. I would rather say that there should be a means provided for affording equitable adjustment of abnormal tax situations.

Thirdly, a provision should be made for giving credit for obsolescence of plants erected specifically to meet this emergency. It can be done very easily by providing for special deductions over the period in which it is anticipated these facilities will be used. A mining plant located perhaps in an inaccessible section of the country will have no value whatever once the production which warranted its erection has ceased.

In conclusion, I want to say this: The mining industry stands ready and has been ready and willing and anxious to assist and to give all it has in this great defense effort. I know that even if you do not see fit to recognize the peculiar conditions which I have tried to call attention to, and permit this bill or something similar to it to practically eat up the substance of our mining properties, the mining industry will not go on strike. But it should not be asked to make such a sacrifice. It should not be forced to make decisions such as will be required if this tax bill is passed in its present form. Its managements are loyal. They love the institutions of this country, because they believe they are the fairest and the best of any government in all the world. You do not want that faith shaken and destroyed. You want to encourage it, and you have the power to do so.

Everybody is asked to make sacrifices and concessions in this great emergency, in this all-out effort to defend our beloved country. Everybody, I say, except the Government itself. It goes on its merry way, and men and women toil and accumulate incomes which are to be taxed; business executives give up their work of lifetimes and come into the Government to assist with whatever genius they possess; men go down into the bowels of the earth to take out these important metals; men go into the forest to hew the trees and convert them into lumber so essential; railroad executives bend every effort to afford transportation of military and nonmilitary commodities. Everybody

is giving up something important in his life. Everybody except the Government. Its hordes of public servants crowd the streets of Washington and many of our other cities. Its beautiful buildings are filled and filling still more with civil servants. Its agents are traveling up and down the face of the earth regulating and regimenting the industry of the Nation. It is not too much for those of us who have to do with a production so essential for the defense of this Nation that we ask also for a little sacrifice upon the part of the Government, a little tightening of the purse strings, a little lessening of the all-out effort to control and regiment a business which must be free now in an hour of emergency to provide those goods and services so essential to the preservation of this Nation. You men of this committee, the Congress of the United States, in my humble opinion, should give some thought to this.

I am attaching hereto certain examples of the effect this bill would have upon actual mining enterprises in my State. I hope that you can find time to examine them.

EXAMPLES OF THE EFFECT OF PROVISIONS OF THIS BILL UPON ACTUAL MINING ENTERPRISES

Let us presume five different mines contiguous to each other and competing in the same market. The mines have exactly similar ore bodies. Each produces 100,000 tons of ore per annum.

The base period income of those corporations which were in production during all or part of the base period was the rate $150,000 per annum; it is presumed that those corporations which were not in production during any part of the base period would have had similar earnings if they had been in production. During the excess-profits period—say, 1941—each makes $300,000 per annum before taxes, and, presumably, each will pay to the Federal Treasury the same amount of tax.

But, unfortunately, this is only a presumption. Actually, the taxable status of each is quite different, due to accidental factors which have not even a remote relationship to true excess profits, or to any profits whatever arising from the defense program.

Mine A was purchased in 1929 at the peak of prices; it has invested capital of $3,000,000. It has base-period earnings of $150,000.

Mine B was purchased on January 1, 1940; its invested capital is $3,000,000 and has no election between credit based on invested capital or base period. It must use invested capital.

Mine C was purchased in 1932, at the depth of the depression, and has invested capital of $500,000. It also had base-period earnings of $150,000.

Mine D was discovered by the taxpayer, and came into operation during the base period; its base-period earnings are $75,000, and its invested capital is $250,000.

Mine E was discovered; it has invested capital of $250,000, but the corporation was not organized until January 1940. Therefore, it is compelled to use invested capital in computing its excess-profits credit.

The total of normal and excess-profits taxes to be paid by each corporation under proposed 1941 rates would be as follows:

Mine	Income before taxes	Total tax	Effective tax rate, percent	Tax per ton of output
A	$300,000	$112,050	37.23	$1.12
B	300,000	104,875	34.96	1.05
C	300,000	137,423	45.81	1.37
D	300,000	162,363	54.12	1.62
E	300,000	181,175	60.39	1.81

The fact that such widely varying results are obtained in computing the tax on what is in effect the same income brings forcefully to mind the absolute necessity for some form of special relief. There seems little either of equity or common sense in a rigid tax law that takes 60 cents out of each dollar of income accruing to E and only takes 35 cents from B. Particularly is this true when it is considered that the profits of each are won under identical conditions.

Recently much has been heard of the necessity of increasing the production of materials entering into the defense work, and particular attention has been paid to increased production of metals.

The mining industry as an industry is thoroughly alive to the necessity of increasing production. When, however, as to an individual taxpayer, the result of increasing production is the payment of excess-profits taxes on what are in reality normal profits, such a taxpayer is rather heavily penalized if he does give the cooperation he would like to give to increase production.

Illustrative of this statement, a computation has been made of the tax result in the case of the five mines instanced above of a 40-percent increase in output and profit. The profit of each corporation would be increased by $120,000, and the tax result would be as follows:

Mine	Increase in annual profit	Increase in tax	Effective tax rate on profit increase, percent	Tax per ton of increased output
A	$120,000	$76,425	63.69	$1.91
B	120,000	75,425	63.69	1.91
C	120,000	78,787	65.66	1.97
D	120,000	81,281	67.73	2.03
E	120,000	82,200	68.50	2.07

On the increased output of 40,000 tons, however, the amounts remaining to the different taxpayers after payment of taxes are as shown:

Tax per ton of output

Mine	Ordinary production (100,000 tons)		Increased production (40,000 tons)	
	Tax	Net to taxpayer	Tax	Net to taxpayer
A	$1.12	$1.68	$1.91	$1.09
B	1.05	1.95	1.91	1.09
C	1.37	1.63	1.97	1.03
D	1.62	1.38	2.03	.97
E	1.81	1.19	2.07	.93

A final table is appended, illustrating not only the unfair competitive condition created by the excess-profits tax, but the increasing tax cost of increased production. This table follows:

Tax per dollar of profit

Mine	Ordinary production (100,000 tons)	Increased production (40,000 tons)	Average on total production (140,000 tons)
	Cents	*Cents*	*Cents*
A	37	64	45
B	35	64	43
C	46	66	51
D	54	68	58
E	60	69	63

From the above it is quite apparent that the proposed rates and provisions definitely impose an excess-profits tax on normal profits, and the tax is imposed at such high rates that there cannot but be a definite reluctance to dissipating an ore body of limited extent without even a normal profit.

Now, then, we are faced with this unique situation: The Government, as I said, is urging us to increase production. On the other hand, the industry is cooperating with the Government in keeping down the price of metals. There is no profiteering in the mining industry at all. The price now is only a little above the average price for base metals over a period of 40 years. That policy has been continued during all this defense effort, and will be continued, I believe, because the mining industry is cooperating, together with the petroleum industry, in the effort to keep the prices down in the very essential materials.

Here is our situation: If we increase the production of units of metal in response to the Government's demand and at the same time do not receive any more per unit, we are still faced with the fact that at the end of the year, when we come to make up our tax return, because of the increased volume of production due to this demand we have made what might be called a larger profit. In doing this we have used up our capital; in doing this we are taking out the units that might have been left there for future years, and in doing this we are adding to what may be called profits because they are coming in this year's business, added to what we had before, but they are not actually excess profits, because the price of the unit has not been increased. These profits, if there are any, simply come from increasing the number of units that you produce during the year.

Senator GERRY. Are not you in much the same condition as the coal companies?

Mr. CALLAHAN. Yes, indeed. I cannot see any difference, except, perhaps, that coal seems to have an almost inexhaustible supply ahead of them. In the mining business, our mine bodies are developed for a certain period. It is not good practice, and it has not been, to develop too far ahead of your operation. We do not know how many there are there; we do not know anything about the content of the ore body. The geologist and engineer may make an estimate, but it is only an estimate. The ore we take out today can never be replaced, it never grows again. Consequently, we must add new ore bodies; we must keep developing those we have. In doing that, of course, we are reaching the point where we are going to mine what might be called marginal bodies of ore, where the cost of production is very much greater.

In addition to that, in order to take out this increased production we must build additional facilities to treat the increased production, and those increased facilities will be absolutely of no value to the mining company after the emergency which demands the increased production has passed. Therefore, I want to endorse what Mr. Fernald for the American Mining Congress said this morning, that opportunity be given to depreciate the additional facilities over the reasonable life of the use of the facilities that are provided.

The CHAIRMAN. Before you go, there might be some questions that somebody might desire to ask you.

Mr. CALLAHAN. Yes.

The CHAIRMAN. You do have a depletion allowance, do you not, against your investment?

Mr. CALLAHAN. We have a depletion allowance, but you remember that depletion allowances should be allowed against production even if excess profits do not apply.

The CHAIRMAN. Yes; of course.

Mr. CALLAHAN. That would be allowed just the same after the passage of the emergency if the ore were taken out.

The CHAIRMAN. Let me ask you, generally speaking, taking the small and medium-size mining operations, are they almost compelled to adopt the prior-earnings base credit, rather than the invested-capital base?

Mr. CALLAHAN. Practically so. One reason was given very clearly by Mr. Willis this morning as to the difficulty of having the invested capital base, because of the fact that so much goes into the opening up and bringing into production of the mine, which is really its capital investment, but is not in dollars and cents.

The CHAIRMAN. It is not kind of capital investment that the Treasury allows?

Mr. CALLAHAN. No; they do not allow that kind of capital investment at all.

The CHAIRMAN. Are there any further questions?

Senator TAFT. You are against eliminating that exemption of the strategic materials?

Mr. CALLAHAN. Very definitely; yes.

Senator TAFT. Is your company concerned with those materials?

Mr. CALLAHAN. My company is not; no. In the particular district in which we live we do not have any of those strategic metals, but we have in central Idaho, and we have vast potentialities in that direction. As a matter of fact, the United States Bureau of Mines and Geological Survey, under its appropriation of $500,000 a year which was made several years ago, has been making some intensive examinations down there that we believe have uncovered some sources of those very valuable strategic metals.

I want to endorse heartily what Mr. Willis said with regard to that this morning. I think it is extremely important that that section be put into the bill.

The CHAIRMAN. Thank you very much for your appearance.

Mr. Leo J. Hoban.

STATEMENT OF LEO J. HOBAN, WALLACE, IDAHO, TREASURER, SULLIVAN MINING CO.

Mr. HOBAN. My name is Leo J. Hoban. I am treasurer of Sullivan Mining Co., the main office of which is located at Wallace, Idaho. Sullivan Mining Co. owns a zinc-lead mine, located near Burke, Idaho, and an electrolytic zinc smelter, located at Silver King, Idaho.

My purpose in requesting a hearing before this committee is to point out the manner in which the Second Revenue Act of 1940, both as at present constituted and as proposed in the House bill now under consideration, inflicts almost confiscatory taxes on Sullivan Mining Co., thereby impairing our competitive position in the industry.

In discussing this matter I will confine my presentation to the affairs of the company with which I am connected, and with whose affairs I am familiar; however, my conversations with the representatives of other small companies in the industry convince me that many small taxpayers have the same sort of problem and are subject to the same sort of discrimination as Sullivan Mining Co.

History of Sullivan Mining Co.—Sullivan Mining Co. was organized in 1917, and after years of development, the Star ore body was discovered in December 1924. There was no domestic outlet, on a reasonable basis, for the zinc concentrate production, and for several years we were compelled to ship these concentrates to Belgian smelters. This was an unsatisfactory situation, and in 1926, even this market having been cut off, construction of an electrolytic zinc smelter was started, which was completed and put into operation during October 1928.

The mine has not been profitable at ordinary metal prices; the smelter has been profitable, except during periods of depression. Due to large losses suffered during the depression, and which were never recouped, the corporation had an operating deficit at December 31, 1939, of $1,035,000, and the investment in the mine and smelter was about $9,000,000.

Operations during base period—Star mine.—On January 1, 1936, the Star mine was operating; its output was about 375 tons per day; the ores were beneficiated in a leased concentrator. The mine was forced to close in December 1936, when the leased concentrator was no longer available. By the time the shut-down occurred the output of the mine had increased to 600 tons per day. Upon loss of the use of the leased concentrator, construction of our own concentrator, with a capacity of 850 tons per day, was authorized, and it was placed in operation in August 1937. The mine was again forced to suspend operations in February 1938, due to low metal prices incident to the depression that started about that time. Production was resumed in September 1939 and has since continued at a rate of 850 tons per day.

Electrolytic zinc smelter.—Early in 1937 an increase of the productive capacity of the smelter was authorized to provide for the expected increase in production from the Star mine. The new unit was completed in February 1938, but the shut-down of the Star mine left it without a supply of concentrates on which to operate. The new unit was compelled to lie idle, therefore; in fact, by April 1938 it became necessary to shut down one of the two units of the original plant. In September 1939 the second unit resumed operation, and the new third unit was placed in operation for the first time on December 1, 1939.

Senator DANAHER. Will you pardon the interruption? Over that interim, from 1938 to September 1939, was zinc being imported into this country?

Mr. HOBAN. I think in 1937 there was some importation of zinc, but that was not due to lack of capacity of the zinc industry, it was due to the shortage of water which cut off electric power at the zinc plant in Montana. We were not handicapped in that manner.

Senator DANAHER. Thank you.

Mr. HOBAN. Inadequacy and discriminatory nature of base-period credits:

There are a number of reasons why the excess-profits credits based on the average income method are unsatisfactory and discriminatory

as applied to Sullivan Mining Co. Principally these reasons are as follows:

(*a*) The period 1936–39 was distinctly a subnormal period in the zinc-lead industry.

The base period years, 1936 to 1939, inclusive, were not average years for either zinc or lead. Almost any combination of years, except pure depression years, would have given a more reasonable average.

The arithmetical average St. Louis price for zinc for the base period years was 5.29 cents per pound.

Following are the averages for other periods:

	Cents
1904 to 1913	5.57
1914 to 1918	9.47
1919 to 1935	5.61
1936 to 1939	[1] 5.29
1904 to 1935	6.20
1904 to 1935 [2]	5.60
1904 to 1939	6.10
1904 to 1939 [2]	5.56

[1] Base period average.
[2] Excluding 1914 to 1918.

The years 1904 to 1913 are the 10 years preceding the first World War. They include the short-lived prosperity extending through 1906 and the first three quarters of 1907 and the years of stagnant business thereafter. There was no income tax in effect prior to March 1, 1913, and thereafter was a rate of only 1 percent. There was no National Labor Relations Act, no restrictions on wages and hours, no reciprocal trade program, no capital-stock tax, and no social-security tax; yet during that period the price for zinc was 0.29 cent per pound higher than during the selected base period.

The years 1914 to 1918 were the war years, when prices reached fantastic levels. The average of these years is set down here merely to complete the record.

The years 1919 to 1935 included the short boom after 1918, the depression of the early twenties, the prosperity of the middle and late twenties, the devastating depression after 1929 when metal prices reached the lowest level in recorded history, and the first 3 of the recovery years. The average price during this long period of 17 years was 5.61 cents—0.32 cent per pound more than the selected base period years.

The grand average for the years 1904 to 1935, inclusive, is 6.20 cents per pound, 0.91 cents per pound more than the average for the base-period years; even if we exclude the high prices for the years 1914 to 1918 but leave in the average low levels of the 1929 and later depression years, the average is found to be 5.6 cents per pound, an excess over the base-period years of 0.31 cents per pound.

The grand average for the years 1904 to 1939, inclusive, is 6.10 cents per pound, and if we exclude 1914 to 1918 we find the average is 5.56 cents per pound, an excess over the base-period years of 0.27 cents per pound.

The comparative figures for lead, New York price, are as follows:

	Cents
1904 to 1913	4.62
1914 to 1918	6.21
1919 to 1935	5.97
1936 to 1939	[1] 5.13
1904 to 1935	5.59
1904 to 1935 [2]	5.47
1904 to 1939	5.54
1904 to 1939 [2]	5.43

[1] Base period average.
[2] Excluding 1914 to 1918.

It will be seen that, except as to lead for the period 1904 to 1913, every period stated above, and every combination of periods, gave a higher average result than is the case in the selected base-period years.

It is quite apparent, therefore, that 1936 to 1939 were not representative years either as to zinc or lead, and that excess-profits taxes, at extremely high rates, are being paid by the zinc and lead miners on what are in reality merely normal profits.

Senator BROWN. We recognized that possibility when we wrote the last tax law. A great deal of effort was made by this committee to enact a hardship statute to cover that situation. One was adopted on the floor of the Senate; and then the chairman, the present chairman, Mr. George, largely was responsible for rewriting that section when the bill went to conference; and when it came out we thought we had a reasonably good hardship statute. I note in reading on a little ahead that that did not aid you any.

Mr. HOBAN. That did not aid us any.

Senator BROWN. My question is: Why could not you use it?

Mr. HOBAN. You mean what, Senator?

Senator BROWN. The hardship statute. I think it is section 722.

Mr. HOBAN. I am just coming to that, sir.

I give you two good examples of why that does not do us a bit of good.

(*b*) The limitation in section 722 (b) (4) effectively prevents Sullivan Mining Co. from obtaining recognition of its increase in capacity during the base period.

That is what you refer to, Senator.

The CHAIRMAN. That is it; yes.

Mr. HOBAN. During the base period, Sullivan Mining Co. increased its productive capacity at the mine from 375 tons per day to 850 tons per day. It also increased its smaller capacity from 65 tons per day to 115 tons per day.

Section 722, relating to adjustment of abnormal base period net income specifically recognizes a difference in the capacity for production as one of the abnormalities which justify adjustment of the base period income. However, section 722 (b) (4) further provides that the base period income so adjusted shall not exceed its excess-profits net income as adjusted for the last year in the base period. Since 1939 was for Sullivan Mining Co. the poorest year in the base period, with the exception of 1938, which was a deficit year, and since all the additions to productive capacity had been made prior to 1939, and, therefore, that year is not seemingly subject to adjustment, the net results is that the entire increase in productive capacity is subject to excess-profits taxes, since the base period net income of Sullivan

Mining Co., computed under section 713 (d) is greater than the excess-profits net income for the year 1939.

Senator BROWN. Did you hear that, Mr. Stam?

Mr. STAM. What?

Senator BROWN. Do you understand what Mr. Hoban was saying here about a criticism of our hardship statute?

Mr. STAM. Yes.

Senator BROWN. Do you agree with what he says, that it was impossible for them under those circumstances to get relief?

Mr. STAM. The only thought I had in mind was that possibly he is taking the position that it is the actual income for that last year of the base period that he had to take, and under the statute as written it seems to me that he could construct a proper income for that last year of the base period, and that would be his credit. In other words, the credit could not exceed the income for the last year of the base period, but it must be constructed rather than actually for that last year. In other words, if these same conditions had been eliminated, this strike and everything in the last year of the base period, he might have had a higher base period income than he actually showed, and that would be the limitation rather than the actual income.

Mr. HOBAN. I would be very happy if that were true, Mr. Stam, but these facilities were all constructed, and in being prior to January 1, 1939. That being the case, and they were not in use in 1939, is it your opinion that we could reconstruct 1939?

Mr. STAM. I think there is a chance that you could; yes.

Mr. HOBAN. All right, sir.

It the investment in increased capacity had been made in 1940, rather than during the base period, section 714 (a) (1) (B) would have allowed an addition to the base-period earnings, excess-profits credit of $128,000, being 8 percent of the investment, $1,600,000. When it is considered that the concentrator operated for only 9 months and the new smelter capacity for only 1 month, of the base period, and, therefore, added only negligibly to base-period earnings, it would seem that something less than justice is being accorded Sullivan Mining Co.

Section 722 (a) (2) would seemingly allow Sullivan Mining Co. an adjustment of base-period earnings, since there was an abnormal shut-down due to the loss of use of the leased concentrator. However, section 722 (b) (4) again intervenes, and for the same reasons outlined above as to increased capacity, any adjustment is denied.

Undoubtedly it was the intent of Congress to recognize abnormalities such as those described above, and to provide equitable relief, but the provisions for relief were so circumscribed and limited that many taxpayers are deprived of the relief to which they are equitably entitled.

Senator BROWN. That is exactly what we tried to do.

Mr. HOBAN. I will discuss this, Senator, with Mr. Stam. If I made a misstatement here, I would like to have an opportunity to correct it.

Senator BROWN. I grant we did go into it at considerable length.

Mr. HOBAN. The limitation of the last year in the base period is what ruins us.

Senator BROWN. The original idea was to leave a great deal of discretion in the Commissioner, but subsequently we were persuaded, as

I said, to put limitations upon that discretionary power. I still think the only way it would tend to work out to meet the many abnormal cases that arise is by the provision which was in the law in 1918.

Mr. HOBAN. Yes; in 1917 and 1918.

Senator BROWN. We are very much interested in that problem.

The CHAIRMAN. Mr. Hoban, I might say that originally when the bill was on the floor of the Senate an amendment was put in that would have covered your case, but as Senator Brown has pointed out, subsequently in conference were not able to get through the provision that many others on this committee and in the Senate wished.

Mr. HOBAN. I hope you have better luck this year, Senator.

The CHAIRMAN. I think you should talk with Mr. Stam and the Treasury. It is quite probable that you are entitled to relief that you do not think now you are entitled to.

Mr. HOBAN. I would be happy to find that out.

The CHAIRMAN. You would not object to it?

Mr. HOBAN. Not a bit.

Senator BROWN. There is an excellent case, in his case, I will say that.

Mr. HOBAN. May I proceed?

The CHAIRMAN. Yes; you may proceed.

Mr. HOBAN. (*c*) No provision of the law provides for adjustment of base period earnings, where income in the excess profits period is increased by reduction of expense.

Two typical examples affecting Sullivan Mining Co. follow:

1. *Shut-down expenses.*—In the case of mines with many openings, shut-down expenses are very heavy. This is particularly true of the Star Mine, which has been opened up on 15 levels, through a vertical area of 3,100 feet. It has an 8,500 foot haulage tunnel, 2 shafts totaling 3,100 feet, and numerous stopes and cross-cuts. All the openings must be kept in repair during a shut-down, pumping, hoisting, mechanical, and electrical crews must be maintained, taxes, rentals, and other overhead expenses must be paid. The shut-down cost in the Star Mine is about $15,000 per month and when it is considered that the Star Mine was shut down for 27 out of the 48 months in the base period, it can be readily seen that the reduction in base period income, through failure to allow elimination of this abnormal expense, has resulted in a very substantial reduction in base period earnings.

Since the Star Mine resumed operations in September 1939, thereby eliminating the shut-down expense, it cannot be contended that this saving in expense has any connection with an increase in metal prices due to the defese program. It is difficult to understand how a saving in expense in 1939 becomes excess profits in 1940 and succeeding years. Yet there is nothing in section 711 (a) (1) which provides any adjustment of base period income on this account.

2. *Elimination of royalty payments, due to expiration of patents.*—In the construction of the electrolytic smelter, a patented process was used; royalties were paid regularly to and including April 1941, when the patent contract expired. The cost in 1940, that is, the cost of royalties, exceeded $42,000.

Here again it cannot be contended that this augmentation of income had anything to do either with increased metal prices, or national defense. Yet, under the law, the entire amount automatically

becomes excess profits net income, taxable in the highest bracket—a tax of 72 percent, combined excess profits and normal tax.

Inadequacy of excess profits credit based on invested capital.—The Second Revenue Act of 1940 allowed an excess profits credit of 8 percent on invested capital. This allowance was wholly inadequate to measure the profits of the mining industry which, in all of its phases from prospecting, through discovery, development, and operation, is a more than ordinarily risky business as far as capital is concerned. It is grossly unfair to lump all industry in a catch-all average rate. The use of an average rate results in an overallowance to certain classes of industry, whereas, other industries will receive less than a proper allowance. Evidently, it is already realized that some industries have been given an overallowance, hence the proposal for a special 10 percent excess-profits tax. Seemingly, however, there is no intention of extending relief to the industries which have received an inadequate allowance.

Quite the contrary, in fact. The House bill proposes a new method of computing the excess-profits tax. The report of the Ways and Means Committee is quite lengthy in explaining what could have been explained in a very few words—merely that the 8-percent allowance was being reduced to 5.6 percent on capital up to $5,000,000 and to 4.9 percent on capital in excess of that amount.

The equity of reducing by 30 percent an allowance already grossly inadequate needs no extended discussion. The 1940 provisions for levying the excess-profits tax on the excess profits net income, rather than on the normal net income as proposed in the House bill, should be continued.

Special 10-percent tax.—Sullivan Mining Co., will, in addition to a large tax at the highest bracket rates, be subject to the proposed special 10-percent excise-profits tax on the difference between the excess-profits credit on base-period earnings and the credit on invested capital.

Included in this tax is a relatively small amount which, however, is so inequitable that attention is called to it. In the use of the base-period-earnings method for computing the excess-profits credit, the credit is limited to 95 percent of the determined average. The limitation to 95 percent is strictly a penalty on the use of the average-earnings method.

The effect of the present proposal is to levy a tax of 10 percent on the 5-percent reduction of base period earnings even though the corporation has elected invested capital, and has no reason to expect to pay a penalty tax on the use of the invested-capital method.

Due to the limitations outlined in the discussion of the average-earnings method of computing the excess-profits credit, this special tax will be especially burdensome to Sullivan Mining Co.

Sullivan Mining Co. is not objecting to the rates of tax in the House bill. It realizes that the need for revenue necessitates high rates. It does feel, however, that revision of the law to remove inequities incident to its faulty construction are the more urgent at these high rates than when the rates were lower.

Most of the competitive disadvantages pointed out would disappear if provision were made in the case of mines for an excess-profits credit based on normal profit per unit of output. This would put

similarly situated competitors on the same plane, and more important than all else would remove the hesitancy on the part of the mine to dissipate an ore body and account for the profit at almost confiscatory tax rates.

The necessities of national defense are more important at this time than the need for revenue, urgent as that is. The need for revenue should not, at any time, obscure the necessity for fair tax laws, equitably applied. In addition, it is particularly important now that the operation of a tax law should not act as a brake on production, which is already far below our requirements.

The CHAIRMAN. Are there any questions?

Senator BROWN. I want to ask one more question, Mr. Chairman. I think you made an excellent case. You do not say very much about the reason you did not adopt the invested-capital theory.

Mr. HOBAN. We did adopt the invested-capital theory.

Senator BROWN. You did?

Mr. HOBAN. We did. Now, we have to compute our base-period earnings.

The CHAIRMAN. That seems peculiarly illogical to you, does it not, Mr. Hoban?

Mr. HOBAN. I agree with you, Senator.

The CHAIRMAN. That is, that you are on the invested capital base and you have no occasion to resort to the average earnings method, you could not use it. Your capital structure was such, and your prior history was such that you had to take the invested capital method.

Mr. HOBAN. That is so.

The CHAIRMAN. And the illogical situation arises because you were then referred to a credit base which you had never used, had not intended to use, to wit, your normal earnings, to determine on what sum you should pay this additional 10 percent, although you did not reach your minimum credit, your base credit under the invested capital.

Mr. HOBAN. That is true. It is only since I have been here in Washington studying this thing that I find all these inequities that I point out here. In attempting to compute the base period earnings I ran into all these different things.

The CHAIRMAN. You probably know the argument that was submitted before the House. I have every respect for these conscientious and able men who compose the House Ways and Means Committee and the Treasury. Although you have not earned, say, your 8 percent, or, say, 7 percent, or even the reduced percentage under the present method of computing, 4.9 and 5.6, although you have not reached that, since you have made more than you were making in the base period you should pay the 10 percent.

Mr. HOBAN. In other words, it is a good deal like using the unfortunate experience of past years to take a little bit more.

The CHAIRMAN. I have not been able myself to see how it can be logically justified, nor actually justified as it may be applied to a business, any kind of a business that cannot use the average earnings, has no occasion to use the average earnings, that has used the invested capital, and until it has made earnings in excess of its credit under

that system, even though you may say that it has profited some by the general defense program, the general spending on the part of the Government, that it should suffer that special tax of 10 percent.

Mr. HOBAN. It has profited through the increased price, but, on the other hand, it is being hurt very badly because of our inability to have recognized, as normal profits in the excess-profits period, the profit from the production of these units which result from an increase of productive capacity which was completed during the base period.

You asked Mr. Callahan a question as to whether or not it was not almost necessary for most mines to adopt base-period earnings rather than invested capital. I am also treasurer of another mine, a rather old mine, the Hecla Mining Co., which will probably have its ore body worked out next year. It adopted the unit method of depreciation and depletion, which means that, as you get to the end of the life of a mine, your invested capital in plant facilities practically disappears. Hecla Mining Company has a $2,000,000 plant. So long as there is ore to be extracted, it must have such a plant, even to the last day of the operation of the mine. On its books, however, the plant has a depreciated value of only $350,000, due to the gradual diminution of its book value through use of the unit method of depreciation.

The CHAIRMAN. Your capital has been depleted?

Mr. HOBAN. Yes.

The CHAIRMAN. You are obliged to diminish the capital earnings to stay in business at all?

Mr. HOBAN. That is right.

Senator JOHNSON. Mr. Hoban, after your conversation with Mr. Stam and the Treasury, if you find that you are mistaken in your statement here, you will give us a corrected statement, will you?

Mr. HOBAN. I will do so.

Senator JOHNSON. Because this is a point of tremendous importance, as you know, to the whole mining industry. I am sure this committee wants to be very sure of its ground.

Mr. HOBAN. I will be glad to do that, Senator.

Senator BROWN. Mr. Stam handed me the report of this committee headed by Senator Harrison in February of this year, in which the precise subject matter is discussed in that report.

Mr. HOBAN. I have a copy of that. I would not presume to get into a discussion with Mr. Stam, for whose ability I have too much respect. I will be glad, however, to discuss this. My own opinion, after reading this thing very carefully, is that the limiting provision that your base-period average shall not exceed the adjusted average of the last year is the thing that puts us out of business.

The CHAIRMAN. I am not at all sure that you are not right, Mr. Hoban, but I do think it worth while for you to talk with Mr. Stam and with the Treasury and see if you might not be permitted to reconstruct your last year in such a way as to afford you some additional relief.

Mr. HOBAN. I will be glad to do that. Thank you, sir.

The CHAIRMAN. Thank you very much for your appearance.

(The letter referred to follows:)

AUGUST 21, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: In the course of my appearance before the committee on August 19, I pointed out some of the difficulties confronting Sullivan Mining Co. The difficulties arise from what I consider unreasonable limitations of the abnormality relief provisions of section 722, and specifically section 722 (b) (4). A difference of opinion arose as to whether or not this taxpayer is entitled to relief under this section and it was suggested by Senator Johnson that Mr. Stam and I have a conference on the subject, and that the committee be informed by letter as to the result.

This conference has been held and the particular circumstances affecting this company were rather thoroughly reviewed. I think Mr. Stam and I are now agreed that relief might be granted in this case under section 722 but the relief extended would depend on administrative interpretation of the section, particularly as to the combined effect of the reference in section 722 (b) 1 to low prices and volume, and the limitation in section 722 (b) (4) as to 1939 income.

We are also in agreement that there is enough doubt as to the meaning of certain of the provisions of the section to call for clarification by appropriate amendment.

May I ask that this letter be made part of the record following my testimony?

Yours truly,

LEO J. HOBAN,
Treasurer, Sullivan Mining Co.

Copies to:
Committee members.
Colin F. Stam.

The CHAIRMAN. Mr. Maurice Thorner.

STATEMENT OF MAURICE THORNER, ATTORNEY AT LAW, LOS ANGELES, CALIF.

Mr. THORNER. My name is Maurice Thorner. I am an attorney representing small producers of tungsten in California.

The CHAIRMAN. And your address is West Los Angeles?

Mr. THORNER. Los Angeles.

The CHAIRMAN. Yes; you may proceed.

Mr. THORNER. I wish to present to the committee my views relative to but a single feature of the revenue measure now under consideration. Last year Congress, in pursuance of its well-conceived policy of fostering and encouraging the discovery and exploitation of certain strategic and critical metals, decided to exempt from the provisions of the excess-profits tax any income derived from the production of these metals. I refer specifically to section 731 of the Internal Revenue Code, granting this exemption to "tungsten, quicksilver, manganese, antimony, platinum, chromite, and tin." This was a wise decision on the part of Congress because it produced precisely the result everyone wanted. It immediately stimulated and encouraged prospectors to scour the western country in search for these mineral deposits, and if the momentum given by the adoption of the exemption last year is not interfered with, it is the opinion of competent mining engineers that in the course of

a few years the United States can become self-sustaining with respect to most of the metal mentioned.

Mining is a risky and hazardous business, and without some special incentive it will never be possible to increase our domestic production of these rare metals. Congress last year by section 731 attempted to supply this extra incentive for the investment of time and money in an effort to increase our domestic production. The problem of getting "venture capital" to go to work is a serious one, and the T. N. E. C., as a result of its extensive studies, has frankly recognized that fact. Bear in mind that the odds against the discovery of new ore bodies that are any good is very high. Only 1 out of 20 properties that are turned up by prospectors prove to be workable. Consequently, new capital is very shy, and the rate of return on the 1 property in 20 that really has an ore body must be very much higher than the return on a conventional investment, because the risk of loss is that much greater. And it is no use suggesting that the Government, through the R. F. C., will invest the necessary capital and take the risk, because they will not do so. Before the R. F. C. will go into a property it must be practically proven beyond doubt, and there must be blocked out ore in sight.

If there is anything more important to our defense program than these strategic metals, I don't know what it is. The O. P. M. are constantly clamoring for these metals. They are the lifeblood of the steel industry. Without an assured supply of them our great steel industry would bog down, and all of us know, that at the present time we are still pretty much dependent upon the outside world for these vital supplies. Let us look at a few of them for a minute: Twelve and one-half pounds of manganese is needed to desulfurize and deoxidize every ton of steel produced, most of it is imported from India, South Africa, and Cuba, and substitution is extremely difficult, if not impossible. Tungsten is imported from Indochina and Bolivia and Argentina, and without it we cannot make our high-speed steels. Quicksilver, most of which formerly came from countries now controlled by the Axis Powers (Italy and Spain), is badly needed for pharmaceuticals, for the manufacture of torpedoes, and for our shipbuilding program, for mercurial paints, which prevent barnacles from forming on ships.

Now, the House of Representatives has with one fell swoop wiped out this exemption. They did it by section 206 of the revenue law passed several weeks ago. I cannot believe that it could have received the careful attention in the House that it deserved. I am sure that the practical aspects of this problem have been overlooked altogether in their understandable anxiety to find new sources of revenue. I realize full well the seriousness of the times and the great necessity of taxing everything and everybody until it hurts. I agree with that policy. But when you begin to levy taxes which will, in actual operation, have the effect of throttling and choking off vital production you are losing sight of the larger question involved, and that is the efficient and increased production for national defense, before which everything must give way.

I think Senator Johnson this morning accurately termed this "killing the goose that lays the golden egg."

There are several outstanding reasons for refusing to disturb the exemption to strategic metals, and I will urge this committee to give them careful study and consideration.

First. I think it would be an act of bad faith toward the many small corporations, with small capitalizations, who relied upon the assurance implicit in section 731 of the Internal Revenue Code, and have gone ahead with expensive research and development work, looking to the discovery and production of these minerals.

Second. It would result almost at once in the discontinuance of further prospecting for these ore bodies, and the stoppage of production from many sources in the United States. Thousands of prospectors have spent their time and their money searching for these badly needed metals during the past year. This was done because of the incentive given them last year. This was done because it was generally believed that the exemption granted by section 731 established a principle which would be adhered to, until such time as we as a nation had uncovered a sufficient supply of these metals to warrant a different policy.

Third. I contend that the Treasury will not derive any appreciable revenue by repealing this exemption. This is a revenue measure we are talking about here, and the problem must be examined from that point of view. I wonder if the Treasury experts, or the experts for the committee, have taken the trouble to study last year's tax returns and on the basis of those returns submitted to you any estimate of the additional tax collections, if any, to be obtained by this repeal? I venture to guess that they have submitted no such estimate. Why do I say that? I have before me some figures, compiled from the records made available by the Bureau of Mines for the year 1940. I wonder if it is generally realized that the total value of all of these minerals produced in the United States during 1940—and I think this answers the question that Senator Taft asked earlier today of a previous witness—was in the neighborhood of $20,000,000?

Senator DANAHER. What percentage of the total of such minerals used in this country does that represent?

Mr. THORNER. I think we use nearer $50,000,000 worth of these rare metals annually.

Senator DANAHER. So we are getting up to 40, 50 percent of our needs?

Mr. THORNER. Yes.

If it is assumed that the average net profit on such production is about $5,000,000, I know that the Treasury experts will readily agree that at least one-half of that amount would be attributable to individuals and partnerships, with whom we are not concerned in this discussion. As to the other half, $2,500,000, you can quickly see that after (1) normal corporate taxes, plus (2) capital-stock taxes, plus (3) defense taxes, plus (4) State corporate income taxes, amounting in all roughly to about 40 percent or more, are deducted, that the "net profit" remaining subject to excess-profits schedules would be almost negligible. On the contrary, to continue the exemption is much more likely to increase the revenues from the normal corporate taxes because

of the increased production brought about through the attraction of new-venture capital and the discovery of new ore bodies.

And, finally, I wish to conclude my argument as I began, with the assertion that the five, ten, or fifteen million dollars worth of new production of tungsten, quicksilver, and manganese that will be mined and brought into use as a result of the incentive given to prospectors by section 731 is infinitely more important to us right now because of the dire need of these metals in our armament program than any small additional revenue that might be obtained by the Treasury. If we look at this problem in its right perspective we will not sacrifice this production for the tenuous hope of a little revenue.

I appreciate very much the opportunity to appear before your committee, and I am satisfied that this problem will receive your careful study.

The CHAIRMAN. Mr. Thorner, it is probably true that the trouble with the producers of these particular strategic metals—tungsten, manganese, quicksilver, and so forth—got hit in the eye because some producers of other metals, say, copper, wanted to have the same exemption from excess-profits tax.

Mr. THORNER. Frankly, I don't know how it landed in the House bill, because I very carefully followed the testimony coming before the Ways and Means Committee in May and June and not a single word was uttered on the subject one way or the other.

The CHAIRMAN. I say that it is very probable how the trouble commenced and resulted in the elimination of the whole thing rather than to justify the exclusion of other vital metals. Of course, in the case of copper, while you might make a very good case for the exemption of all excess profits for minerals, in the case of copper, where you have a fully developed production in this country, or a large production, the situation is quite different.

Mr. THORNER. I agree it is.

The CHAIRMAN. I think that is very likely. Mr. Stam, has any estimate been made of the loss of revenue by virtue of 731?

Mr. STAM. No; so far as I know, no estimate.

The CHAIRMAN. It is not high; it is not great in any event.

Mr. STAM. Well, I am inclined to believe Mr. Thorner's testimony, and on that basis the loss is not very great.

Mr. THORNER. I don't see how it could be very great.

The CHAIRMAN. Any further questions?

(No response.)

The CHAIRMAN. Mr. J. Carson Adkerson, American Manganese Producers Association.

STATEMENT OF J. CARSON ADKERSON, WOODSTOCK, VA., PRESIDENT, AMERICAN MANGANESE PRODUCERS ASSOCIATION

Mr. ADKERSON. My name is J. Carson Adkerson; home address, Woodstock, Va.; office, National Press Building, Washington, D. C.

I appear as president of the American Manganese Producers Association, representing the majority of manganese producers in the United States. I have listened to the testimony which has already been given regarding the strategic-minerals item of the bill and I

wish to say that is the only item in which I am interested at the present time. That is section 206, which, in effect, eliminates the section carried in the previous bill. We are in favor of a similar exemption being granted in this bill for strategic minerals; I am appearing only on behalf of the manganese producers and represent only one of these strategic minerals.

Manganese is the No. 1 strategic mineral largely for the reason that we consume over 1,000,000 tons of manganese a year. The Bureau of Mines' figures for the year 1940, just released, show that the consumption for 1940 was 1,322,202 tons. Domestic production was only 40,000 tons. I think that sufficiently serves to emphasize the need for giving every encouragement possible to the development of manganese in the United States. We have not had all the encouragement which we thought the industry deserved. I have been before this committee before and representatives of the manganese industry have joined with me from time to time trying to point out to the committee the problem and possibility of an emergency where foreign sources of supply would be cut off; and we have tried to bring forth the development of American resources. We are now facing that situation. During the last year or so, there have been substantial investments in manganese. They have not yet gotten into production. The exemption from excess-profits tax, as provided in the law of 1940, would greatly encourage private capital investments in further development, whereas if that exemption is thrown out not only would it discourage further capital, it will and has caused the suspension of operations already under way. I feel that this committee understands that; I think that the witnesses who have preceded me have brought those facts out. I just want to let you know that manganese is of tremendous importance because of the distances from which this material is brought, and also for the fact that last year we actually consumed, as indicated by the Bureau of Mines' reports, 1,322,202 tons, while domestic production was 40,000 tons.

That concludes my statement.

I would like to insert in the written record something further on the subject which I believe will be of interest to the members of the committee.

The CHAIRMAN. You may do so.

Senator GUFFEY. Has anything developed in Virginia as started during the last war?

Mr. ADKERSON. There are a number of developments in Virginia, in the Shenandoah Valley area and also at other places. Virginia, up to the last war, was the leading manganese producing State in the United States. Since that time Montana has forged ahead but all of them are now more or less at a standstill except some operators in Montana who have been given Government contracts and have been financed and have gone ahead. All of them thought they had this exemption under the act of 1940 and if it is removed the only alternative would be Government money for the development of the properties and the installation of the necessary equipment. Private industry would like to go in and do it and will if that exemption is continued and other Government policies are favorable.

Now, answering that question as to the location of the deposits, I have a recent map of the United States Bureau of Mines, copies of which I would like to leave with each member of the committee. This is the latest map made by any Government bureau I know of. It shows the location of the larger known deposits of manganese in the United States.

Senator TAFT. What is it used for?

Mr. ADKERSON. Largely in the manufacture of steel and dry-cell batteries; manufacture of brick and paints. The primary use is for steel.

Senator GUFFEY. Have they found any large bodies of manganese in this country?

Mr. ADKERSON. Yes; one of the largest is now under development at Artillery Peak, Ariz.; the next is at Chamberlin, S. Dak., and the third is in Minnesota, and then the Appalachian area. Most of those deposits are low grade, but through the efforts of the producers with the help of the Bureau of Mines there have been developed processes which raise those ores to higher grades than any other known in the world. For instance, in Montana they are now mining low grade, normally running 25 to 30 percent manganese. With a new process, flotation process, a concentrate running around 60 percent manganese is being produced.

Senator GUFFEY. What does the imported ore run?

Mr. ADKERSON. Normally, around 48 percent. Now, in one of the specifications issued by the Government they asked for 48 percent and the call was upon all domestic producers to give them that or not deliver. The producers did take contracts to deliver that grade but only the ones able to put in plants at a cost of say a million dollars have been able to go ahead on those contracts, others have not been able to provide the funds necessary to build the plants to raise the ore up to the necessary 48 percent; others have tried to raise funds by operating on a small scale. Then we heard that the Government had let some contracts in favor of foreign producers and had obtained some ore from foreign producers running less than 48 percent. That has been confirmed, and in view of that, and then throwing out this exemption, most of the producers who have been going ahead have come to a standstill to find out first what is the Government's policy. Does the Government want private capital to go ahead or are we to stand back and let the Government do it?

Senator GUFFEY. What is the price of 48-percent manganese?

Mr. ADKERSON. Senator, Mr. Henderson of the Metals Reserve Company testified before the Military Affairs Committee that the price given the foreign producer was 59 cents and the price for the domestic was 61 cents; that is, 59 cents and a fraction and 61 cents and a fraction, per unit of manganese.

Senator GUFFEY. For what unit?

Mr. ADKERSON. All above 48; a unit is 22.4 pounds of metallic manganese.

Senator BYRD. What do you estimate the requirements of this country for next year?

Mr. ADKERSON. Last year, as shown by the Bureau of Mines report, they indicated consumption for 1940 as 1,322,202 tons. I have

just recently given a release to the press that sometime during the year 1942 we may reach a consumption at the rate of 1,500,000 tons per year, and have asked where is it coming from.

Senator BYRD. Are you president of the association?

Mr. ADKERSON. Yes.

Senator BYRD. What do you think will be the production in 1942 under the present plans?

Mr. ADKERSON. The best answer is that for the present year at the rate we were going ahead the total production would be 100,000 tons for 1941. Consumption, now mind you, was over 1,300,000 tons total last year. Production, balance of the year estimated, will be 100,000 tons.

Senator BYRD. Where do you propose to get the balance?

Mr. ADKERSON. From foreign sources and increased domestic production, provided sufficient encouragement is given.

Senator BYRD. You say there is 3 cents difference between foreign and domestic in price?

Mr. ADKERSON. That is the testimony of Mr. Henderson of the R. F. C.

Senator BYRD. In other words, the American manganese would only cost 3 cents more?

Mr. ADKERSON. That is the quotation, and efforts are being made to bring it forward at that price but we are not getting the production.

Senator BYRD. You say you are only going to produce 100,000 tons and you need 1,500,000 tons for the year?

Mr. ADKERSON. Yes. Testimony has been given before this committee—I have said it all the way along—that with some encouragement we could increase that production at the rate of 100,000 tons a year; with high speed and Government aid within a few years we could produce 600,000 tons per year but again we ask, where is the balance coming from? It behooves this committee, as I have pointed out and as producers have constantly howled, to recognize that it takes time to produce this metal. There must be the mine development and it takes time to work out the process for each individual deposit, and you shouldn't lose a day now to speed that up. What we have tried to emphasize is that this development should go forward in peacetime; we should not wait for the emergency.

Senator BYRD. You have been urging that for years.

Mr. ADKERSON. I have; I have even been to the White House. I took a petition signed by 186 Members of Congress including 41 Senators to the President back in 1934 and 1935, during the depression, and for national-defense purposes and to help meet the depression we asked serious consideration be given to the development of these resources at that time because it takes time to develop these properties; work out processes; and build plants.

Senator GERRY. Did the Government lay up any supply before the war started?

Mr. ADKERSON. Yes; they have around 320,000 tons reserve. They have authorized purchase of 1,000,000 tons or more. At the committee hearings last year you will recall I gave testimony that the Government had authorized and was trying to buy 1,000,000 tons of

manganese. At that time, my testimony was the Government could not get a million tons of the grade desired from all sources, foreign and domestic; it wasn't available, and time has borne me out.

Now we are face to face with a situation where you should encourage us in every way possible to stimulate production in the United States. Fortunately there are rather substantial reserves in this country now, however, because private industry has been buying. Stocks in bond, as shown by the Bureau of Mines, are 913,000 tons of ore, whereas consumption for 1940 was over 1,300,000 tons. Those were the figures as of the beginning of 1941. There are some stocks in consumers' hands. Ordinarily those stocks are not large because as the ore is used it is reported and withdrawn from bond and it remains in bonded warehouses until consumed.

So all I want to do is emphasize to you that anything that can be done to encourage and stimulate the investment of private capital in the development of manganese should be done; and this exemption from tax will help, because some of the mines which have gotten under way have now suspended. They have asked me to determine what the Government's policy will be. It is this one day, and tomorrow it is something else. The first thing we heard was that the Government has been buying foreign ores at specifications lower than they have asked us domestic producers to meet. The next thing is they encouraged us with the financing through the elimination of the excess-profits tax, and now they have swept this away with the new bill of 1941. You have to have the manganese. I ask the question, where is that tonnage coming from? For years and years past domestic producers have been anxious and willing to speed production. We have brought it to the attention of all interested parties, and now we are face to face with the situation which we had hoped would not happen—that is, interference with the sea lanes, foreign shipping—and even though it were possible to get foreign ores from some other country, a million or a million and a half tons of manganese is a large tonnage when it comes to shipping.

Senator GUFFEY. Where do you get it from?

Mr. ADKERSON. The larger part of the supply in former years came from Russia; that is cut off. Second in importance is Africa, third is India, and fourth is Brazil, and the next is Cuba.

Senator GUFFEY. How many tons would it take to haul that; I mean tons of shipping?

Mr. ADKERSON. Well, it is 1,000,000 to 1,500,000. And, regardless of the ships, you cannot get anything from Russia today. Regardless of the ships, you would have to go all the way around the cape to get it from India, and today it is difficult to get it from Africa. You have to depend on Brazil and Cuba and the United States, and United States production is constantly faced with this and that discouragement, which leaves the producers confused as to whether the Government's policy is "Go ahead and produce," or whether the Government intends itself to do that.

Senator GERRY. Is there any difference between the ores—are they all equally good?

Mr. ADKERSON. Well, manganese is manganese, the same as gold is gold, lead is lead, and zinc is zinc. It is just a matter of concentration

by throwing out the waste material. The process means concentrating the manganese to a richness of 40 percent and above. That can be done with domestic ores or foreign ores. In some foreign countries—in India, for instance—they employ labor at 1½ cents an hour, employing the natives to pick out by hand the high-grade pieces of ore. In this country we have to employ machinery to pick those lumps, to concentrate the ore to a richness we desire, say, 45 or 48 percent or above, like at Butte and Anaconda, Mont., where today we raise it up to 60 percent, whereas as it comes out of the ground it is about 25 percent. Through this process it is raised to 60 percent, which is the highest grade in the world. That shows what can be done. We have an abundance of it here; it has not been developed. We have the process; it is not being utilized.

Senator DAVIS. Are you of the opinion that we have sufficient manganese to supply the United States if developed?

Mr. ADKERSON. I will say this, as I have said throughout: That we can increase production in the United States at the rate of 100,000 tons a year if the proper market is supplied. That means 100,000 tons this year, 200,000 the next, 300,000 the next, and so on.

Senator DAVIS. How would it work in competition with the Chilean and Brazilian manganese being shipped, in view of our higher production cost?

Mr. ADKERSON. Our costs would be greater; that is, wage and freight costs would be greater than those of foreign countries. During normal times foreign countries can supply it at a price lower than we can compete with, but the essence is—and what we have been trying to point out—that as long as that continues, all right; but what are you going to do if this foreign source is cut off? The question is, Where are you going to get your manganese?

Senator GUFFEY. How much differential would there be between what the American producer should get for his manganese of 48 percent compared with what we pay for the foreign? What is the average? The figures you gave indicated there was a 3 cents' difference.

Mr. ADKERSON. That doesn't amount to a thing. We should have had the tariff differential which would have amounted to 11 cents. The "buy American" law also should have made a differential of 25 percent effective. If we had had that, you would have had greater stimulation of the domestic development now.

Senator GUFFEY. What does that all mean in the price of an imported ton of ore as compared with the domestic ton?

Mr. ADKERSON. That would figure out about 88 cents for domestic as against 60 cents for foreign.

The CHAIRMAN. Thank you very much.

(A summary of the statement by Mr. Adkerson is as follows:)

SUMMARY OF STATEMENT OF J. CARSON ADKERSON, PRESIDENT, AMERICAN MANGANESE PRODUCERS ASSOCIATION

RE H. R. 5417, SECTION 206: CORPORATIONS ENGAGED IN MINING STRATEGIC METALS

Manganese is the No. 1 strategic mineral.

The Second Revenue Act of 1940 provided for the exemption, from the excess-profits-tax law, of domestic corporations mining strategic minerals.

Section 206 of H. R. 5417, as now written, will in effect nullify the excess-profits-tax exemption granted strategic minerals in the Second Revenue Act of 1940. It will discourage further investment of private capital in the develop-

ment of domestic manganese for national defense and will cause suspension of many new developments already under way.

The United States Bureau of Mines Bulletin, Manganese and Manganiferous Ores, Review of 1940, recently released, shows that stocks of manganese ore in bonded warehouses at the end of 1940 were 913,016 long tons and indicated consumption for the year 1940 was 1,322,202 tons. (See table, p. 568.)

Domestic production for the entire 12-month period of the current year will be approximately 100,000 tons, or only 8 percent of our present annual requirements.

During the next year our consumption of manganese ore may reach the record high of 1,500,000 tons annually.

Due to an increasing shortage of ships, there is increasing danger of a shortage of manganese. Additional new sources of supply must be developed.

During the war year 1918, domestic mines produced 305,000 tons of ore, averaging 40 percent metallic manganese. Most of it came from small producers and pioneer developments in mountain areas. With proper plants or equipment, domestic ores can be concentrated to 48 percent, as now desired by the Government. It takes time and money, and plenty of both.

One new domestic beneficiation plant at Anaconda, Mont., is just starting production of an estimated 100,000 tons per year of concentrates, running around 60 percent manganese.

However, in the face of Government action unfavorable to domestic manganese, private capital will not invest in additional plants.

To encourage and stimulate domestic developments, manganese should be exempt from the excess-profits-tax laws.

The CHAIRMAN. Senator Bunker, of Nevada.

STATEMENT OF HON. BERKELEY L. BUNKER, UNITED STATES SENATOR FROM THE STATE OF NEVADA

Senator BUNKER. Mr. Chairman, gentlemen, I am appearing on behalf of my State of Nevada, to speak particularly upon two points of deep interest to the people of my State. It is true that these two points affect only the mining industry, but whatever affects the mining industry affects the entire State of Nevada.

First, the bill before you repeals section 731 of the existing excess-profits-tax bill, which exempted the income from the production and sale of certain strategic minerals, namely, tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin, from excess-profits taxes. Every reason which existed for writing this section into the Second Revenue Act of 1940 still exists; and, as a matter of fact, these reasons are more urgent now than they were when that law was written.

Second, the provisions of the law which subject to excess-profits tax the increased income due to increased production of metals is having a disastrous effect upon the mining business generally and, if incorporated in the new law which you are considering, together with the other adverse provisions of that law, will seriously retard the production of the metals so necessary to national defense.

Third, the fact that in the mining industry few corporations have reasonable earnings or invested-capital credits has subjected the mining industry to an excessive tax in comparison with other industries.

Fourth, the fact that the production of metals results in a using up of the capital of the mining corporation which can never be replaced must be taken into consideration in the imposition of excess-profits taxes.

Accordingly, I urge—

First. That the provisions of section 731 of the present law be restored.

Second. A formula should be written into the bill which will provide for subjection to excess-profits tax only so much of the income of a mining corporation as is derived from an increased price for the units mined. In other words, increase due to increased production and not increased price should not be treated as excess profits.

Third. Provision should be made for special treatment of cases where insufficient tax credits exist. In other words, there should be provided a tribunal which will adjust inequities due to abnormal situations.

There is no reason now for repeal of section 731. That section was put in the law because of the crying need for development of strategic minerals. Even before the present emergency became acute the Strategic Metals Act was passed. This provided for expenditure of $500,000 a year, for the years 1940, 1941, 1942, and 1943, to search for and appraise ore deposits containing metals which had been designated as strategic, this work to be done by the United States Bureau of Mines and the Geological Survey.

The Minerals Division of the Office of Production Management has been exerting every effort to bring about increased production of these strategic metals and to acquire stock piles by importations from abroad. A special corporation in R. F. C. has been formed to purchase metals and to allocate them among the defense industries. The situation as regards practically all metals has become acute.

Many mining companies have made contracts to furnish certain tonnages of metals and have gone to great expense in expanding plant facilities in order to fulfill these contracts. These contracts were made upon the theory that the proceeds would not be subject to excess-profits tax because of the passage of section 731. It was because of the situation then existing that the Congress made this exemption, realizing that only some extraordinary incentive could bring about domestic production of the metals listed in the exemption. It was attempted to supply this incentive for the investment of time and money in the attempt to increase domestic production. In effect, the Government said to the taxpayer: "You gamble your time and money in the effort to increase the production of these essential minerals, and if you are successful, the Government will give you preferential treatment, not as to normal taxes, but as to excess-profits taxes. The Government realizes that you are embarking upon an extremely risky and hazardous business. If you are unsuccessful, you lose your investment, and there is nothing we can do about it. But we do extend to you the promise of exemption from the excess-profits taxes if you are successful. We hope that you will be successful, because only through your success can we attain our objective—an increased production of these essential minerals."

If this section is repealed, the Government will gain little, if anything, in additional revenue, because unquestionably it will lose much of the normal tax that would have been levied upon metals produced because of the exemption. The defense authorities are crying out for these metals. It is important that the Congress continue this exemption which will assist so materially in providing what the defense authorities need.

To my mind it is unreasonable to subject to excess-profits tax the increased profits of the mining industry, which are brought about only by increased production and not through increased price per unit.

Mining is an industry which uses up its capital in the very process of production. The units extracted this year can never be replaced. Consequently, it is unfair, in my judgment, for the Government to urge the miner to produce more, thereby diminishing his capital, and at the same time levy a severe tax upon the increased production because of the miner's response to his Government's request. Of course, I do not mean that increased profit due to increased price per unit should not be subjected to excess-profits tax, but where the price is stabilized as it is at the present time, again in response to the Government's request, the miner should not be penalized for taking out more units when the Government needs them. Remember this, there are only so many units of metal in a mine. There may be more units than the miner anticipates; there may be less, but it is certain that the number is limited, and when they are exhausted the mine is done. A manufacturer or processor may increase his production and pay excess-profits taxes upon the increased profit therefrom, but after the emergency has passed he can purchase new raw materials, shape them into articles of commerce, and place them on the market. The situation is entirely different.

There should be provided a special tribunal of some kind to take care of special situations which are due to abnormal conditions. I understand such provisions were written into the excess-profits tax laws in effect during the first World War. I do not believe this Congress wishes to destroy any essential industry. I do not believe this Congress wishes to so cripple any essential industry that, when the emergency is over, it will not be able to proceed in an orderly manner to produce the goods necessary for our American way of life.

It is a fact that there are many mines in my State which suffered grievously from the depression and had no adequate earnings for the years 1936 to 1939. It is a fact that few, if any, mines in my State would have an adequate invested-capital allowance under the technical provisions of this act by which to measure the normal profits which should be exempt from the excess-profits tax. In this respect there is a wide difference among mining corporations, and the smaller corporations suffer most. Two, at least, of the base period years provided in this act were years of actual depression in the mining industry, and in none of the years was there anything above normal return. Consequently I believe that in all justice, at least as affects mining corporations, they should be permitted to select any 3 of those 4 base period years and to take the average of those 3 years in computing normal earnings.

Perhaps I am asking you to do the impossible in view of the heavy task which confronts you in the consideration of this bill. But I would like to refer you to the testimony of Charles B. Henderson, president of the Metals Reserve Company in the R. F. C., which testimony was given before a subcommittee of the Committee on Military Affairs on May 19, 1941, and will be found in the published hearings on Strategic and Critical Materials beginning at page 73. From this testimony you can secure a picture of the necessity for extraordinary measures to secure these all-important materials. In addition to the testimony of Mr. Henderson, there also appear statements of numerous other persons, completely informed upon this very important subject. I recommend your study of this testimony before you take the serious step of voting to repeal section 731.

The CHAIRMAN. Thank you, Senator Bunker. Mr. Evan Just?

(No response.)

The CHAIRMAN. Any other witnesses in the room who wish to be heard?

Senator DANAHER. Mr. Chairman, will you excuse me a minute?

The CHAIRMAN. Yes. That exhausts the list of witnesses. If there are other witnesses here who would like to appear, we will be glad to hear them. If Senator Danaher has anyone, he may come forward.

Senator TAFT. Mr. Schieffelin is here.

Mr. SCHIEFFELIN. I notice that the list of witnesses for tomorrow is considerable and I should like the opportunity if the committee desires to hear me, to be heard today. I have three copies here of a statement, copies of which I have for all members of the committee which I will have furnished to them.

Senator TAFT. Mr. Schieffelin represents the New York State Chamber of Commerce.

The CHAIRMAN. All right, Mr. Schieffelin, proceed.

STATEMENT OF W. J. SCHIEFFELIN, JR., CHAIRMAN, COMMITTEE ON TAXATION, CHAMBER OF COMMERCE OF THE STATE OF NEW YORK, NEW YORK, N. Y.

Mr. SCHIEFFELIN. My name is W. J. Schieffelin, Jr., my address 16 Cooper Square, New York City. I am chairman of the committee on taxation of the Chamber of Commerce of the State of New York. With your permission, I will go straight ahead to save your time.

The CHAIRMAN. Yes.

Mr. SCHIEFFELIN. Mr. Chairman and gentlemen, I represent the oldest commercial organization in our country, the Chamber of Commerce of the State of New York, with over 1,200 members responsible for the livelihood of hundreds of thousands of citizens working in scores of our Nation's leading industries.

The New York chamber fully endorses raising three and one-half billions of new revenue in the fiscal year ending June 30, 1942, and we record that weeks before Mr. Morgenthau made this proposal we asked Congress to raise "not less than three billion additional dollars." We congratulate both major parties that this has been made a nonpartisan issue, and we submit that recent appropriations perhaps make advisable the raising of an even larger sum this year.

We also endorse Mr. Morgenthau's clear statement to the Ways and Means Committee in April as to the four objectives of the new tax bill:

1. To pay two-thirds of the expected expenditures;
2. To provide that all sections of the people shall bear their fair share of the burden;
3. To help mobilize our resources for defense by reducing the amount of money that the public can spend for comparatively less important things; and
4. To prevent a general price rise by keeping the volume of purchasing power from outrunning production.

The present bill before you will not now accomplish (1), to pay two-thirds of the present expected expenditures. The principle, however, is still sound and our proposals will raise the additional

billions if Congress finds such immediate action desirable. We submit that such action would stave off inflation more simply and surely than any tinkering with the price structure.

We believe that neither the Treasury's proposals nor the House bill before you will accomplish the other three major objectives. In fact, the destructive practices which (3) and (4) are designed to prevent, are already well under way.

Before stating the reasons for our belief that the House bill fails to accomplish these purposes, and before presenting our specific program which we believe will accomplish these purposes, I should like to say a personal word.

I had the privilege of fighting in our Second Division, and my battalion commander was Major "Pa" Watson, now General Watson, aide to the President. As a man now medically unfit for active service, I am chairman of one of your 6,000 draft boards. After 9 months' experience I am happy to testify to the satisfaction of working as an administrator of the splendid, fair, democratic draft law you enacted.

In these ways I have tried to do my part for the country, and as one who has worked steadily to earn his living, I mention them to indicate that the harsh words to follow are offered not on behalf of any class or group, but for the benefit of every citizen.

We have all heard and perhaps approve the old statement that no tax is a good tax; yet today conditions force us to raise sums hitherto undreamed of. The New York Chamber's criticisms and concrete proposals are made from the point of view that the best interest of the Nation will be served first by increasing the yield from the present tax structure only to the maximum point which will not interfere with nor discourage national productivity, nor begin to dry up these existing sources of Government revenue; second, by entirely new taxes never heretofore levied by the Federal Government. This second step we believe essential, for our judgment is confirmed by many that the present structure cannot be safely expanded sufficiently to maintain the Nation's credit in the face of its obligations.

Now, first, for criticism of this bill. It appears to us that the House has completely failed to realize that an extension of the present too complicated, patchwork tax structure is not enough. This bill will neither prevent inflation nor carry the Nation's credit unimpaired through the critical days ahead.

While there is courage in this administration and in Congress, we see only one evidence of it on the part of the House in this bill; namely, the retention of the alternative method for computing excess profits tax. We are glad to extend our sincere thanks and appreciation to the Ways and Means Committee and to the House for this sound and just decision. We understand that the Senate is disposed to confirm it. If any serious conflict arises before you on this point we ask the privilege of again appearing before you to present compelling arguments for its retention.

On the other provisions of this bill both the Treasury and the House seem to be making a last frantic attempt to squeeze the major part of the new revenue out of one-tenth of the votes, all of whose property in toto is not enough to pay the expenditures. Realizing this stern fact the House has travailed to find ways to sugarcoat the

levies which can only be paid by the 90-odd percent of the voters who receive 70 percent of the national income. Unwilling as yet to tax this majority openly, the House refuses to broaden the base and imposes a hodgepodge of hidden sales or excise taxes on hundreds of products bought by almost all our people. While such taxes tend to lay the blame on business for increased retail prices, they actually increase costs to consumers far more than the actual amount of the taxes, due to trade discount schedules which cannot be changed without disrupting distribution. For a short arithmetical demonstration of this fact please see appendix II, appended to and made a part of this testimony.

Furthermore, in imposing these hidden sales taxes, the House has neglected to follow the recommendations (sound if such taxes are to be imposed at all) of Messrs. Eccles and Henderson that they apply only to articles the ingredients of which are needed for defense production, leaving increased purchasing power free to buy products which do not compete with national defense.

Senator BROWN. Before you leave the broadening of the base, are there any figures as to what we would gain thereby?

Mr. SCHIEFFELIN. I haven't any detailed figures on that.

Senator BROWN. Well, the Treasury has got them and they were available a while back. Though I am not opposed to it if it will produce the results, I am not at all sure that broadening the base would yield the proportionately increased income. My recollection is that the increased revenue, the major part of the $65,000,000 received after the last amendment came from those who were already taxpayers but whose exemptions were lower. My recollection further—and Mr. Stam can check me on this—is that the Treasury people testified that we got $19,000,000 from new taxpayers but it cost us $14,000,000 to collect it, and we made a net addition of $5,000,000. It is the revenue we are after and it doesn't seem to me we are doing a very wise thing in creating this huge class of new taxpayers from whom we may expect a yield of 75 cents to $1.50 and finally resulting in no substantial gain, as was the experience in the last bill. I grant that there is argument on the basis of making them tax conscious. The essential need, however, at this time is to raise money and we are not going to get it simply by broadening the base.

Mr. SCHIEFFELIN. You say, in effect, that the major part of the money comes from the existing taxpayers and that you would get more if these additional taxpayers were included but the collection problem is such as not to recommend their inclusion. I think it was Senator Connally who suggested a few days ago that if that were done those who paid wages, disbursed dividends, and so forth be made the tax collector, which would bring in considerably more money. Of course, if you make the reduction as suggested, you are going to get a considerably bigger figure and if it is done as the Senator recommends it is going to be practically net income to the Government.

The CHAIRMAN. I think, Senator Brown, that by lowering the base, I think if the base is lowered, the Treasury estimates $300,000,000 in new taxes.

Perhaps our staff has estimated it a little higher, but undoubtedly the great bulk of that would come out of the taxpayers already on the rolls.

Senator BROWN. My thought is it could be done without going to those people in the $750 class and thereabouts. You might increase the rate on those already taxed.

Mr. SCHIEFFELIN. May I say there that one of the arguments of our chamber is that it is a fairer way to get taxes from those people directly by lowering the exemptions, than by this hodgepodge method; I think that is a proper word for it—hodgepodge of hidden or excise taxes on hundreds of products bought by almost all our people, and on some of which the Government is already getting a large tax.

The CHAIRMAN. The House has one tax that directly affects the low income group as well as the high, and that is this use tax on automobiles.

Mr. SCHIEFFELIN. And that tax, I was happy to see, the Senate was considering eliminating; and if they broaden the base, they can eliminate it. By broadening the base you would get a fair proportion of revenue from these people.

Senator BROWN. I am not yet ready to advocate a sales tax, but I am ready for excise taxes on luxuries, but there is an argument there from the tax collectors' standpoint. It doesn't cost very much money to collect the revenue in that form.

Mr. SCHIEFFELIN. We are coming to that a little later, if I may proceed.

The CHAIRMAN. You may proceed.

Mr. SCHIEFFELIN. As for mandatory joint returns for husbands and wives, the House wisely yielded to the sound arguments against it, but threw in your laps the raising of the additional revenue lost by retaining the present alternative provision. Broadening the base and our proposal below for a brand-new tax will do it.

If joint returns pop up as a live issue before the Senate, we again ask the privilege of appearing before you to oppose it.

Final general criticism—and for this the administration must bear even greater blame than the House and the Senate—the House and you have failed to make even the billion-dollar economy recommended by Mr. Morgenthau. Only those who think you can have your cake and eat it too can support continuation of the present scale of nondefense expenditure. Close to 2 billions can be saved without interfering with essential Government functions. (See National Economy League publication, Indefensible Spending, sent months ago to every Member of Congress.)

Unless we are to have inflation, major economy has become a must. Inflation is partial national bankruptcy, taking from every worker and other citizen part of his property. It is the refuge and then usually the downfall of governments without the political courage to cut expenses to the bone and to tax widely and heavily enough to maintain national credit. It would make a hollow sham and quibble of the President's and the Treasury's promise that our citizens will be repaid by their Government all that they lend it.

To keep away this grim destroyer of the people's security and happiness, and to insure a sound foundation for the Nation's gigantic defense tax, the Chamber of Commerce of the State of New York presents the following twofold program and calls on Congress to enact its major provisions:

Federal taxation for national defense.—Resolved, That the Chamber of Commerce of the State of New York reaffirms its action of January 9, 1941, entitled

"Suggestions on Taxation," which are reproduced herewith as appendix No. 1; and be it

Resolved, That the chamber reaffirms its action on several other occasions as well opposing any new manufacturers' excise or sales taxes or any increase in present excise or sales taxes, because such taxes pyramid costs to consumers far more than the actual amount of tax. (See appendix No. 2.)

Senator TAFT. How do you feel as between this excise-tax program and a general manufacturers' sales tax?

Mr. SCHIEFFELIN. We think a manufacturers' sales tax has all the objections that a miscellaneous set of excise taxes has because it is hidden and actually increases the cost to consumers far more than the actual amount of the taxes.

Appendix 1 explains the arithmetical method of that. There are trade-discount schedules which are such an essential part of business that they cannot be materially changed without disrupting all distribution. The wholesaler is used to a 16½-percent discount and when he sells to the retailer the price is again pyramided; the retailer gets 40 percent, and with this 40 percent to the retailer and 16 percent to the wholesaler, the price increase paid by the consumer is far more than the actual amount of the tax. Our chamber opposes both the manufacturers' sales tax and excise taxes and in one moment I will be up to where we recommend two alternatives, entirely new taxes—retailers' sales tax where the consumer pays exactly what the Government gets and doesn't have the cost pyramided; and, too, a defense tax collected at the source on all gross income paid out to individuals. Those are the two new taxes we advocate.

The CHAIRMAN. Now, you would impose that on all income?

Mr. SCHIEFFELIN. That is the purpose, sir, based on the principle that the existing tax structure has gone to its safe maximum limit. It is a defense tax, purely and simply, a temporary tax only imposed for national credit security.

The CHAIRMAN. That would work fine in organized industry or in the case of disbursements made to collectors. When you come to apply it to several million farmers around the country you have a headache.

Mr. SCHIEFFELIN. That would be harder. It has been brought out that, in the cases of doctors, lawyers, and members of partnerships there would be difficulty. The law would have to be drawn as in the detailed study by Professor Lutz to provide for a check on withdrawals by members of partnerships, doctors, lawyers, and small businessmen.

The CHAIRMAN. I would be willing to go for that kind of a tax because I had the Treasury look into it months ago, but I must recognize the difficulties when you try to apply it to domestics, farmers, and where you can't have it withheld at the source. It would be a terrifically burdensome thing.

Mr. SCHIEFFELIN. Mr. Chairman, we admit that and I have said there would be some evasion there.

The CHAIRMAN. It is not so much a matter of evasion; it is the mechanics of the thing.

Mr. SCHIEFFELIN. It is strictly an emergency levy.

Senator BROWN. Would that be figured on the national income, say, $80,000,000,000? You would just take 4 percent or 5 percent of that?

Mr. SCHIEFFELIN. Yes; and we don't expect to get it all for the reasons the chairman has mentioned.

May I make one comment: The point has been raised also against this that it doesn't seem a fair tax because it doesn't take into account ability to pay; no exemption. Now, if this were the only tax to be paid by individuals, we would agree with that, but take a man that earns $100 a month and under this tax he would pay 5 percent or $5. It has been said that it is harder for a man receiving $100 to pay $5 of it than it is for a man earning $1,000 to pay $50. We agree with that but whereas the first man pays no income tax if married and pays only this $5 tax, the man receiving $1,000 pays, in addition to the $50 a month, another steeply graded income tax; and, in our judgment, that makes for fairness. We recommend this tax only as an emergency tax to be paid on a flat percentage basis by everybody because we feel that Federal credit is more important than the hardship such a tax would impose.

The CHAIRMAN. There would be no difference of agreement on it as an emergency or defense tax. There isn't anything our people couldn't bear. Of course it would work a greater burden on a man earning $25 or $50 a week income than on a man with a larger income. Nevertheless, it could be borne, but if you impose it the burden will be on the Treasury to collect it uniformly throughout this vast country and you have a large number of people with some cash income, personal income from many sources, who are not accustomed to paying a tax and making returns to the Government and others whose income is not in the form of cash; it is in the form of something produced which they take to the market to sell. That terrific burden would be more difficult to so many of our people than the actual cost; and that is the thing that has worried me about the suggestion.

Mr. SCHIEFFELIN. You have put your finger on the weakest part of this tax. At the other end I have taken the other example; tremendous sums would come in from corporations——

The CHAIRMAN. There would be no trouble from corporations; salaries or from lawyers, doctors, or organized industry; there would be no considerable trouble wherever you could have the tax withheld without throwing the burden on a vast number of small earners.

Mr. SCHIEFFELIN. Well, we weighed just those things and our chamber has recommended either a tax on retail sales or a defense tax collected at the source on all gross income paid out to individuals. Our taxation committee, however, though not by formal action of our chamber, thought there were fewer objections to this gross tax on income than this retailers' sales tax so that our official recommendation is one of the other of them with all their objections.

Mr. Robertson, of the House Ways and Means Committee, asked me how high a retail sales tax would have to be in order to bring in the $2,400,000,000. I didn't have the figures then but got estimates from the Department of Commerce. The last figures they give show $39,000,000,000 of retail sales for the year 1937, I think. Judged on the increased national income, Mr. Robertson agreed with me that probably $50,000,000,000 of retail sales for this year would be fair. Now, on that basis, to raise over $2,000,000,000, you would have to have a retail tax of just over 4 percent.

Senator BROWN. With food or clothing exempted?

Mr. SCHIEFFELIN. On everything. If you exempt food, clothing, and medicine, immediately to raise the revenue, the rate on everything else has to go up. It is a terrible dilemma. We thought however, that with all its faults, in a year or two these people whom you speak of, who for the first year would not pay, or who would experience difficulty in paying the tax—they are the one with the smallest incomes anyway—we feel slightly leaning toward this tax.

Senator TAFT. I would like to suggest two things: In the first place, we are going to get something like 17,000,000 individual returns and I doubt whether, out of this 17,000,000, there will be many who will not be the ones making the disbursement of wages. I don't see why, on their annual income tax return, you couldn't require an additional return by them of money paid out for wages, particularly any wages paid under say $500.

Mr. SCHIEFFELIN. Well, this proposal contemplates that every employer, paying wages to anybody—assuming you want to start at, say 2 percent—will withhold the amount of the tax.

Senator TAFT. I am referring to the cook, for instance. Most anybody paying a cook would probably be paying a personal income tax and I should think that a slight addition to their return would take care of the withheld tax in such a case; it would probably have to be done on an annual basis. The other point is, I think you would have to exempt rents. I don't see how you are going to make people pay a tax on the rents they pay. I think you would have to exempt them entirely from the withholding tax.

Mr. SCHIEFFELIN. Well, in almost all of these instances mentioned if a retail tax were imposed probably, as a practical matter, some basic essentials would have to be exempted but, as I said before, wherever you exempt, if you are going to raise a sum of money, you have to charge that much more some place else. I didn't follow your point, what you said concerning the case of a cook.

Senator TAFT. I am saying that the thought occurs to me that there are a number of those people, a very large number, and it is going to be difficult to have them make monthly returns—that is the employers of such domestics—but it occurs to me they would be practically all making annual returns in any event and could, as a part of such return, pay over to the Government the tax withheld by them.

Mr. SCHIEFFELIN. That is a very practical point. I think obviously, in the case of people such as you mentioned, the plan suggested by you would take care of the situation by withholding the tax and making annual or quarterly or semiannual returns to the Government. Everyone employed by anyone else would never receive this part of his income and that, I have understood, would be one of the strongest things to help keep down this inflation which seems on the way.

Mr. Chairman, I have only our conclusion to come to. Now, back again to what our chamber has finally and unanimously approved.

The chamber believes that the time has come for Congress to impose one or the other of these new taxes, not both; or such other tax as Congress may devise outside of and in addition to the present tax structure.

Let us again record our conviction that the people of our country are ready to undergo the sacrifices required by much higher taxes, as soon as they see sincere and effective action to put into effect the President's plea months ago that all nonessential Federal expenditures be cut to the bone.

In conclusion, let us summarize the three steps we believe necessary to put Federal finances on the firm basis required to carry our Nation through the critical days ahead:

I. *Stringent economy.*—Deferment and cessation of all nondefense capital and public works projects, holding these in abeyance as a backlog to help stabilize employment and business during the major readjustments of post-war reconstruction, such capital outlays being especially suitable for this purpose.

Close supervision of defense expenditures to keep necessary waste through haste to a minimum.

II. Increased and new taxes as presented in the Resolutions below, such taxes being designed for maximum yield consistent with minimum interference with national productivity.

III. *Borrowing.*—The required balance of funds not secured by economy and taxation can only be met by borrowing. Such borrowing should be kept to a minimum and so designed as to be subscribed to as far as possible by millions of individuals out of current earnings.

The defense bonds fulfill this requirement, and we congratulate the Treasury on this sound method of financing deficits. We call on all citizens to buy more of these bonds and to join us in insisting that Congress both economize and tax us the people more widely and heavily as urged herein. Economy and more taxes are all that will keep even United States obligations good.

(The resolutions and appendixes referred to are as follows:)

TAX PROGRAM

PART I

To make our recommendations specific for action by this Congress: Be it *Resolved*, That the Chamber urges Congress to—

(1) Decrease exemptions on individual incomes.

(2) Increase normal tax on individual incomes from present 4 percent to 6 percent (a 50 percent increase).

(3) Abolish capital-stock tax and the related declared value excess-profits tax on corporations, and increase present normal rate on net incomes of corporations from 24 percent to a figure not to exceed 30 percent. (This is almost a 67 percent increase over rates in effect before the Revenue Act of 1940, just over a year ago.)

In the judgment of the chamber these increases in the present tax structure will bring the yield to the maximum point which will not interfere with national productivity nor begin to dry up these sources of Government revenue.

We realize that the sound maximum return from the present tax structure presents debatable points. This House bill taxes individuals, particularly in the middle brackets, far higher than we recommend. As the financial picture has expanded so much since we testified before the Ways and Means Committee in April, we today concede that individual income taxes can perhaps safely as well as productively be increased somewhat over our above recommendation (2). We submit, however, that the refusal of the House to lower exemptions and thus tap directly the greatest source of increased national income, plus the raising of so much of the new revenue from present income-tax payers, will have far-reaching pernicious effects not only on the payers of these taxes but on that vast majority of wage-earning voters, now apparently sacrosanct, as well.

We feel the House underrates the intelligence and patriotism of its wage-earning constituents. We are convinced that these fine citizens are ready to undergo the sacrifices direct taxes will require of them. A few days ago the President himself called on the House to impose such taxes by lowering present exemptions.

True, these citizens will begin to say, "Stop wasting my money." Any member of the administration, any Member of Congress, who in the present world cataclysm continues to let fear of this result sway his influence or vote deserves to be returned to the private life the voters may send him to if refusal to economize and to tax widely and soundly now brings inflation.

Gentlemen, we verily believe our free Nation stands at a crossroads. More direct taxpayers, courageously legislated into existence by you, will help you stop the flagrant, spendthrift spending which persists to this day.

In spite of our concession above as to present income-tax paying individuals, it is our sincere belief that enactment in this bill of one of the two alternatives in part II below of our program will raise the needed revenue without going beyond our part I recommendations; and that parts I and II together constitute the soundest and fairest program we have seen, and one so flexible and simple that the ever higher taxes the President has said we must have every year in the near future can be raised without the months of hearings and hard work we are all going through now. This statement will be amplified below in our comments on part II B.

PART II

It is further the considered judgment of the chamber that the time has arrived for Congress to impose entirely new taxes never heretofore levied by the Federal Government.

Such taxes will bear heavily on the low- as well as on the high-income groups in our population. The chamber believes that no part of our people can be shielded from bearing a share of the defense burden. The chamber believes that the low-income group will be hurt less by paying more cash now than by a continuation of accelerated borrowing, with its inevitable inflationary effect of higher prices: Therefore be it

Resolved, That the chamber urges Congress to enact an entirely new tax to be paid by all the people, which added to the three increases recommended above should be at a rate designed to raise not less than 3½ billion additional dollars in the coming fiscal year ending June 30, 1942.

Either one of two new taxes will accomplish this result:

(A) A Federal tax on retail sales.

(B) A defense tax collected at the source on all gross incomes paid out to individuals.

This tax (B) is explained in detail by Prof. Harley L. Lutz in a publication of the National Economy League entitled "Financing the Defense Program," though the chamber does not now recommend as high a rate as proposed by Professor Lutz. This publication has been sent to every Member of the Congress and copies may be secured upon application to the National Economy League, 280 Madison Avenue, New York City.

This tax (B) is far more than a so-called pay-roll tax. It is a tax on all dividends, interest, rents, and all other cash income received by individuals. It is even better than pay as you go: Actually the Government receives it without the taxpayer ever having had it, as all payers of income become the tax collectors. For example, the American Telephone & Telegraph would deduct from its dividend checks the percentage imposed by Congress, and send to the Treasury in one check the taxes of each of its 630,000 stockholders.

While there might be some evasion as in most taxes, yet on an estimated 90 billion national income a 2% rate should raise close to 1½ billions. And here we come to the flexibility and simplicity referred to above. Impose this tax at whatever low rate you require to raise the amount you want this year, over and above whatever increases you make in the existing tax structure, which we assume will be pushed to the safe maximum limit. Then next year and the year after, if even greater revenues are required, all you have to do is to pass a one sentence tax bill: "Gross individual income tax for this year shall be 3, 4, 5, or 6 percent." No hearings, no months of head-scratching.

While this principle also applies to a retail sales tax which our chamber presents as an alternative, our tax committee feels that this tax on all gross incomes paid out to individuals is free from many of the disadvantages urged

against a retail sales tax. We therefore, though without formal action by our whole membership, recommend this gross individual income tax as the soundest and fairest method we have seen of raising the additional sums the present tax structure cannot stand.

Now back again finally to what our chamber has formally and unanimously approved:

The chamber believes that the time has come for Congress to impose one or the other of these new taxes, not both; or such other tax as Congress may devise outside of and in addition to the present tax structure.

Let us again record our conviction that the people of our country are ready to undergo the sacrifices required by much higher taxes, as soon as they see sincere and effective action to put into effect the President's plea months ago that all nonessential Federal expenditures be cut to the bone.

In conclusion, let us summarize the three steps we believe necessary to put Federal finances on the firm basis required to carry our Nation through the critical days ahead:

I. *Stringent economy.*—Deferment and cessation of all nondefense capital and public-works projects, holding these in abeyance as a backlog to help stabilize employment and business during the major readjustments of post-war reconstruction, such capital outlays being especially suitable for this purpose. Close supervision of defense expenditures to keep necessary waste through haste to a minimum.

II. Increased and new taxes as presented in the resolutions above, such taxes being designed for maximum yield consistent with minimum interference with national productivity.

III. *Borrowing.*—The required balance of funds not secured by economy and taxation can only be met by borrowing. Such borrowing should be kept to a minimum and so designed as to be subscribed to as far as possible by millions of individuals out of current earnings.

The defense bonds fulfill this requirement, and we congratulate the Treasury on this sound method of financing deficits. We call on all citizens to buy more of these bonds and to join us in insisting that Congress both economize and tax us the people more widely and heavily as urged herein. Economy and more taxes are all that will keep even United States obligations good.

APPENDIX No. 1

At the regular monthly meeting of the Chamber of Commerce of the State of New York, held January 9, 1941, the following resolution and report, submitted by its committee on taxation, were unanimously adopted:

To the Chamber of Commerce:

The committee on taxation offers the following resolution:

Resolved, That the Chamber of Commerce of the State of New York directs that the following suggestions on taxation be sent to the President and the Members of Congress and to other chambers, business associations, and labor organizations throughout the United States:

SUGGESTIONS ON TAXATION

With the Nation united in demanding and supporting adequate defense, it is far from united on how to pay the cost. Following the President's call for "great sacrifice," it is not yet facing the individual sacrifices, inconveniences, and self-denial which must be grimly and, if possible, cheerfully accepted. To the New York chamber it appears that a major task before organizations of labor and business is to convince the people that even desirable public improvements, such as highways, parks, new school buildings, and many other things for the public welfare, must be put off until the world is again at peace; that the alternative is national bankruptcy, with its destructive effect on the life and home of every citizen. Organizations can undertake this task through their memberships and local newspapers.

After the fall of France the great defender of Verdun, Marshal Petain, on June 20, 1940, broadcast the following to his people:

"We should learn a lesson from the battle which has been lost. Since the victory (of 1918) the spirit of pleasure has prevailed over the spirit of sacrifice. People have demanded more than they have given. They have wanted to spare themselves effort."

The larger taxes to pay for our defense can only be made supportable if other expenditures which cause taxation are reduced. They cannot be reduced enough to pay fully for our armaments, in spite of great relief savings due to increased employment. Unless local and State and all Federal expenditures except for defense, are cut to the bone, it is our judgment that the present rate of expenditure by these three forms of government, plus rearmament, will bring national and personal financial ruin.

As a program for business and labor organizations to work on side by side we bring forward the following proposals:

1. Nation-wide campaign to bring public to realization that the only way to reduce taxes is for the people to demand deferment of even desirable public improvements. Nondefense expenditures can be cut by billions, but only when the majority of citizens realize that they must wait for many things they would like to have.

2. State and local taxes and expenditures must be reduced to make possible the payment of the huge costs of defense, which the Nation is united in demanding.

3. National Budget on sound accounting principles. All Federal income and expenditures should be on condensed income and expense statement for the Nation's stockholders—the people—with the same completeness of disclosure required of business by the Securities and Exchange Commission.

4. Tax program:

A. Lower personal income-tax exemptions still further. Reduce highest bracket individual surtaxes, as long advocated by tax experts, congressional leaders, and others.

B. Abolish capital-gains-and-loss taxes.

C. Abolish Federal capital-stock tax.

D. Increase flat corporation income tax by more than enough to make up the loss of revenue from these simplifying reductions. Corporations can in our opinion pay such higher tax if they are relieved of present harassing and time-wasting provisions such as the capital-stock tax.

E. Oppose manufacturers' sales tax and larger excise taxes. Such taxes pyramid costs to consumers far more than the actual amount of tax, due to trade-discount schedules which are such an essential part of business that they cannot be materially changed without disrupting all distribution.

5. This suggestion touches on a controversial subject. It embodies our belief that it is of such importance it should be discussed. While not advocating a Nation-wide retail-sales tax at this time, we recommend the spreading of the knowledge that this is the ultimate means for our Government to collect revenue if the time comes when such action is necessary. This tax will bring tax consciousness to every citizen. While it bears proportionately harder on the poor than on the rich, it does not bear so hard on the poor in increasing prices as present hidden indirect taxes, for the reason explained in 4–E above. By itself a retail-sales tax would be neither just nor tolerable, yet superimposed on the graduated-income and corporation taxes, this unfairness is to a large degree wiped out. It should be considered a last resort to maintain national credit and used only when other taxes based on ability to pay have reached or passed the point of diminishing returns, or serve to increase unemployment.

Conclusion.—While these suggestions do not pretend to be all-inclusive, they are presented in the belief that the world emergency calls for coordinated action by the leaders of labor and business.

Suggestions 1, 2, and 3 of the above program appear to us to contain general principles on which all can unite.

No. 4—the tax program—epitomizes our own present thoughts for constructive Federal action. To attain unanimity over the country is a gigantic task which we feel must be tackled. We are ready to accept and support sound modifications of the proposals outlined. We send them to you with the urgent request that you bring them before your membership and your local press, and notify us of their reactions and suggestions.

Then we may all be able to back our elected representatives in producing a sound tax law, which only means one that is best for the future of every human being in our country.

Respectfully submitted.

W. J. SCHIEFFELIN, JR., *Chairman,*
GEORGE W. BOVENIZER,
THATCHER M. BROWN,
GEORGE H. COPPERS,
CLEVELAND E. DODGE,
OTTO E. REIMER,
HAROLD S. SUTTON,
Committee on Taxation.
PERCY H. JOHNSTON,
President.
CHARLES T. GWYNNE,
Executive Vice President.

Attest:
B. COLWELL DAVIS, JR.,
Secretary.

NEW YORK, *January 9, 1941.*

APPENDIX NO. 2

Comments by W. J. Schieffelin, Jr., on retail sales tax versus manufacturers' sales tax and excise taxes at the monthly meeting of the chamber January 9, 1941:

Mr. President, since so much discussion has come up on the question of the sales tax, might I be permitted about 3 minutes, for the sake of the record, to make a short clarfying statement, answering a number of questions which were asked me about 4–E, opposing manufacturers' sales tax and larger excise taxes.

Gentlemen, if you approve it, finally, this report is going all over the country, and this statement about manufacturers' sales taxes pyramiding the price to consumers far more than the extent of the tax is not fully understood by a good many people.

Here is a short arithmetical example. Take an item that retails at a dollar, and, to take a rather extreme but simple case, assume that the retailer receives a 40-percent discount. He pays 60 cents to the wholesaler. Take 16⅔ off that. A sixth off 60 gives you 50 cents that the manufacturer gets. The manufacturer gets half what the public pays.

Now, assume a 10-cent manufacturers' sales tax added to the 50 cents. It means that the manufacturer receives 60 cents from the wholesaler. On the scale of discounts, 40 and 10⅔, on which that whole trade is based, the public is going to pay double that, or $1.20. A 10-cent tax makes the public pay 20 cents more for the item.

The additional 10 cents goes to the wholesaler and the retailer, but is not net addition to their profit, because their accounts payable are bigger, their accounts receivable are bigger, and, more important than all, that big increase of 20 percent in retail price has an effect on the sale of that item. If sales go down materially, the Government loses as well as the wholesaler, retailer, and manufacturer, by having their profits and income taxes reduced.

Now, take that 10-cent tax, which is all the Government gets out of this 20-cent increase that the public pays, and tack it on as a retail sales tax at the last point of sale (in the form of stamps, if you like, as was done in the Spanish-American War, making it easy of collection). The manufacturer, wholesaler, and retailer do not upset their prices at all. The price to the public is still listed as $1, plus a 10-cent tax.

The public pays exactly the 10 cents that the Government gets, and the price to the consumer has gone up the exact amount of the tax instead of double the amount of the tax.

Now, in all trade discount schedules less than 40 and 16, the public pays more than the amount of any manufacturers' sales tax. It is not double, but in every case it is more than the amount of the tax, and that is one reason, in addition to making the public realize that they are paying the tax, in this case for defense purposes, why actually a retail sales tax saves the public money over a manufacturers' sales tax or an excise tax.

The figures I have given are true of existing manufacturers' sales taxes on cosmetics and other things, and the high present excise taxes.

Thank you for letting me make that statement.

The CHAIRMAN. Thank you very much. Any questions?

(No response.)

Senator HERRING. Mr. Chairman, I wish to have incorporated in the record, for the consideration of the committee, a statement prepared by Mr. E. H. Pollard, of Fort Madison, Iowa, on behalf of the W. A. Sheaffer Pen Co. of that city. Mr. Pollard is submitting this statement or brief in lieu of a personal appearance.

The CHAIRMAN. It will be incorporated in the record.

(The statement by Mr. Pollard is as follows:)

STATEMENT BY E. H. POLLARD ON BEHALF OF W. A. SHEAFFER PEN CO., FORT MADISON, IOWA

Section 2400 of the revenue bill of 1941 as passed by the House subjects to a 10-percent retail sales tax: "Articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof."

The "engine" of the fountain pen—the part that makes smooth and easy writing possible—is the nib or pen point. This nib is likewise the part which is subjected to the greatest amount of wear. No material has ever been developed which is comparable to a gold nib suitably tipped with precious metals of the greatest hardness—not a gold plated nib or gold washed but of at least 12-karat gold throughout and the best nibs of 14 karat. No other nib wears as long or is as noncorrosive when in contact with writing fluids. A stainless steel nib has to a limited degree these same qualities; but a good gold nib will outlast literally dozens of such steel nibs.

The W. A. Sheaffer Pen Co. and the Parker Pen Co. guarantee their best quality fountain pens for the life of the purchaser; the only requirement imposed for the fulfillment of the guaranty is a service charge of 35 cents to partially defray the cost of postage and handling. The average life of the nibs in the pens thus guaranteed is many, many years, and these nibs under normal usage do not wear out during the life of the purchasers. Other fountain-pen companies give guaranties of equal or even greater length. It will not be possible to give such guaranties or service contracts unless gold nibs are used.

It will therefore be apparent:

1. No long-life fountain pen can be made without making the nib or pen point of gold.

2. Such long-life fountain pens will therefore be subject to the 10-percent retail sales tax of section 2400 no matter how the fountain pen is ornamented—in fact, even though it is not ornamented in any way, let alone with precious metals or imitations thereof.

3. The solid gold nib or pen point in a fountain pen serves a utilitarian and not an ornamental purpose. A fountain pen is therefore not properly included under section 2400 which is directed primarily at articles of an ornamental character.

4. Frames or mounting for spectacles or eye glasses are excluded by section 2400. The same reasons or grounds exist for exempting fountain pens, viz, that they are necessary and useful articles. There is also the additional reason that frames or mountings for spectacles or eye glasses can be made just as well out of many materials other than gold or any precious metal or imitation thereof.

5. There is no shortage of gold. It is not a priority material. The solid gold nib will replace many pen points or nibs made of such material as stainless steel for which a demand exists for defense purposes.

In addition to the foregoing reasons applicable to fountain pens the following reasons exist for exempting mechanical pencils and fountain pen desk sets as well as fountain pens:

(*a*) They are all time saving, efficiency producing articles—a fact not to be ignored in any office force or on the desk of a busy executive, particularly in a factory engaged in defense work. Management tools are as essential for production as production tools.

(*b*) If it is desired to discourage through taxation consumer purchasing of articles which use a large amount of defense and priority materials such as

automobiles, this objective can be furthered if other articles are available toward which the increased purchasing power of the public can be directed. Unless such other articles are available, purchases of articles using a large amount of defense materials will not be effectively discouraged even though the price of such articles is materially increased.

(c) The amount of revenue derived by this tax will be very small, if the industry changes over its mechanical pencils, desk sets, and cheaper and shorter-lived fountain pens to avoid the use of ornamentation, mountings, or fittings with precious metals or imitations thereof.

(d) The largest portion of the sales of fountain pens, mechanical pencils, and desk sets takes place in stationery stores, department stores, and drug stores. In these retail stores there will be relatively few articles in the same price class which compete with writing instruments for the purchaser's dollar and which are subject to this special and very high tax. In practical operation the tax will be almost double the 10-percent manufacturers' sales taxes imposed by section 3406 of the House bill. In jewelry stores there will be a substantial percentage of competing articles bearing this same retail sales tax but only a relatively small part of fountain pens, mechanical pencils, and desk sets are sold in jewelry stores.

It is suggested that section 2400 be amended by striking out the period at the end thereof and inserting in lieu thereof: ", or to fountain pens, mechanical pencils, or fountain pen desk sets."

As a minimum of relief from the discriminatory effect of this section the retail sales tax should be reduced to 5 percent and the following words should be added to the end of the section, viz: "or to fountain pens," even if the committee does not see fit to exempt mechanical pencils and desk sets as well as fountain pens.

Respectfully submitted.

W. A. SHEAFFER PEN CO.,
By E. H. POLLARD.

The CHAIRMAN. The committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:30 p. m., a recess was taken until 10 a. m., Wednesday, August 20, 1941.)

REVENUE ACT OF 1941

AUGUST 20, 1941

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

The committee, at 10 a. m., pursuant to adjournment, met in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Mr. Ray Murphy.

Mr. Murphy, will you please, sir, give your name to the reporter?

Mr. MURPHY. My name is Ray Murphy. I am assistant general manager of the Association of Casualty and Surety Executives, New York City.

The CHAIRMAN. You may proceed.

STATEMENT OF RAY MURPHY, NEW YORK, N. Y., ASSISTANT GENERAL MANAGER OF THE ASSOCIATION OF CASUALTY AND SURETY EXECUTIVES

Mr. MURPHY. Gentlemen of the committee, my appearance is on behalf of the Association of Casualty and Surety Executives, a group of capital stock casualty insurance and surety companies.

Perhaps the majority of witnesses appearing before this committee, not denying the necessity of raising large sums of money by means of the 1941 revenue bill, have nevertheless contented themselves with attempting to demonstrate why the levy of the proposed tax upon their particular groups will be inequitable. Varying the procedure, and, frankly, affected by a competitive condition, it is the purpose of this association to point out a source of revenue which has been virtually untapped, consisting of a group which each year shows large incomes and yet contributes but a pittance to the cost of operation of the Federal Government.

For many years a discrimination favorable to large commercial mutual casualty, fire, and surety companies has existed, due in part to provisions of law and in part to interpretations thereof, by reason of which capital-stock casualty, fire, and surety companies have been required to pay the same rates of taxation as are applied to corporations in other fields of industry, whereas such large commercial mutual companies almost completely escape the payment of Federal income taxes. Such nontaxpaying commercial mutuals are directly competitive with the taxpaying capital-stock companies. The capital-stock companies are subject to the laws pertaining to excess-

profits taxes; the mutual companies paying practically no income taxes, of course, pay no excess-profits taxes.

At a time when the efforts of the Government and our people are directed to all-out national defense, capital-stock companies pay taxes as prescribed by law for the support of those efforts, including taxes on any profits from national-defense projects. Mutual companies pay none, yet they receive a part, and for a time it seemed would receive all, of the casualty insurance and surety business incident to national-defense contracts.

This presentation is directed toward that group of mutual casualty and surety companies which are strictly commercial and national in scope, and not toward the local organizations whose reason for existence is to provide insurance at cost to persons located within limited territories.

During the years 1936, 1937, and 1938 the commercial mutual casualty insurance and surety companies of the United States, as shown by exhibit 1 hereof, had total investment and underwriting profits of approximately $140,000,000 and paid a total combined Federal income tax of less than $25,000 per annum.[1] An individual example is as follows: In the year 1938 a certain capital-stock casualty company had earned premiums of $37,500,000; a certain mutual company had earned premiums of $40,200,000; the stock company had an underwriting gain of $4,170,000; the mutual company had an underwriting gain of $9,365,000; the capital-stock company had an investment gain of $1,790,000; the mutual company had an investment gain of $1,768,000. On such business the capital stock company in 1939 paid Federal income tax of $891,000; on such business in 1939 the mutual company paid Federal income tax of $8,245.

The basis of this virtual exemption from income tax of these mutual insurance companies is section 207 (c) (3) of the Internal Revenue Code, which provides that such companies, in computing their taxable net incomes, shall be allowed to deduct from the gross:

(1) "The amount of premium deposits returned to their policyholders," by reason of which dividends paid to policyholders are now deductible.

(2) "The amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves"; that is, all profits which are added to their surpluses. In practice, and as a consequence of a Treasury Department regulation under section 207 (c) (3),[2] these mutual companies are further allowed to deduct.

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[1] 1936, 1937, and 1938 are the last years for which complete income and tax figures are available. The statements of mutual companies for the years 1939 and 1940 probably show greater profits than in the years considered, with a correspondingly greater disparity between total profits and Federal taxes.

Attached hereto as exhibit 1 is a chart showing the incomes and Federal taxes of the stock and mutual casualty and surety companies during the years 1936 to 1938, their Federal tax payments, and an estimate of what the taxes of the mutual companies would be if taxed on the basis suggested by us in this statement. The source and significance of the figures therein contained are explained in a memorandum attached to the chart. Unless otherwise specified all further aggregate figures contained in this statement are from the annexed chart. Unless otherwise specified all further aggregate figures contained in this statement are from the annexed chart and explanatory memorandum.

[2] Sec. 19.207-6, Regulations 103, which provides that "In determining the amount of premium deposits retained by a mutual fire or a mutual casualty and surety company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits * * *." Pursuant to this rule, a mutual company, in computing its taxable income, is permitted to apply its investment gains to the payment of losses. An amount of premium deposit equal to its investment gains is thus released to be added to nontaxable "premium deposits retained for the payment of losses, expenses, and reinsurance reserves." Thus its investment gains are exempted from the income tax.

(3) Their profits from investments. The net result is that no taxable income remains and the mutual companies are, therefore, practically exempt from the Federal income tax law.

We propose that section 207 (c) (3) be amended so as to put commercial mutual casualty and surety companies on the same basis for tax purposes as capital stock insurance companies writing the same lines of business. If the profits of these mutual companies during each of the years 1936, 1937, and 1938 had been taxed on the same basis as those of their stock company competitors, they would have contributed $5,000,000 annually to the Treasury instead of the negligible amounts paid.

This estimate does not include the possible tax income from commercial, national mutual fire insurance companies, to which the principles of this brief apply as well.

There is no equitable reason why the large commercial mutuals should be allowed these deductions in computing their taxable incomes. Dividends paid to policyholders come from the profits of these companies just as do the dividends to stockholders of stock companies. To argue that, in computing their incomes for tax purposes, stock companies should be allowed first to deduct dividends paid, would be patently absurd. Equally is this so in the case of mutual company dividends.

"The deduction of the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves," as permitted by section 207 (c) (3) of the Internal Revenue Code, is a euphemism to describe deduction of additions to surplus. These sums represent profits of mutual companies no less than do the stock companies' additions to their surpluses. Short of a catastrophe comparable to another Biblical flood, these surpluses, which have grown by the millions of dollars through tax-free additions thereto in recent years, will in large part never be touched by policy claims. In any event, these surpluses are sufficiently large so that there will be no prejudice to policyholders if additions thereto are taxed on a fair and equitable basis. It should further be borne in mind that these mutual companies have already set aside in their liabilities all of the necessary additions to reserves for losses and expenses and reinsurance reserves, and are allowed such additions as deductions in the computation of their net incomes.

The case for taxing the interest, dividends, and rents derived from the investments made by these large commercial mutual companies is such an obvious one as to need no laboring. It is questionable whether the Congress ever intended that these profits be exempted from tax, but, if not, by regulation of the Treasury Department, this result is achieved. Amendment of section 207 (c) (3) as suggested, would eliminate the present exemption.

In making the suggestion that the Internal Revenue Code be amended as above, this association, as heretofore indicated, has not been unmindful of the fact that, as distinct from the large commercial mutuals, there are a vast number of small, genuinely "mutual" and "nonprofit" insurance companies, serving their policyholders at cost, for which the Congress had provided special consideration in the matter of Federal income tax. The larger number of these companies are already completely exempted from income tax by subdivision (11)

of section 101 of the Internal Revenue Code.[3] Further to insure that no mutual, whose principal objective is to sell insurance at cost but which, incidental to its operation during a particular year, may show some profit, shall be subject to tax, this association proposed that, coincidentally with the amendment of section 207 (c) (3), section 207 (a), which fixes the rate of tax upon commercial mutual insurance companies, other than life and marine, be amended so as to provide that such a company be allowed a credit of $100,000 against net income.

Surely the allowance of such a generous credit will provide more than ample protection for the local mutuals. And to the end that no commercial mutuals shall be permitted to come within the provisions of section 101 (11) of the Code, we further suggest that such subsection be amended to provide clearly that no company with a net income in excess of $100,000 shall be exempted thereunder.

I am not going to take the time of the committee, I am sure, to refer further to the exhibits attached to the statement, but I would like to have them inserted in the record.

The CHAIRMAN. That will be done. Did you appear before the Ways and Means Committee, Mr. Murphy?

Mr. MURPHY. I did not, sir.

The CHAIRMAN. This matter was not opened up before the Ways and Means Committee; that is, your suggestion?

Mr. MURPHY. Not to my knowledge.

(The exhibit and table referred to are as follows:)

EXHIBIT 1.—FEDERAL TAX PAYMENTS, 1936-38, STOCK AND MUTUAL CASUALTY AND SURETY COMPANIES

The table attached hereto is based upon a study of the Federal income tax payments of 58 stock and 10 mutual casualty and surety companies on business done during the 3-year period ending December 31, 1938. These 58 stock casualty and surety companies wrote approximately 70 percent of the total business written by all stock casualty and surety companies and the 10 mutual companies wrote 75 percent of the total business written by all mutual companies for the same 3-year period in the United States. As is indicated by this table, during the period covered, the stock companies had a total of investment and underwriting gains of approximately $174,000,000 (item A (4)) on which they paid an income tax to the Federal Government of approximately $19,000,000 (item A (5)). The mutual companies had corresponding aggregate investment and underwriting gains of approximately $105,000,000 (item B (4)). On these net investment and underwriting gains of $105,000,000 mutual companies paid a total income tax, for the 3 years, of only $50,000.

The taxes of $19,000,000 paid by the stock casualty companies represented approximately 11 percent of their total gains of $174,000,000. The mutual companies, writing 75 percent of the total business written by all mutual companies, had total gains of $105,000,000. Thus it may be estimated that all mutual causalty companies combined had total investment and underwriting gains of $140,000,000. If mutuals had been taxed on the same basis as stock companies during these years, they would have paid in Federal income taxes approximately 11 percent on this total of $140,000,000, or $15,400,000. Their total combined taxes for 1 year would have been approximately $5,000,000.

[3] "SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.—The following organizations shall be exempt from taxation under the chapter—

"* * * (11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses; * * *."

Federal income taxes, 1936–38

A. 58 STOCK CASUALTY AND SURETY COMPANIES

	Premium income (1)	Underwriting gain (2)	Investment gain (3)	Total gain (cols. 2 and 3) (4)	Federal taxes paid (5)
1936	$579,447,925	$24,354,320	$65,144,551	$89,498,871	[1] $5,306,008
1937	631,942,270	38,214,596	−43,307,020	−5,092,424	7,327,853
1938	614,572,164	41,077,098	48,515,500	89,592,598	[2] 9,102,563
Total	1,825,962,359	103,646,014	70,353,031	173,999,045	[2] 22,279,853

B. 19 MUTUAL CASUALTY AND SURETY COMPANIES

1936	$142,826,209	$24,171,654	$8,883,326	$33,054,980	$229,722
1937	171,265,803	32,736,054	−1,114,268	31,621,786	220,690
1938	169,855,992	33,677,683	6,743,797	40,421,480	[3] 281,800
Total	483,948,004	90,585,391	14,512,855	105,098,246	[3] 732,212

[1] 1937 statement.

Federal tax payments of a company on business of a particular year appear in the annual statement for the following year. Thus taxes of 1936 business appear in the statement of 1937 business, etc. Column 5 reflects this fact.

[2] Of which $1,102,563 was Social Security.

[3] Of which $265,110 was Social Security.

The 1939 annual convention statements indicated what part of the companies' Federal tax payments was for the Social Security taxes. Employing as a guide the ratio between Social Security and income taxes there indicated, it may be estimated that the 58 stock companies, on 1936–38 business, paid income taxes aggregating approximately $19,000,000; the 19 mutuals paid about $50,000 taxes on income during those years.

Source: Best's Reproductions of Principal Schedules from Casualty and Surety Statements (1937, 1938, 1939, and 1940 editions).

Senator DANAHER. Mr. Chairman.

The CHAIRMAN. Senator Danaher.

Senator DANAHER. Who gets the advantage of the earnings that thus are not taxed, Mr. Murphy, in the mutual companies?

Mr. MURPHY. The advantage, of course, inures to those to whom the so-called dividends are returned, and then, of course, there is the addition to surplus. No individual gets any particular benefit from that, I assume.

Senator DANAHER. Do the policyholders get the benefit of it?

Mr. MURPHY. They get the benefit to the extent that their policies, I assume, are made more secure by the addition to surplus, but they get no distribution of that money.

Senator DANAHER. Do they get an advantage in lower rates?

Mr. MURPHY. They do when dividends are returned.

Senator DANAHER. Are not dividends returned when earned?

Mr. MURPHY. When earned, usually I assume so, yes. In the case of all these so-called larger commercial mutual companies, I should say they are uniformly returned.

Senator DANAHER. Then when dividends are earned and are returned to the policyholders, are they not taxable to the policyholders?

Mr. MURPHY. I assume they are, the same as the dividend returned by the stock companies, that are returned to their stockholders.

Senator DANAHER. So that they are subject to tax on that extent anyway?

Mr. MURPHY. In the hands of the individual, assuming he pays an income tax, they would be. That same thing is true, Senator, as I say, of the dividends paids to stockholders of the stock com-

panies. At the same time those dividends are already previously taxed by payment of the tax to the Federal Government.

In the one case, we might assume there is a double tax, and in the other, there is the ordinary tax paid by the individual.

Senator DANAHER. Granting that the earnings are carried over to surplus, or are distributed to policyholders as earned, where is there any advantage to the company, the Mutual Co.?

Mr. MURPHY. The advantage to the company is, I assume, a competitive one, showing that they have a strength comparable to their competitors.

Senator DANAHER. Thank you, sir.

Senator VANDENBERG. The net results is a competitive advantage in rates in the final analysis?

Mr. MURPHY. That is one of the net results, Senator. A net result, of course, is that no tax is paid to the Government.

The CHAIRMAN. Thank you kindly for your appearance.

The CHAIRMAN. Mr. Paul W. Adams.

STATEMENT OF PAUL W. ADAMS, HARTFORD, CONN., COUNSEL FOR MANUFACTURERS ASSOCIATION OF CONNECTICUT

Mr. ADAMS. My name is Paul W. Adams. I am counsel for the Manufacturers Association of Connecticut, Hartford, Conn.

The CHAIRMAN. Yes, sir. Mr. Adams, you may proceed with your statement.

Mr. ADAMS. Our association represents practically all of the bona fide manufacturers in Connecticut, and their employment includes approximately 95 percent of the total manufacturing employment in Connecticut.

We have studied very carefully the bill as passed by the House and we have several items which we would like to present to your committe for consideration in your action on this bill.

First, we are very much concerned in the matter of the average-earnings method of computing the credit, and we hope that your committee will see it possible to include that alternative method as the House bill does. If it is not retained, many Connecticut manufacturers will suffer great hardship as the result of this.

Second, we believe that the present rates, based on the amount of excess profits, work a great hardship to the stockholders, particularly in the large corporations, or corporations who have large earnings, and we hope that this committe will again give favorable consideration to the matter of basing the excess-profits tax rate on the ratio of the profits to their average earnings, or to their credit.

The CHAIRMAN. We did that last year.

Mr. ADAMS. Yes, sir.

The CHAIRMAN. We did not have any luck in the House.

Mr. ADAMS. We hope that you will have some luck this year. If you will present it to the Senate for consideration.

It has been demonstrated that the effect of this is to take from the stockholders' return on his capital investment, a larger portion where the amount of the earnings is large than where the earnings are small.

I have a statement which I would like to file with the clerk as a part of the record.

The CHAIRMAN. We will be pleased to have you put it in the record; yes.

Mr. ADAMS. With that statement is a chart, showing the effect and the impact of this rate provision.

The CHAIRMAN. I do not think there could be any doubt about that, in fact, I think this committee thoroughly agreed with you in the past. We were not able to get it, because one of the great difficulties always in getting a sound principle frequently is we are going to lose a lot of revenue and that deters us, it enables the House to stand out against it. I do not think the House would approve the present bracketing on the dollar basis any more than we would and, at the same time, there is tremendous revenue involved. There cannot be any doubt in the world that it will adversely affect the stockholder in a corporation, having large incomes most adversely, as against the stockholder having the same amount of stock in a small corporation, or a corporation that does not have very heavy earnings.

Mr. ADAMS. In the matter of revenue, it would seem that if the rates were made on the ratio basis, that could be greatly increased by taxing at higher rates, profits in excess of a reasonable ratio of earnings.

The CHAIRMAN. It could be made up by stepping up the rates, of course.

Mr. ADAMS. Yes; without sacrificing revenue.

The CHAIRMAN. We would be glad if you would file the chart or memorandum that you have on that point showing the inequality, as it actually works itself out against the stockholders.

Mr. ADAMS. We are also concerned about the 10-percent penalty tax which the House imposed on corporations computing their credit on the invested-capital method if they had had earnings in the taxable year in excess of their average earnings over the base period. That would, in most cases be a severe penalty to the corporation having a high capitalization, and not being very successful in making earnings, but suddenly being able to earn. And it seems also that it is contrary to the basis of our excess-profits tax, that is, allowing a normal return on investments, or the alternative, allowing them to earn their average earnings over a base period before the tax is imposed.

We believe also that the deduction of the normal tax in the computation of the excess-profits tax should be retained. The effect of this, of course, is simply to add the tax—I will say it differently; the effect of not deducting the normal tax in the computation of the excess-profits tax is to add the amount of the normal tax to the taxpayer's bill at the highest bracket rate. It seems manifestly unfair to require the taxpayer to pay, at the high excess-profits tax rate, a tax on the amount of his normal tax.

We are very much in favor of the provision allowing for greater credit on new capital, as provided in the House bill, and we hope your committee will see fit to retain it.

At the present time the excess-profits tax provides for an adjustment for abnormalities in the case of the average-earnings method of computing the credit. There have come to our attention numerous examples where abnormalities have occurred in the case of a corporation which would like to use the invested-capital method, and they are not able to make those adjustments. We believe that this extension should be made for them.

On the matter of the capital-stock tax and declared-value excess-profits tax, it has always been a gamble with corporations to guess a declared value high enough to cover their anticipated profits, and they guess low at their peril.

We hope that this committee will see fit to repeal the declared-value excess-profits tax, since the amount of revenue derived from it has been insignificant, and if corporations are successful in guessing high enough they could completely eliminate the revenue of the declared-value excess-profits tax.

As far as the capital-stock tax is concerned, it seems that to continue the declared-value basis for computing the capital-stock tax, if you repeal the declared-value excess-profits tax, would result in a useless and meaningless base and, therefore, we suggest that the capital-stock tax be retained as a revenue producer, but the method of computing the tax be the method used in the old capital-stock tax previous to the enactment of the declared-value excess-profits tax.

At the present time, section 102 of the Internal Revenue Code imposes the unreasonable accumulations tax on corporations, which accumulate earnings and profits in excess of their normal requirements. The Treasury Department, as you know, has imposed an arbitrary rule called the 70-percent rule, the effect of which is to require a corporation, which does not distribute at least 70 percent of its earnings, to prove to the Treasury Department that its accumulation of earnings was reasonable. We submit that, in times such as these where it is desirable and almost imperative that corporations accumulate larger reserves than ordinarily, it would be a very equitable thing for this committee to either require the Treasury Department to reduce its 70-percent rule, or set up some alternative procedure than that provided in the present law. It is our hope that corporations would not be required to go to the tremendous expense of proving that this accumulation is reasonable simply because it, in mathematical figures, did not figure out to be 70 percent of their earnings.

We also want to subscribe to the recommendations of the Army and Navy in connection with the amortization deductions. They have made certain suggestions as to revision of procedure in the granting of necessity certificates, certificates of nonreimbursement, and certificates of Government protection.

In addition, we hope that that law may be clarified to allow the amortization of replacement facilities which corporations purchase in order to cooperate in the speed-up of production. Their present machinery is entirely adequate for normal production in peacetimes, but because of the pressure placed upon them by the Government, they have gone out and purchased new machinery in order to speed up their productive capacity, and it seems to us that these expenditures should be allowed to be amortized.

We want to add our voice to that of others, that we believe that nondefense expenditures can be reduced and should be reduced in order to aid in the revenue situation which confronts us.

The CHAIRMAN. Thank you. Are there any questions?

(No response.)

The CHAIRMAN. Thank you for your appearance, Mr. Adams.

(The statement submitted by Mr. Adams is as follows:)

THE MANUFACTURERS ASSOCIATION OF CONNECTICUT, INC.,
Hartford, Conn., August 18, 1941.

To the Honorable Committee on Finance of the United States Senate:

We submit herewith a brief in behalf of the Manufacturers Association of Connecticut, Inc., on the matter of the 1941 revenue bill.

The finance and taxation committee of the Manufacturers Association of Connecticut, Inc., has studied carefully both the present tax law and the amendments as proposed in H. R. 5417, and the recommendations that follow are made for your serious consideration. These recommendations have been submitted to the members of this association and the recommendations have their approval. The members of the Manufacturers Association of Connecticut, Inc., include substantially all of the bona fide manufacturers, both large and small, in Connecticut. They employ over one-third of a million employees, which employees constitute approximately 95 percent of the total manufacturing employment in Connecticut. Nearly all of the members are corporations which are subject to the Federal corporation taxes. The manufacturers whom the association represents have a vital interest and concern in the measure before your honorable committee.

The recommendations are divided into four (4) parts:

I. The excess-profits tax.
II. Capital-stock tax and declared value excess-profits tax.
III. Unreasonable-accumulation tax.
IV. Amortization of emergency facilities.

I. EXCESS-PROFITS TAX

1. The average earnings method of computing the excess-profits credit should be retained.
2. Rates should be based on the ratio of excess profits to normal profits instead of on the amount of excess profits.
3. The 10 percent tax on any increase in average earnings when the invested capital method of computing the excess-profits credit is used should be eliminated.
4. The deduction of normal tax and surtax in the computation of the excess-profits tax should be retained and deduction of excess-profits tax imposed should be allowed in the computation of the normal tax.
5. The "New capital" provision allowing an additional 25 percent in figuring invested capital should be included.
6. The adjustment provision for abnormalities should be extended to include computation of the credit under the invested capital method.

1. *The average earnings method of computing the excess-profits credit should be retained.*—We subscribe to the attitude of the House Ways and Means Committee in their feeling that the soundness of the policy of allowing a computation of the excess-profits credit on the basis of average earnings appears to have been adequately demonstrated. The alternative methods of computing the credit are a necessary adjunct to an equitable application of the tax. If this tax is to be truly a war excess-profits tax, and we think it should be, the average earnings method of computing the credit is absolutely essential to provide a base for determining what constitutes normal profit.

2. *Rates should be based on the ratio of excess profits to normal profits instead of on the amount of excess profits.*—The present excess-profits tax rates are based upon the amount of excess profits. The result is that the larger the amount of a corporation's profits the greater the portion of the profits that are taken in taxes, without any relation to the reasonableness of the profits in proportion to normal profits. This schedule of tax rates evidences an attempt at progressive taxation of corporations. The principal should be discouraged, and its fallacy should be known.

Progressive taxation of corporations is not sound. In the last analysis a corporation is simply the aggregate of its stockholders. Income to the corporation is in reality income to the stockholders. Reduction of the corporation's income by taxation is a reduction of the income of the stockholders. The imposition of graduated excess-profits tax rates; i. e., progressive rates, upon income of corporations according to the amount of their taxable income, without consideration of the amount of the average earnings or the invested capital, is rank injustice to the stockholders of large corporations in favor of the stockholders of corporations with small incomes. It should be considered

that as a general rule the larger the corporation the greater the number of stockholders and the smaller the average amount of capital invested, per stockholder. For example, in one large corporation, one-third of the total number of stockholders hold from one to five shares each. It is Mr. Average Stockholder who suffers when a schedule of rates such as that in the present excess-profits tax law is imposed upon the profit of a corporation, and Mr. Average Stockholder is the widows and orphans; he is the working man who has saved a few dollars and invested them in some large but sound, nationally known corporation; he is not a would-be war millionaire. He is the forgotten man.

Accompanying this brief is a table showing the computation of corporation excess-profits taxes based on H. R. 5417 as passed by the House of Representatives. It shows that a corporation which earns a net income before Federal taxes of $15,000 and entitled to an excess-profits credit of $8,000 was taxed at $700; that is, the excess-profits tax was 4.7 percent of net income before Federal taxes. It shows also that a corporation with $15,000,000 net income before Federal taxes would be taxed $4,190,000 for excess profits, assuming an excess-profits credit in similar proportion to the small corporation, with the result that the ratio of its excess-profits tax to its net income is 27.9 percent. This tremendous span in percent of net income taken by the excess-profits tax is attributable only to the fact that the corporation with earnings of $15,000,000 had a large amount of earnings, even though the ratio of normal earnings to actual earnings was the same as that in the case of the corporation earning $15,000. The impact of this tax is on the small investor. Thirty percent of the return on his investment is taken by the excess-profits tax before it gets to him.

The need for treatment of this problem was recognized by the Senate in an amendment which it adopted to the Excess-Profits Tax Act of 1940, but which was eliminated in the conference by the two Houses. The amendment was introduced by your present chairman, Senator Walter F. George, who at the time of its introduction considered that it corrected the "manifest error" of basing the graduated excess-profits tax rate "merely upon dollar value, without any reference to the percentage of earnings to invested capital, or the prior earnings of any company." The text of the amendment appeared on page 18669 of the Congressional Record for September 10, 1940. For the convenience of your committee, we quote the rate schedule in the Senate amendment:

"Twenty-five percent of so much of the adjusted excess-profits net income as does not exceed the greater of $20,000, or 20 percent, of the excess-profits credit; 30 percent of so much of the adjusted excess-profits net income as exceeds the greater of $20,000, or 20 percent, of the excess-profits credit and does not exceed the greater of $50,000, or 40 percent, of such credit;

"Thirty-five percent of so much of the adjusted excess-profits net income as exceeds the greater of $50,000, or 40 percent, of the excess-profits credit and does not exceed the greater of $100,000 or 60 percent of such credit; 40 percent of so much of the adjusted excess-profits net income as exceeds the greater of $100,000, or 60 percent, of the excess-profits credit and does not exceed the greater of $250,000, or 80 percent, of such credit;

"Forty five percent of so much of the adjusted excess-profits net income as exceeds the greater of $250,000, or 80 percent, of the excess-profits credit and does not exceed the greater of $500,000, or 100 percent, of such credit; and 50 percent of so much of the adjusted excess-profits net income as exceeds the greater of $500,000, or 100 percent, of the excess-profits credit."

3. *The 10 percent tax on any increase in average earnings when the invested capital method of computing the excess-profits credit is used should be eliminated.*—The effect of this tax is to penalize corporations which have been struggling under a high capitalization simply because they now earn a small amount of profit in addition to earnings of the previous years base period. The imposition of this 10 percent additional tax becomes ridiculous in the case of a corporation which has suffered losses over the base period years. The method of computing the 10 percent additional tax is extremely complicated. The provision, of course, is a nonsequitur, because it contradicts the very basis of the invested capital method of computing the credit, namely that a corporation is entitled to a fair return on its investment before any profits should be called "excessive" and made subject to tax. The committee should not tolerate this confusion of tax principle.

4. *The deduction of the normal tax and surtax in the computation of the excess-profits tax should be retained and the deduction of the excess-profits tax*

imposed should be allowed in the computation of the normal tax.—There is more unfairness in not allowing the deduction of the normal tax in the computation of the excess-profits tax than vice versa. If the normal tax is not deducted, obviously the taxpayer is paying an excess-profits tax on the amount of the normal tax at a rate which is the highest bracket rate for the taxpayer under his excess-profits tax. The deduction as it was in the 1940 excess-profits tax is in accordance with sound procedure for determining what profits are excess profits, and it should be continued.

It is suggested that in addition to continuing the present deduction of the normal tax in computing the excess-profits tax, there also be allowed the deduction of the excess-profits tax in computing the normal tax, as provided in the House bill. A simple procedure could be worked out for the computation of the two deductions.

5. *The "new capital" provision allowing an additional 25 percent in figuring invested capital should be included.*—We favor the treatment of "new capital" provided for in the House bill. The allowance of a total of 125 percent new capital in computing invested capital will aid in the encouragement of private financing of changes in facilities and equipment.

II. CAPITAL-STOCK TAX AND DECLARED VALUE EXCESS-PROFITS TAX

1. The declared value excess-profits tax is an anomaly in the tax structure and should be repealed.

2. The present capital-stock tax should be repealed.

1. *The declared value excess-profits tax is an anomaly in the tax structure and should be repealed.*—This tax, based as it is on the fictitious declared value of capital stock, has been a guessing game with corporations. The winners have guessed a declared value high enough to absolve them from payment of the tax; the losers, however, having guessed conservatively, pay a tax of thousands of dollars. The gamble becomes all the more fierce now that corporations must pick a declared value which will cover them for the next 3 years, since the present law provides that no revision other than routine adjustments may be made until with the return for 1944 for the capital-stock tax. If all corporations guessed for this year a declared value high enough, there would be no revenue from the declared value excess-profits tax.

The declared value excess-profits tax produced $24,484,167 revenue in 1939 and only $15,388,825 in 1940, or a decrease of over $9,000,000. That revenue received from this tax represents either a penalty imposed upon corporations for their inability to foretell the amount of profit which they receive or a penalty upon a taxpayer who was not aware of how to play the guessing game. The tax is a disgrace to our Federal tax structure. It should be repealed.

2. *The present capital-stock tax should be repealed.*—The provision for an arbitrary declaration of the value of capital stock of a corporation for purposes of the capital-stock tax is manifestly inequitable. The taxpayer who makes an honest effort to declare a fair and accurate value of his capital stock does so only to be penalized tenfold or more by the declared value excess-profits tax. The revenue from capital-stock tax is substantial, and it is not suggested that the form of tax should be eliminated. We recognize that the Federal Government can properly demand from corporations a tax in the nature of a franchise tax based upon capital stock. We believe that the declared value basis for the capital-stock tax should be repealed along with the declared value excess-profits tax. We suggest that the method of computing the capital-stock tax which was used in the old capital-stock tax would be more equitable and could be used to produce more revenue than the declared value formula. The old capital-stock tax (previous to the enactment of the declared value excess-profits tax) used the highest of three alternative methods of computing the value of capital stock, as your committee will no doubt recall.

III. UNREASONABLE-ACCUMULATIONS TAX

The 70-percent-distribution rule of the Treasury Department in connection with unreasonable accumulations of earnings under the provisions of section 102 of the Internal Revenue Code should be voided by Congress.—Because it is to be desired that corporations in these times accumulate more reserve than normally, it will work an undue hardship on corporations to be subjected to the enforcement of the Treasury Department's "70-percent rule." We suggest that if the burden is going to be placed upon the corporation to prove the reasonableness

of its accumulation of earnings unless a certain percentage is distributed, the burden imposed should be clearly defined and the percentage of distribution should be set by Congress. Your committee should know that the Internal Revenue Bureau has as a matter of enforcement been applying the "70-percent rule" strictly and arbitrarily, so that each corporation which fails to distribute 70 percent or more of its earnings is required to submit proof of the reasonableness of the accumulation. This submission of proof, as you can well understand, involves considerable and careful analysis and other work, because failure to satisfactorily prove to the Bureau of Internal Revenue that the accumulation is not reasonable would mean the imposition of the most drastic penalty tax.

IV. AMORTIZATION OF EMERGENCY FACILITIES

The recommendations of the Secretary of War and the Secretary of the Navy with respect to the revision of the procedure for the certification in connection with amortization of emergency facilities should be adopted.—We subscribe to the recommendations with respect to the special amortization procedure made in a joint letter by the Secretary of War and the Secretary of the Navy addressed to the Honorable Sam Rayburn, Speaker of the House. We believe that the suggested revision of the procedure will greatly facilitate the granting of the proper certificates.

In addition we believe that the amortization provision in section 124 of the Internal Revenue Code should be clarified to definitely allow the amortization of replacement facilities necessitated by production speed-up on defense work. Many plants have in them machinery which is entirely adequate for their normal production requirements, and this machinery would continue to meet these requirements for some time. But because of the necessity for increased efficiency and speed in the production of defense products, these plants have replaced or plan to replace slower operating machinery with modern high-speed equipment. We believe that these plants should be allowed to amortize a large portion of the cost of this new equipment over the 5-year period as provided in section 124.

We submit these matters for your serious attention.

Respectfully,

PAUL W. ADAMS, *Counsel.*

Comparative excess-profits taxes (based on H. R. 5417, 1941 revenue bill)

Net income before Federal taxes....	$15,000	$150,000	$1,500,000	$15,000,000
Excess-profits credit (average earnings or percentage of invested capital).....	$8,000	$80,000	$800,000	$8,000,000
Computation excess-profits tax:				
Net income.....	15,000	150,000	1,500,000	15,000,000
Less:				
Excess-profits credit.....	$8,000	$80,000	$800,000	$8,000,000
Specific exemption.....	5,000	5,000	5,000	5,000
	13,000	85,000	805,000	8,005,000
Adjusted excess-profits net income.....	2,000	65,000	695,000	6,995,000
Excess-profits tax:				
First $20,000 (35 percent).....	700	7,000	7,000	7,000
Next $30,000 (40 percent).....		12,000	12,000	12,000
Next $50,000 (45 percent).....		6,750	22,500	22,500
Next $150,000 (50 percent).....			75,000	75,000
Next $250,000 (55 percent).....			137,500	137,000
Over $500,000 (60 percent).....			117,000	3,837,000
Total excess-profits tax.....	700	25,750	371,000	4,190,000
Total excess-profits tax, percent of net income before Federal taxes.....	4.7	17.2	24.7	27.9

The CHAIRMAN. Mr. Tanzer.

Mr. TANZER. My name is Laurence Arnold Tanzer, chairman of the committee on taxation and public revenue, Merchants' Association of New York.

The CHAIRMAN. You may proceed.

STATEMENT OF LAURENCE ARNOLD TANZER, NEW YORK, N. Y., CHAIRMAN OF THE COMMITTEE ON TAXATION AND PUBLIC REVENUE OF THE MERCHANTS' ASSOCIATION OF NEW YORK

Mr. TANZER. I appear on behalf of the Merchants' Association of New York, the city's largest chamber of commerce organization, representing all phases of the business and professional life of that city and thus expressing the view not of any special interest but of a cross section of the city's life.

The association heartily approves the program of financing defense expenditures through taxation so far as practicable, with a view to averting inflation resulting from too much deficit financing and preserving the national credit and the private-enterprise system.

We are here to make constructive suggestions to assist in raising the taxes needed by avoiding mistakes which will defeat their purpose. The heavier the tax burden, the more important it becomes to avoid injustice and unnecessary uncertainty, complexity, and confusion. The criticisms which we have come here to present are directed not at the amount proposed to be raised by taxation, but at features of the bill which tend to prevent the collection of the necessary revenue by mistaken methods.

Increased surtax rates.—It is proposed to raise surtax rates to unprecedented levels—in many cases to several times what they are now. What justification can there be for adding to these rates an additional 10-percent "defense tax"? Originally imposed for a limited period as a "temporary defense tax," if it is required permanently, honesty and simplicity require that it be incorporated in the permanent rates, as in fact the bill proposes to do in the case of excise taxes and of the declared value excess-profits tax. If, for example, it is felt that a particular class of taxpayers should pay a tax of 22 percent, they should be openly and honestly taxed at that rate. To tell them that their tax is only 20 percent with a 10 percent "defense tax" added, is merely to deceive them and to add an unnecessary complication to an already complicated tax calculation.

This criticism applies not only to the income-tax provisions, but also to the estate and gift taxes, as well as to the special tax on personal holding companies.

Excess-profits tax.—In several respects the practice as proposed in the bill is not made to square with the principle of taxing "excess profits." This is due largely to the inherent difficulty of defining what is normal income, and hence of determining what are "excess profits." These difficulties are at best so great as to raise the question whether the interests of national defense might not be better served, and injustice and uncertainty and complexity avoided, by simply raising the rates of tax on normal income.

We call attention merely to some of the more flagrant injustices in the bill.

The greatest danger lies in levying so high a tax as will tend to defeat its own purpose by stripping the corporations taxed of the resources needed for continuing operations, for carrying out the defense program, and for paying future taxes.

The proposed increase in the rates of the excess-profits tax by adding 10 percentage points to each bracket is, we believe, too drastic and threatens to destroy the tax base on which it is levied.

In considering the effects of this tax, it should be borne in mind:

1. That the tax is imposed not only on ordinary profits, but also on capital gains, which are not taxed in England, and is to that extent a tax on capital;

2. That it is payable in cash and if too high deprives a business of its working capital, and hence of the means of going on in business and paying future taxes and wages;

3. That it reduces the sums available for distribution to stockholders, thus reducing the base for income taxes as well.

Insofar as the bill measures the amount of the tax by the return on capital, it departs from that principle, and unjustly discriminates against mere size by reducing the rate of invested-capital credit, ordinarily 8 percent, to 7 percent on amounts of invested capital in excess of $5,000,000. This manifestation of the superstition that the mere size of a business is evil is, we believe, unsound and unjust.

The bill contains a wise provision allowing a more liberal credit for new capital. It should, we submit, apply to new capital invested since June 10, 1940, the date from which the present law recognizes the right to amortize defense facilities, rather than December 31, 1940, the date proposed in the bill.

This provision properly gives some relief to new businesses which cannot avail themselves of the average earnings method, where they have substantial capital. It will not help a new business having a small capital, and which is built up, as the report of the Ways and Means Committee expresses it (p. 23), "not mainly from capital but from good management, skill, development of goodwill, favorable locations, trade advantages, and other important factors of personal efficiency." We urge that Congress enact a relief provision to cover such cases.

Capital stock tax and declared value excess-profits tax.—These taxes, based on a guess by the taxpayers, with heavy penalties for a wrong guess, have no justification in principle. Their complexities and uncertainties will be greatly multiplied by the increases in corporate taxes, and particularly in the excess-profits tax. These uncertainties are a serious threat to the increased production required by our defense effort, and even to the continued existence of a business which may be ruined by an erroneous guess.

We recommend that these taxes be repealed, and that if the revenue is found necessary, it be raised through increased rates of normal corporation income taxes.

If these taxes are retained, corporations should be given the right to declare the value of their capital stock annually, as it is impossible under present conditions to make valid estimates for the future.

In computing income for declared value excess-profits tax, the present law properly allows a deduction for income taxes. To disallow this deduction, as is proposed in the present bill, would be unfair and deceptive. If additional revenue is required from this source, it should be honestly sought by an increase in the rate of the tax.

Excise taxes and broadening of the base.—The bill continues a number of the existing excise taxes, increases the rates or reduces the basis of others and adds a number of new excise taxes. It adopts this hit-or-miss method of imposing a series of miscellaneous taxes, a method bound to result in discrimination and injustice, instead of squarely facing the problem of finding some general method of taxation which will spread the burdens of taxation more uniformly and justly, and which at the same time will enlarge the tax base and increase the number of taxpayers contributing to national defense. We urge that Congress give serious consideration to formulating some general tax affecting all commodities and business with some measure of equality, such as a manufacturers' excise tax or a general gross income tax deducted at source from all wages, dividends and other personal income payments. Such a tax, we believe, would be sounder in principle, less complicated and uncertain, and much more easily collectible than a large aggregate of excise and "nuisance" taxes.

Reduction of nondefense expenditures.—The people of this country are ready to pay any taxes required to insure its safety. But in calling upon them to shoulder unprecedented burdens for defense, Congress owes it to them to reduce to the lowest possible minimum the burdens of nondefense governmental expenditures. Congress itself should rise to the emergency and cut down nondefense expenses.

Conclusion.—We believe that the American people stand solidly behind the defense effort, and that they will gladly shoulder any burdens for the protection of America. It is in that spirit that we appear before you, not to object to proposed taxes, but to cooperate in making them effective through the elimination of provisions which, by introducing injustice or discrimination, or unnecessary complexity or uncertainty, tend to destroy the tax base itself and to defeat the very purpose of raising the revenue needed for defense.

I should like, if I may, to mention one matter which is not in my prepared statement. Our association protested to the Ways and Means Committee against the provision for joint returns of married couples. That was not included in our statement because we had been advised it had been omitted from the bill. We hear now that there is agitation for its restoration.

We hope the committee will not restore that provision, because we believe it will do a great injustice and work discrimination against married couples and go counter to the tendency all over the world in case where discrimination is made in making the discrimination rather against those who remain single than those who marry.

The CHAIRMAN. Are there any questions?

Senator DANAHER. I would like to ask one, please.

The CHAIRMAN. Senator Danaher.

Senator DANAHER. On page 3 of your prepared statement, sir, you are talking about allowing a more liberal credit for capital and you then suggest that it should apply to new capital invested since June 10, 1940, rather than December 31, 1940.

What is your understanding, please, as to the reason for the change?

Mr. TANZER. The reason for it is that the provision for amortization was inserted in the existing law in order to recognize new capital invested in defense activities and that was made to apply to investments made after the date the defense effort commenced, so that people

would not be able to claim the credit on capital which was not invested for that purpose.

People have been making these additional investments ever since June 10, 1940, and even before, for that purpose; and where the credit is given for new capital we think it should be recognized that it really goes back to the defense effort.

Senator DANAHER. I understand that. I am wondering if you have any understanding as to why December 31, 1940, has been proposed in this bill?

Mr. TANZER. Oh, no; it seemed to us illogical; therefore we thought the same date should be adopted which was in the existing law.

The CHAIRMAN. Thank you very much.

Mr. Wright.

STATEMENT OF ANTON P. WRIGHT, SAVANNAH, GA., PRESIDENT, SOUTH WESTERN RAILROAD CO.

Mr. WRIGHT. Mr. Chairman and gentlemen, I regret to say that the prepared statement from which I will read was sent by express to the clerk of this committee on Saturday, and for some unforeseen reason has not been delivered. The statement which I am about to offer is cumulative and supplemental to a statement made by Mr. Walter A. Edwards, of Providence, R. I., for this committee on the 12th instant.

The CHAIRMAN. Yes; we have the report of that, Mr. Wright. You also appeared before the Ways and Means Committee?

Mr. WRIGHT. I appeared before the Ways and Means Committee and this statement is practically in the language that I submitted at that hearing.

The CHAIRMAN. Yes, sir; well, you can proceed. I am sorry the brief did not get here for every member of the committee, but we have it covered here very well in the record.

Mr. WRIGHT. The decision of the Supreme Court of the United States in the case of *Helvering* v. *Bruun*, rendered March 25, 1940, and reported in 309 U. S. 461, has excited grave apprehension in the minds of those taxpayers who may come within its purview.

No doubt the members of this committee are fully conversant with this decision. However, it may not be inappropriate to briefly recapitulate the holding of the Court in that case, which is as follows:

> Where a tenant by virtue of the provisions of his lease is permitted to erect and does erect at his own expense new buildings upon the property of the landlord and where the lease is subsequently canceled before the expiration of the term, for default in payment of rent and taxes, and where the landlord has regained possession of the land and the buildings, then and in such an event the net fair market value of the buildings erected on the premises by the tenant is taxable gain to the landlord, realized in the year in which the forfeiture of the lease occurs.

This ruling reverses the trend of previous decisions of the courts on this subject, is far-reaching in effect and harsh in its results. The Congress in adopting the Excess Profits Tax Act of 1940 seemed to have in mind the harsh results which would follow from an application of this ruling and section 721 (e) of said act excepted from the taxation, imposed by it, income derived from the termination of a

lease. This section, of course, does not affect the income tax on net income.

The hardship imposed by this decision may be more fully exemplified by its application to a concrete example.

Senator BROWN. Let me interrupt, please. You say that tax is assessed entirely in the year in which cancelation occurred?

Mr. WRIGHT. Yes.

Senator BROWN. You want to spread it over a number of years, is that the idea?

Mr. WRIGHT. No; not that exactly. What we wish to do is when the property is disposed of that then any gain or loss should be taxed.

The South Western Railroad Co. is a corporation chartered December 27, 1845, by act of the General Assembly of Georgia. On the 10th day of February 1848, the company was formally organized and from that day to this, or for 93 years, it has enjoyed a continuous corporate existence, which was not even interruppted by the War between the States. The road has a main-line trackage of 333 miles in round figures, and extends from the city of Macon, Ga., which is practically the geographical center of the State, to various points in southwest Georgia. In 1869, the South Western being then a fully equipped, going railroad executed a perpetual lease of its property and franchises to the Central Railroad & Banking Co. of Georgia at a minimum rental equivalent to 7 percent upon its capital stock. The railroad was operated under this lease until March 4, 1892, at which time, the lessee, the Central Railroad & Banking Co., was placed in the hands of a receiver. The Central Railroad & Banking Co. was reorganized in 1895 under the name of the Central of Georgia Railway Co. and the reorganized company at that time adopted the lease of the South Western Railroad Co. to the Central Railroad & Banking Co. with certain modifications, one being that the term of the modified lease should run for 101 years. In 1932, the successor corporation, Central of Georgia Railway Co., was placed in the hands of a receiver and subsequently, the receiver adopted the lease of the South Western to the Central of Georgia Railway Co. with certain modifications. Subsequent thereto, in June 1940, the Central of Georgia Railway Co. filed a proceeding for reorganization under section 77 of the Bankruptcy Act and the trustees appointed under said act, in turn adopted the renewal lease of 1895 to the Central of Georgia Railway Co. with certain modifications.

Under the terms of the original and renewed leases, the lessee undertook to keep the South Western Railroad in good order and repair. Of course, many vital changes have taken place in the technique of railroad operation since 1869, and, naturally, in order to maintain the South Western as a modern, efficient railroad, the lessees have been forced to expend large sums upon this line. In the natural course of events since the original lease of 1869, all of the equipment of the South Western Railroad Co. has been consumed in use and the equipment now serving the line is that which is furnished by the Central of Georgia Railway Co.

The additions and betterments made to the property of the South Western Railroad by the Central of Georgia Railway Co. from July 1, 1914, through October 1940, amount to a total of $3,220,171.45. (No figures are available for the period prior to July 1, 1914.)

The financial structure of the South Western Railroad is simple, consisting of 51,911 shares of common stock of the par value of $100 per share of a total capitalization of $5,191,100. This remarkable state of affairs appears. It has no bonds, debentures, preferred stock or debts of any kind. Owing to these favorable factors and a fixed return guaranteed by the terms of the lease, the stock of the South Western Railroad Co., for many years, has been a favored investment. It has some 1,100 stockholders and among these will be found many trust estates, eleemosynary institutions, and small investors. It is obvious, however, that if the betterments placed on the property at a cost of $3,200,000, in round figures, is taxable gain to the railroad, should its lease be abrogated, the solvency of this enterprise will be substantially impaired. Under the accounting practices prescribed by the Interstate Commerce Commission, no depreciation is taken by the Central of Georgia Railway or by its leased lines, except upon equipment; additions and betterments are charged to capital account and where retirements are made, the value of the same, if any, is credited to the same account.

The lease to the Central of Georgia Railway Co. of 1895 provides for a rent equivalent to 5 percent upon the capital stock of the South Western, which amounts to $259,555 per annum.

If the lease should be abrogated and even if the South Western Railroad Co. were fortunate enough to secure a new lessee at a rent equivalent to 5 percent upon its capital stock the untoward results above pointed out could not be avoided.

In the present unhappy state of the railroads, it is futile to attempt to prognosticate what will be their ultimate fate. Even under the improved conditions brought about by large defense projects, it is conceded that there will have to be drastic changes made in the capital structure of the Central of Georgia Railway Co. in reorganization. It is not disputed by any one familiar with the affairs of the Central of Georgia Railway Co. system that the South Western Railroad Co. is an important and indispensable part of that system.

While the South Western Railroad is only capitalized at $15,666 per mile, and while its depreciated value, as ascertained by the Interstate Commerce Commission is in excess of $12,000,000; and while a rental of $259,555 per annum seems to be exceedingly reasonable, its peculiar situation renders it difficult to engage the attention of competing lines. In a word, the South Western is worth more to the Central of Georgia Railway Co. than it is to any other railroad in this territory.

Undoubtedly when the Central of Georgia Railway Co. is reorganized, if it is deemed important to preserve the integrity of the system, it will be incumbent upon the reorganizers to assume the present lease of the South Western with such modifications as may be agreed upon between the reorganized company and that company. Such negotiations would unquestionably be hampered by the fact that if the South Western were unwilling to submit to a modification of the present lease embodying less favorable terms, it would be difficult to maintain such a position in view of the fact that the abrogation of the present lease would expose it to the large tax liability imposed by virtue of the decision in Helvering versus Bruun.

In view of these facts, we venture the opinion that this decision

produces a situaton which ought to be releved against by appropriate legislation.

If the observations submitted seem to warrant the favorable consideration of this committee, and if it is proper to make such a suggestion the remedy would seem to lie in an amendment to paragraph (b) of section 22 of the Internal Revenue Code by adding at the end thereof a paragraph reading as follows:

(10) Income received by a lessor upon the expiration or termination of a lease by reason of additions, betterments, and improvements to the leased property made by the lessee.

The CHAIRMAN. Are there any questions?

(No response.)

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

Mr. Mitchell B. Carroll.

STATEMENT OF MITCHELL B. CARROLL, NEW YORK, N. Y., NATIONAL FOREIGN TRADE COUNCIL, INC., NEW YORK, N. Y.

Mr. CARROLL. Mr. Chairman and members of the committee, my name is Mitchell B. Carroll, 67 Broad Street, New York. I am counsel for the tax committee of the National Foreign Trade Council, Inc.

In behalf of the American companies that are still endeavoring to carry on trade abroad, particularly in Latin America, I wish to bring to your attention a situation which has developed in foreign countries beyond the reach of your committee, yet which frustrates the operation of a section of the Internal Revenue Code adopted in 1918 by your committee and has since been maintained in our revenue legislation.

As you know, foreign countries, in their effort to maintain their monetary resources, have adopted exchange restrictions. As the result income derived in one year by an American enterprise operating in, say, Brazil or Chile or Colombia may be blocked by local exchange restrictions so it cannot be brought home to the American enterprise, and that income may not be released until the second year or the third year. When this happens, by reason of a decision rendered by the Board of Tax Appeals, the American enterprise may be deprived of its credit for foreign taxes. A provision was adopted in 1918 to put our American enterprises, competing in foreign markets after the World War, on an equal footing with the enterprises of other countries which were receiving exemptions and subventions and other benefits.

Consequently, I come before you with a very simple amendment which is, in effect, to permit the carrying forward of foreign tax on income which has been blocked as a credit against the United States taxes until the income, which is imposed is released and brought into gross income.

In other words, there is a simple amendment to rectify a situation which has been brought about through the disturbed economic conditions in the world today.

I have here a memorandum that I would like to submit to your committee which goes into the technical details, which are well known to your staff and, if you will permit me, sir, I might go into the details at some later date with Mr. Stam, or some other representative of the committee or the Treasury.

The CHAIRMAN. Yes; you may file your statement, if you wish, for the record.

Mr. CARROLL. Thank you, sir.

The CHAIRMAN. All right. Thank you very much.

(The statement referred to is as follows:)

AMENDMENT TO SECTION 131 OF THE INTERNAL REVENUE CODE PROPOSED FOR INCLUSION IN THE REVENUE BILL OF 1941 IN BEHALF OF THE NATIONAL FOREIGN TRADE COUNCIL, INC., 26 BEAVER STREET, NEW YORK, BY MITCHELL B. CARROLL, ESQUIRE

INTRODUCTORY STATEMENT

Mr. Chairman and members of the Committee on Finance of the United States Senate, the members of the National Foreign Trade Council are gratified that the House has adopted in the revenue bill of 1941 section 108 which provides for the reduction, in pursuance of treaties, of the rates of tax to be withheld from certain recurring items of income derived by nonresident alien individuals resident in, and corporations organized under the laws of, Western Hemisphere countries. This provision should indeed tend to accomplish the purpose set forth in the official report of the House Committee on Ways and Means (p. 9, par. 6), namely, that "the extension of this favorable treatment is a part of the program toward improving relations with our sister nations in the Western Hemisphere."

Therefore, the council heartily endorses this amendment and hopes that the Senate will concur in its adoption.

PROPOSED AMENDMENT TO ALLOW DEFERRING OF THE CREDIT FOR FOREIGN TAXES ON BLOCKED INCOME UNTIL RELEASE OF INCOME

You are doubtless aware that, just as you are considering the raising of taxes according to the criterion of the utmost capacity to pay, the legislatures of other countries are likewise engaged in augmenting their rates to about the highest point the traffic will bear. If an American enterprise carrying on business in any one of these countries realizes income there, which is subject to burdensome rates both in the foreign country and again in the United States, the resulting burden would be so great that American enterprises might have to withdraw and leave the field to competitors.

Many of you may recall that our commercial enterprises were faced with a similar situation along toward the end of the last war and, in the Revenue Act of 1918, the Congress wisely decided that if our enterprises were to continue to compete abroad with foreign companies which were receiving tax exemptions and other kinds of aid from their respective governments it would be necessary at least to allow a credit against the United States income tax for income taxes paid in foreign countries. The credit has justifiably been limited so that in no case the offset may reduce the United States tax on domestic income, and where the foreign rate is lower than the American rate, our Government collects the difference in rates on the foreign income. However, in recent years, and particularly at the present time, enterprises are being denied the benefit of this credit because of circumstances arising from the disruption of economic life abroad and the trends of foreign tax legislation.

As you know, an increasing number of countries, including countries of the Western Hemisphere, are forced to adopt exchange restrictions in order to arrest the depletion of their national monetary resources, with the result that, in many cases, profits which have been earned abroad by American enterprises are blocked and cannot be availed of. The question has arisen whether such income, which cannot actually be enjoyed by the American enterprise, should be treated as income for tax purposes here, and the Board of Tax Appeals has ruled that such blocked income need not be treated as income until it is unblocked or becomes convertible into dollars. (*International Mortgage and Investment Corporation* v. *Commissioner*, 36 B. T. A. 187). However, if this unblocking takes place in a later year, the limitations in section 131 (b) prevent taking the credit for the tax paid abroad on such income.

Hence, we respectfully urge you to remove this inadvertent inequity by adopting our proposed amendment which, in substance, would treat the tax as following the income and would allow it to be taken as a credit in the taxable year when the income in question is brought into gross income.

TECHNICAL DISCUSSION OF AMENDMENT

The decision in the case of *International Mortgage and Investment Corporation* v. *Commissioner* (36 B. T. A. 187) to which the Commissioner has given his acquiescence, 1937-2 CB 15, permits the carrying forward for tax purposes of completely blocked income until it is released; and, if this interpretation of the law is generally applied, it may result in the loss of the credit for foreign taxes in a growing number of cases. This problem may become more serious for American export corporations in view of the probable increase in exchange restrictions on foreign currencies because of the war situation. The credit for foreign taxes on blocked income may be assured, however, by a simple amendment which merely states a principle inherent in section 131 of the Internal Revenue Code.

In the above-mentioned case the petitioner realized gain by purchasing at less than their face value mortgages which were paid off at their full value. The Board of Tax Appeals observed that, measured in marks, the petitioner had income from its business in Germany, but that income for our Federal income-tax purposes is measured only in terms of dollars. The marks received after a certain date were blocked and they could not therefore be removed from Germany either physically or by way of a credit during the remainder of the taxable year, nor could the dollar equivalent of the marks be obtained. The petitioner did not have unrestricted use and enjoyment of the marks, and could not use them to retire its bonds as planned. It could not have any of these marks released until a number of years later. The marks were seriously restricted and in no sense the equivalent of free marks. The Board therefore held it was improper to compute a gain to the petitioner from the repayment of the mortgages by translating the gain in marks received into dollars at the rate of exchange applicable to free marks.

However, the Board held that taxable gain had been realized in marks which were received previous to the time of the imposition of the exchange restrictions and because those earlier funds had been freely negotiable, convertible, and transferable. They could have been removed from Germany when received but had been allowed to remain there until they were blocked.

There may be a great many situations in which an American taxpayer will receive foreign currency income in the forms of dividends, interest, royalties, trading profits, or otherwise, which is blocked, and only in a later year susceptible of conversion or of realization through use.

Although the International Mortgage and Investment Corporation decision involved only a very limited class of income, its basic reasoning may well apply in determining what shall be included in gross income in many other blocked currency situations. It would be very difficult to draft legislation to cover the facts of all these situations, and perhaps it may be best to leave to determination in audit whether, under the facts of each case, blocked foreign income should be regarded as realized in terms of dollars and included in gross income, or should be regarded as not realized until a later year. In the former case, the amount of foreign taxes thereon would be converted into dollars at the same rate and taken as a credit under section 131. However, if foreign income were not included in gross income until a year or more after it arises abroad, then any foreign income taxes paid or accrued with respect to such income should be carried forward for the purposes of the credit for foreign taxes in section 131 until the foreign income is included in gross income.

Only such a procedure would be consistent with the underlying principle of the foreign tax credit. The law presupposes that foreign income will be subjected to the United States tax for the year in which it is realized and, under section 131 (a), only taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States may be taken as a credit. Furthermore, under section 131 (b) (1), the credit for the taxes of any particular foreign country may not exceed the same proportion of the United States tax against which it is taken, which the income from such country bears to the entire net income, in the case of a taxpayer other than a corporation, or to the normal tax net income, in the case of a corporation, for the same taxable year (sec. 131 (b)).

Strictly speaking, therefore, under the language of subsection (a), the foreign tax paid on blocked income can be credited only in the taxable year in which it is

paid or accrued. If the taxpayer regularly takes credit on the accrual basis, and if the blocked income involved is not brought into gross income in the given year, no credit would be allowed in that year because the numerator of the limiting fraction would be zero. Situations might also arise where taxpayers could not take credit for the foreign tax on a paid basis for similar reasons. Furthermore, when, in a subsequent year, the funds are freed for conversion into dollars or utilization, they would be subjected to the United States tax, but ordinarily no credit could be taken against the United States tax for the foreign tax which was paid or accrued during an earlier taxable year. Hence, in such cases the income would be doubly taxed and the purpose of the credit for foreign taxes would be frustrated.

The original intent of section 131 could be realized if the section were amended so as to incorporate specifically the principle that the foreign tax would not be deemed to have been paid or accrued until the taxable year when the income is included in gross income. This might be accomplished by inserting at the end of subsection (d), entitled "Year in Which Credit Taken," the following language printed in italic:

SUGGESTED LANGUAGE OF AMENDMENT

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102, shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess-profits taxes, paid or accrued during the taxable year to any foreign country or to any possession of the United States; and * * *

* * * * * * *

(d) *Year in which credit taken.*—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year. *In any case, for the purposes of subsection (a) of this section, taxes paid or accrued to any foreign country or any possession of the United States shall be deemed to have been paid or accrued during the taxable year when the income upon or with respect to which they are imposed is included in gross income for purposes of the tax imposed by this chapter.*

If the above location of the new language seems inappropriate, the amendment might be added to section 131 as a new subsection, as follows:

( ) *Definition of taxes paid or accrued.—For the purposes of subsection (a) of this section, taxes paid or accrued to any foreign country or any possession of the United States shall be deemed to have been paid or accrued during the taxable year when the income upon or with respect to which they are imposed is included in gross income for purposes of the tax imposed by this chapter.*

DEDUCTION OF FOREIGN TAX

The carrying forward of the foreign tax for the purpose of taking it as a deduction under section 23 (c) (2), if the taxpayer prefers, might also be covered, as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.—In computing net income there shall be allowed as deductions:

(c) *Taxes generally.*—Taxes paid or accrued within the taxable year, except—

(2) Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries and possessions of the United States), *and in such case, taxes paid or accrued to any foreign country or possession of the United*

States shall be deemed to have been paid or accrued within the taxable year when the income upon or with respect to which they are imposed is included in gross income.

The CHAIRMAN. Mr. Alfred L. Smith.

STATEMENT OF ALFRED L. SMITH, ELKHART, IND., CHAIRMAN, COMMITTEE ON TAXATION, NATIONAL ASSOCIATION OF BAND INSTRUMENT MANUFACTURERS

Mr. SMITH. Mr. Chairman and gentlemen of the committee, my name is Alfred L. Smith. I am executive vice president of C. G. Conn, Ltd., Elkhart, Ind., manufacturers of band and orchestra instruments, and I am speaking on behalf of the National Association of Band Instrument Manufacturers. This association is composed of the manufacturers of band and orchestra instruments.

This is a separate and distinct industry within the general music industry, manufacturing the instruments of the symphony orchestra; that is, the wind, percussion, and string instruments. Our great market is the public-school system and the children in the system who take instrumental instruction and our secondary and much smaller market is the professional musician who uses these instruments as the tools of his trade.

We are very small industry. I suppose I have the distinction, if it is a distinction, of representing the smallest group of any industry that has appeared before this committee. If you eliminate the small shops employing less than 25 people each, we have only about 15 manufacturers, and we employ only about 2,000 men, but on this tiny industry there depends entirely the development of the musical art in this country.

Also I might say that in no group of employees of this size, or any size, could you find, perhaps, a greater proportion of men who are very highly skilled, who have devoted their entire lifetime to one job. Throughout the entire industry, the employees are old. Probably the average is way over 50 years. These men are not of the type, they have not had the experience, and they are not of the age that they can be transferred to defense work, and they are dependent, and their families are, for their livelihood on this industry. For that reason, I ask your careful consideration of some of the problems of this industry which are affected by this tax.

Senator BROWN. Mr. Smith, you are now taxed at 5½ percent, are you not?

Mr. SMITH. We are not taxed at all now. We are proposed to be taxed 10 percent on the manufacturers' price in the bill.

Senator BROWN. The House report, section 3404, emphasizes the tax on sales, manufacturing certain radio components at the rate of 5½ percent of the sales price. Section 545 amended this to impose a tax of 10 percent on radio receiving sets and certain other instruments, including musical instruments.

Mr. SMITH. Yes; that added the musical instruments, but the musical instruments were not taxed at all.

Senator BROWN. Now it is proposed that you be taxed 10 percent?

Mr. SMITH. That is right.

Senator DAVIS. Mr. Smith, what portion of the instruments are purchased for the young people of this country, especially those in the schools?

Mr. SMITH. Well, as between the children in the schools and the professional musicians who constitute the great market, I should say it is, roughly, in value—about 80 percent goes to the school children and 20 percent to the professional musician. That is not taking into account purchases by village bands, of which there are a few, and the lodge bands, and individual instruments of people for enjoyment; but I presume that between the school children and professionals, they account for 95 percent of the production, and that 95 percent, I should say, is divided about 80 percent between the children in the schools and 20 percent to the professionals.

When it comes to the number of instruments, the percentage to the schools is much larger, because, obviously, the professionals have to use the highest grade, the highest-priced instruments, whereas the children start with the third or lowest-grade instruments; and if they continue their instructions, as many of them do, they get the medium grade, and finally they purchase the highest grade. As a matter of fact, more of the very highest, finest instruments are purchased by the children in the schools than there are purchased by the professional musicians.

Senator DAVIS. If you pass this 10-percent tax on, how much will that increase the price to those youngsters that buy these instruments?

Mr. SMITH. It will increase the price by 10 percent to the consumer. That will mean in dollars to the beginner from about $5 to perhaps $15 or $20, and to the child who has progressed beyond the beginning stage and buys the better instrument, it will probably run from $10 to $25, depending on whether it is a trumpet, for instance, which is a relatively inexpensive instrument, or, we will say, an alto or bass clarinet, which is the expensive type of instrument.

Senator DAVIS. It is going to be difficult for them to buy the instrument. I recall when I was quite a youngster I got 50 cents a day, and I had to pay 50 cents a week on my clarinet. It was a difficult thing to get that half dollar. I presume there has not been much of a change since that time.

Mr. SMITH. Senator, you know parents may endure a lot of privation to give their children an enducation, whether it is a musical education or any other type of education. We know that they do go a long way in the poorer families. We also know these increased prices will curtail sales. They will have to, because our sales are primarily to the poorer people.

In other words, our market is primarily in the rural districts in those States from Wisconsin down through to Texas and in the poorer sections of the industrial States, like in your State of Pennsylvania, Senator, and the State of Ohio, and our poorest markets are in the better suburbs of the big cities. In other words, music is the poor man's art, and he is the one that wants his children to take instrumental music. It is true that you will find the biggest, finest symphony orchestras and bands in the smaller towns and rural schools and in the workingmen's sections of the cities. The consolidated school has been

a great thing in this respect, because it has brought music to the districts where, with the little individual schools, they never had this sort of thing.

Senator DAVIS. I know a great number of men and women, too, as far as that is concerned, that are playing in these symphonies that had a difficult time to get their instruments when they were young people, when they were merely beginners.

Mr. SMITH. That is right. I think it is fair to say that the average person who buys these instruments does it for a serious educational purpose and does it with considerable struggle to get the money, because they are not inexpensive instruments, even the lowest grades of them.

Senator BROWN. Mr. Smith, under the chapter which this section amends, there is an exemption which is the same as the exemption found on page 71 of the House bill which we are considering, which refers to any instruments which are bought by a subdivision of any State.

Mr. SMITH. Yes.

Senator BROWN. That is why, it would seem to me, as to the effect of this particular tax, it would be very easy for the board of education of a school district to buy these instruments and thereby avoid the tax. Is not that very commonly done?

Mr. SMITH. It is with certain types of instruments. There are certain instruments that no parent wants to buy his child. He does not want to buy a bass horn, or a bass drum, or perhaps a bass clarinet. Those are big instruments and the school boards buy those instruments; but all of the smaller instruments and all of the beginners' instruments, which constitute the great bulk of the instruments—I suppose 90 percent are bought by the individuals. In a great many communities, for instance, in the South, in the Southeast, where the movement is developing very rapidly now, the schools are very much restricted for funds, and the parents get together in clubs and raise this money for the big instruments. Of course, all the individuals who buy them individually are subject to the tax, and I do not see any way that they can avoid it.

Now there have been many suggestions before your committee and particularly, I think, before the Ways and Means Committee, which would indicate that the purpose of these excise taxes at higher rates is primarily curtailment of so-called luxury or less essential industries, yet, at the same time, the claim is made that these industries, including our industry, can be taxed at these terrifically high rates, or must be taxed at these terrifically high rates because the Government needs the money. We know the Government needs the money, we know we are all going to be taxed heavily; it cannot be avoided, but we submit that those two purposes are inconsistent. You cannot have both. If you are going high enough to curtail, then the Government does not get the revenue; if the Government gets the revenue then there is no need for curtailment.

Now, if the purpose of this tax, as has been said in some quarters, is curtailment of industry which we think is erroneouly considered less essential in these times, then I submit that you are too late, that other factors, unavoidable factors, are already working and are already curtailing this industry far beyond anything this tax will do; and the

income, the revenue to be derived by the Government by this tax will be only a fraction of the estimate of the Treasury Department. There is every indication that before the end of this year there will be practically no band and orchestra instrument industry in existence, except possibly 10 percent which will go to the Government for the Army and Navy Bands, on which, of course, there is no tax to be collected.

Senator RADCLIFFE. Mr. Smith, do you understand that this tax is on the church organs?

Mr. SMITH. Yes. I am not speaking of church organs, but the tax is applicable to church organs, yes.

Senator RADCLIFFE. What percentage, do you happen to know, goes to the value and number of organs owned by religious organizations?

Mr. SMITH. I do not know. I can only guess from a casual connection with that end of the business, but I would say that, with the decline of the theater organ, practically all of the organs now are sold to churches, but I might be wrong.

Senator VANDENBERG. Well, I think you have proven that bands are essential today. I do not know how you can work up a war without a band.

Mr. SMITH. You are not accusing us of working up a war, are you, Senator?

Senator VANDENBERG. No.

Mr. SMITH. In 1939, according to the Bureau of the Census, this little industry produced about $6,667,000 worth of musical instruments which, at this rate, would yield, even in a good year like that, only $660,000, but our opinion is, according to present indications, next year and for years to come until we are out of this emergency, we will not produce more than $1,500,000, which would mean that this tax would produce, during that period, probably not more than $150,000 a year.

Now, the reason for that is that the biggest groups of instruments in this industry, the cup-mouth pieces, for instance, which are the so-called brass instruments, unfortunately require the four metals which are most critical in the defense program, nickel, aluminum, zinc, and copper. Brass itself is 80 percent copper and 20 percent zinc. The Office of Production Management has stated that in this country there is not more than 75 percent of the nickel and 75 percent of the copper absolutely essential to the defense program alone, and that industries like ours are not going to get any after we have exhausted our present materials, and I think it is easy to see why that is so.

So that the cup-mouth instruments, after we have exhausted our supplies of material, which will be only a few months now, will be nonexistent.

The wood-wind, which are the next group, we estimate will be down to 25 percent. The percussion instruments will not be greatly affected, but they are a comparatively small group. The string instruments are affected probably not at all, because they use no defense material. But because of the curtailment, we will be down to something like $1,500,000, and perhaps produce a revenue of $150,000.

We believe that in view of the essential need of our industry and of our product, or rather, not our industry but the essentiality of our product to the continuance of the art of music, that for a paltry

$150,000, we ought not to be taxed when we find ourselves in this terrible situation.

Senator JOHNSON. Is the price advancing very rapidly in musical instruments?

Mr. SMITH. It is not yet. Our own company—and I think this would apply throughout the industry—had only one price increase. We increased our labor cost as the result of the reduction from 44 hours to 40 hours, and we made that up to our men for some months; we absorbed the increased material costs, but last March we increased our prices somewhere around 10 percent. The raw material costs have continued to increase. We have got to increase again. With the curtailment, due to this defense program, which we cannot avoid, our overhead costs, of course, are going to soar, with the result that we must increase our prices, and I am afraid they will go up very greatly, and, of course, we are afraid that they will get to that point where these people will not be able to buy the instruments to give their children a musical education, and the children, during this time, will not be able to begin their musical education or continue it if they have to have new instruments. Our prices, while they have not gone up very much yet, they are going up. We cannot avoid it.

The CHAIRMAN. Mr. Smith, you have exhausted your time limit. Is there anything you wish to put in the record?

Mr. SMITH. Yes; I have a brief which I should like to put in the record. I would like 1 minute more. I want to make a specific request for an exemption of band and orchestra instruments. I want to state that this industry is willing to do its part. It is going to pay heavy taxes. We believe that the way to raise taxes from industry through the sale of their product is a general manufacturers' tax on all manufactured products, except possibly food, clothing, or some few things like that, and that irrespective of how high this rate will have to be, we should have a rate that will produce this revenue equitably from all manufacturers.

Senator DAVIS. How many persons are employed in the instrument-making industry?

Mr. SMITH. About 2,000, if you except the small local shops of which we have no knowledge. You have a man, for instance, who makes violins who may have two or three employees, or a man who may make bassoons. He has two or three employees. I am excluding them. We have about 2,000 in the band and orchestra industry.

The CHAIRMAN. All right.

Mr. SMITH. I only want 1 more minute. There is another matter we did not know about. I want to call your attention to the section having to do with reporting on installment sales.

There is a provision, if we understand it correctly, that, on all sales made between July 1 and the date of the passage of this act, the seller must pay the tax on the unpaid installments collected after the passage of the act and we submit that that is an impossible situation.

For instance, our company has 11 retail stores. They are not separate corporations. They are operated as divisions of a parent corporation. We are the manufacturer and the seller. Even though we sell at retail, we had no knowledge of this provision in the act, if

we understand it correctly and if it is not changed, we will have to pay 10-percent tax on all of our collections on those sales since July 1, and there is nothing like that profit in the business.

We think your committee should consider that gross inequity.

The CHAIRMAN. Yes, sir. That has been brought to the attention of the committee by several witnesses. I think that will certainly be looked into.

Mr. SMITH. Thank you.

The CHAIRMAN. Thank you very much.

(The brief by Mr. Smith is as follows:)

BRIEF BY ALFRED L. SMITH IN OPPOSITION TO APPLICATION TO BAND AND ORCHESTRA INSTRUMENTS OF THE PROPOSED 10 PERCENT TAX ON MUSICAL INSTRUMENTS

AUGUST 20, 1941.

The FINANCE COMMITTEE,
United States Senate, Washington, D. C.

GENTLEMEN: The National Association of Band Instrument Manufacturers respectfully urges the Finance Committee to adopt, in place of the new manufacturers' sales taxes in this bill, a general manufacturers' sales tax excepting only food, some types of clothing, and fuel, at a rate which will produce the revenue anticipated from these excise taxes, as well as such additional revenue as may now have become necessary.

With respect to section 3404, tax on radio receiving sets, phonographs, phonograph records and musical instruments, subparagraph D, musical instruments, as it applies to band and orchestra instruments, we request your consideration of the insignificant amount of revenue which the tax would yield and the deplorable effects which this tax would have on the industry and the art of music which it serves.

The band and orchestra instrument industry is a separate and distinct industry within the general music industry. Its products are the instruments used in the symphony orchestra—that is, the wind, string and percussion instruments. Its largest market is the public-school system and the children in it taking instrumental music instruction, and its secondary market comprises the professional musicians who use these instruments as the tools of their trade.

The industry is a small one, whose continued existence, however, is essential to the development of the art of music in this country, particularly through instrumental instruction in the schools. Omitting the small shops employing fewer than 25 persons each, there are not more than 15 manufacturers and their factory employees number about 2,000. In no similar number of workman in any industry, however, could there be found more highly specialized and skilled craftsmen who have devoted their entire lifetime to the manufacture of a single product and know no other trade. Most of them are too old to be adaptable to strange occupations in defense work or other industries. They and their families are entirely dependent upon the continuance of this industry. Therefore we urge you to consider this proposed tax on musical instruments, insofar as the band and orchestra instruments are concerned, with sympathetic understanding of the conditions which now threaten the very existence of this industry and the continuance of work for the employees engaged in it.

There have been suggestions made before your committee, and previously before the Ways and Means Committee, based upon the theory of using the taxing power of the Government to curtail drastically alleged non-essential or less essential industries. At the same time these taxes are advocated because the Government requires the revenue which it is hoped they will produce. Both results cannot be obtained. It is impossible to tax so as to curtail production and at the same time maintain the tax yield. Furthermore, in the case of band and orchestra instruments, there is no need of a tax for purposes of curtailment; other unavoidable factors are already doing this far more effectively—so effectively, in fact, that the revenue yield from this tax will be but a small part of the amount which the Treasury Department experts have estimated.

There is every evidence that there will be no band and orchestra industry in this country by the end of this year, except for minor production for Army and Navy requirements, which will not use 10 percent of the facilities of the indus-

try. Under these circumstances, how can this proposed tax be productive of any substantial revenue? Present indications are that at best the revenue yield from this tax in 1942 will be about $150,000.

Estimated tax yield, 1942

	Production in 1939	Estimated production in 1942	Annual tax yield at 10 percent
Cup mouthpiece instruments	$2,787,120	None	None
Woodwind instruments (clarinets and other wind, i. e., oboes, flutes, etc.)	1,445,962	[1] $216,894	$21,689
Percussion instruments	1,468,858	[2] 1,101,643	110,164
Saxophones	842,976	None	None
Violins and other bow instruments	226,074	226,074	22,607
Total	6,770,990	1,544,611	154,460

[1] 15 percent of 1939.
[2] 75 percent of 1939.

Cup-mouthpiece instruments.—Cup-mouthpiece instruments, which constitute over 40 percent of the total production, are made almost entirely of brass. Brass is constituted approximately of 20 percent zinc and 80 percent copper. For several months zinc has been available to vital defense industries only. According to the Office of Production Management, there is more than 25 percent shortage of copper necessary for defense requirements alone. On August 1, our industry was notified by its sources of brass supply that no more brass would be available for the manufacture of band instruments, and it is impossible to obtain any official indication that brass will be available to the industry during the year 1942. Consequently it is expected that the production of cup-mouthpiece instruments will cease completely when the present brass supplies of the industry are exhausted. No manufacturer has sufficient supplies of brass to continue operation beyond December, and most of the production of the industry will have ceased before that time.

Saxophones.—The above remarks concerning cup-mouthpiece instruments apply likewise to saxophones.

Wood winds.—Wood-wind instruments, consisting primarily of clarinets, oboes, bassons, and flutes, comprise about 21 percent of the industry. Probably more than half of these instruments are made of brass or nickel silver, and production on them will have ceased entirely by the end of the year for the same reasons as apply to cup-mouthpiece instruments. Most of the other wood winds are made of grenadilla wood, imported from East Africa, importation of which is no longer possible. Manufacturers' stock of grenadilla wood are limited. Rubber and plastic bodies may be substituted for metal and wood, but rubber is no longer available and plastics are difficult to obtain. The key mechanisms of these instruments require nickel silver, none of which has been available for several months because of vital defense needs which it is expected will continue indefinitely. The manufacturers' supplies of nickel silver are almost entirely exhausted. Therefore it is expected that production of wood winds will be small after December 1, probably not more than 15 percent of normal in 1942.

Percussion instruments.—Percussion instruments account for about 22 percent of the total. Aluminum is essential in the manufacture of some percussion instruments, and where substitutes have not been found, these instruments have already been eliminated from the manufacturers' lines. The recent shortage of steel will curtail further the production of other models of instruments. Relatively, however, percussion instruments will not be so badly curtailed in production and in 1942 might possibly be as high as 75 percent of normal.

Bow instruments.—Violins and other bow instruments will probably not be greatly affected, although some of the imported woods used, as well as miscellaneous hardware, are becoming difficult to obtain.

There is a possibility that this industry, like other nondefense industries using vital metals, will be rationed in 1942. However, if the shortage of vital materials as published by the Office of Production Management continues, it is difficult to see how industries such as this can be rationed without interference with the vital preparations for defense. The British band and orchestra instrument

industry has been rationed at 25 percent. Under any such rationing, the amount of revenue resulting from the proposed tax would still be insignificant.

The manufacturers of band and orchestra instruments will naturally make every effort to make up for the disappearance of band-instrument production by defense work. Their continued existence in business depends on their success in obtaining defense contracts. It is not difficult to obtain defense work to the capacity of screw machine, punch press, and other machine departments, but these departments employ relatively few workmen. It is proving very difficult to obtain sufficient defense contracts of a type to keep polishing, plating, and similar departments busy even partially, and practically impossible to get defense contracts which will maintain employment for the specialized band-instrument workers, such as horn assemblers of all kinds, burnishers, and engravers. Many of these employees are very highly skilled, have worked for many years in their specialized trades, and are no longer young and adaptable enough to make the change to machine operators or assembly of defense products bearing no relationship to musical instruments. Even if the industry is fortunate enough to be rationed at 25 percent in 1942, there will not be work for most of these skilled operatives. Unemployment among skilled workers in the band and orchestra instrument industry will be most severe. It is, therefore, necessary that everything possible be done to prevent the curtailment of regular production below the point at which the industry can provide work for skilled workers who cannot be transfered to defense operations.

Insofar as this is a problem of raw materials, we realize that it is not a matter over which your committe has any control. However, a 10-percent tax imposed at this time on an industry struggling for its very existence will be unduly oppressive and disastrous. Prices, in the opinion of industry, are already approaching a prohibitive point, yet further increases are already necessary as a result of increases in costs of raw materials. With production of band and orchestra instruments at such low levels as must be expected under the most favorable rationing, overhead costs will soar to unheard-of heights, with consequent further increases in prices to the consumer. If, on top of these unavoidable price increases, there is piled another 10-percent increase due to this tax, it may well be that such little peacetime band- and orchestra-instrument business as is left will entirely disappear, because of the inability of children to pursue their musical education further, in the face of excessive prices for their musical instruments.

In view of the critical situation facing the band- and orchestra-instrument industry, and especially in view of the fact that this proposed tax will produce insignificant revenues during the predictable future, we urge you to except band and orchestra instruments from the proposed tax, as a measure of fairness and justice to a struggling industry and to the employees and their families dependent upon it.

Respectfully submitted.

NATIONAL ASSOCIATION OF BAND INSTRUMENT MANUFACTURERS.
By ALFRED L. SMITH, *Chairman, Committee on Taxation.*

STATEMENT OF JOHN G. LERCH, NEW YORK, N. Y., REPRESENTING THE TOY MANUFACTURERS ASSOCIATION

Mr. LERCH. Mr. Chairman and members of the committee.

The CHAIRMAN. You represent the Toy Manufacturers Association?

Mr. LERCH. I represent the Toy Manufacturers Association, and I am appearing here with respect to several items in this proposed bill which we believe were overlooked so far as the toy industry is concerned. There has been a consistent policy throughout the internal-revenue legislation not to tax toys or playthings or juvenile articles. In all of the revenue bills it has been so considered by the Treasury Department, except one instance, throughout the history of that legislation, and we do not think that it was the intent of the framers of this bill to tax toys or playthings or juvenile articles.

For instance, in the sporting-goods section of this bill, great care has been taken to exempt all those toys or juvenile articles. In con-

sidering tennis rackets, golf clubs, badminton rackets, and such, the taxable articles are all limited to that size used by an adult; there is exempted the small toy or juvenile article. We believe that was the intent of the House and has been the intent right through this legislation. We would suggest, therefore, at the end of part V of this act that you add a section, much in this language:

No taxes shall be levied under part V of this Act on children's toys, children's playthings, juvenile articles, or parts thereof.

I think that would carry out what has been considered to be the intent of Congress and what is the intent of Congress in this bill.

Senator VANDENBERG. When does a person cease to be a juvenile under your definition?

Mr. LERCH. There are a number of court decisions on that, and about 18, I would say; between 16 and 18. There are decisions on what a juvenile court has jurisdiction over; some say 16, some 18. In other words, they reach maturity at one of those ages.

Senator VANDENBERG. Well, we are probably safe in saying they have reached maturity when they are old enough to be drafted.

Mr. LERCH. Now, as I said, if that section were added to this bill, it would take care of a number of these instances I would like to call attention to specifically, but there is one item, and that is tires, in the present bill, which the Treasury Department has held to be taxable when applied to children's articles. We think that was not intended by Congress, and it should not be carried into this bill. For instance, it covers items like this [indicating] that go on toys, toy baby carriages, and other playthings. That tax, 2¼ cents per pound, as now applied, amounts to 50 percent of the value of the article and it is all levied on children's articles, children's playthings, and juvenile articles. If it is increased as proposed in this bill to 5 cents per pound, it will be over 100 percent on many articles of the value of the tire itself. That is by reason of the fact that the tires which we believe Congress intended to tax, automobile tires—there is a 10-percent tax there—but this article is made up of shoddy, reconstructed rubber, hence the tax of 2¼ cents makes a large portion of its value.

Therefore, we suggest as to the tire section of the law, the addition of the words—if you eliminate the tax entirely—we suggest:

"No taxes shall be levied under this section on articles or parts of articles designed for use on children's playthings, juvenile articles, or parts thereof"; or, if the tax is left to apply to tires used on these articles, we ask that it be held at least at what it is now, since we think it is exorbitant when increased to 5 cents per pound.

Now, as to section 545 of this bill, musical instruments, we have spent years litigating the definition of "musical instruments." That designation appears in the Tariff Act and applies as well to toys.

Now, the customs courts, for instance, have held this toy piano [demonstrating] to be a musical instrument. Here are two more items that have been held to be musical instruments; they would come under the tax as that section of the law is now drawn, so that we ask that the musical instrument section be changed so as to provide all musical instruments except children's toys, which we think would carry out the intent of Congress.

In this bill, you have added a new section for sporting goods and, as I have already said, great care has been taken to exempt the juvenile or children's articles in that paragraph. However, there is a provision for baseballs. The provision for baseballs doesn't take into account the little 10-cent article which the boy buys that bears the tax just the same as the professional base ball. We do not think that was meant by Congress.

There is another provision for footballs. Here [indicating] is a regulation football that we think was intended to be taxed. Here [indicating] is the toy article constructed out of some cloth fabric and inflated, a very cheap, flimsy article, and one which not even a high school game could be played with. We do not think that was intended to be covered by this tax.

Here is another one, fabricated of pigskin as the regular article is. Softballs are also covered by this sporting goods paragraph. Here is another article that we make for children's use that sells for 15 cents. It is stuffed with various waste material and no adult game could be played with it; it would go to pieces in a very few minutes.

You also have a provision for skis and sleds; 95 percent of all sleds are made for children's use; only 5 percent are of a character used by adults. Therefore, the tax that would be levied, if it is not applied to toys or playthings, would be infinitesimal, with the cost of collection, in our opinion, greater than the revenue itself, so we would suggest that you delete the word "sleds" from this bill.

As to skis, skis for children are under 5 feet in length, and we feel that some exception should be made in the provision for skis, either by value or in length, as you have done in the cases of tennis rackets and golf clubs, to limit it to those that are used by adults.

Now, you have a provision in section 552 for rubber articles. Apparently that provision was put there to catch all rubber articles and, while I do not know the intent of it, I feel it must have been to conserve the use of rubber. Well, now, toy rubber articles consume a total of 2,500 tons of rubber per year, and much of that is not pure gum rubber but shoddy, reconstructed rubber. It is an infinitesimal quantity and considering that they are little articles like toy balloons, toy soldiers, bath babies, rattles, and many other articles which have never been taxed, and which are sold mostly in 5- and 10-cent stores—and if, as I say, the conservation of rubber is the purpose of this provision—it fails of its effort there and unduly burdens a very cheap article of amusement.

Now, I said in the beginning, we earnestly ask that a provision be put on the end of part V which will carry out not only the past intent of Congress, but which we feel is the intent of this bill, not to tax playthings, toys and juvenile articles.

If I might, I would like to leave a memorandum with the committee, and if I may have permission, there are one or two other articles I didn't touch on in this memorandum which I would like to deal with in a supplemental memorandum on the subject.

The CHAIRMAN. That is perfectly all right. Thank you.

(The memorandum submitted by Mr. Lerch is as follows:)

RE H. R. 5417, REVENUE ACT OF 1941

CHAIRMAN, SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

SIR: This brief is filed on behalf of the Toy Manufacturers of the United States of America, Inc., representing the views of these manufacturers as to the above bill but with particular reference to some of the provisions thereof.

In all of the revenue statutes enacted by the Congress, it has shown a very definite cleavage to the principle that playthings of children and articles of juvenile amusement should not be taxed. These statutes have all been so construed by the administrative authorities. Since the policy of Congress has been so definitely fixed and construed over a term of years, we think it unnecessary to comment upon the merits of this policy.

In H. R. 5417, now before your committee, this policy has time and again been manifested. For instance, in section 552, which adds a new section to the law covering sporting goods and other articles, great care has been taken to exempt from the tax those articles which are designed for children's or juvenile use. This was done by limiting the tax to articles which by their size were designed for child use only. However, the language used in other sections of the law without exemptions is so broad that it may include children's playthings or juvenile articles which are known by particular designation.

In view of the long established policy of the Congress in enacting revenue bills, we feel that the proposed bill should contain a provision at the end of part V just after section 559, effective date of part V, in a new section 560 containing language to the following effect: "No taxes shall be levied under part V of this act on children's toys, children's playthings, juvenile articles or parts thereof."

Such a provision would take care of all of the suggestions we are about to make. However, if this cannot be done, we ask that attention be given to the following sections since the language in each instance is sufficiently broad to include a tax on articles which is not intended by the bill.

SECTION 535

Under the language of section 3400 (1) of the existing Internal Revenue Act, the Treasury Department has ruled for the first time in connection with any article of children's or juvenile amusement that the word "tires" included tires that were placed on doll carriages, velocipedes, juvenile vehicles, and other articles of children's amusement. Since this tax is based upon weight it places an undue hardship on the manufacturers of toys and juvenile articles. Rubber tires or articles of this nature are made principally from recovered rubber or shoddy, whereas the tires of utility which Congress undoubtedly intended to tax, are made from pure gum rubber. The existing tax rate of 2¼ cents per pound amounts in some instances to 50 percent of the value of the article, whereas this tax when imposed on automobile tires amounts to but 10 percent of the value. If the rate proposed in the pending bill is adopted, the tax on tires for children's articles described above would, in some instances, equal 100 percent or more of the value of the article. Whatever may be the reasons in the mind of Congress for the levy on utility tires, we do not feel that it is the intent of Congress to penalize the articles of amusement for children by levying a tax which is many times greater than the tax on the article of utility. We respectfully ask that a provision be added at the end of section 535 as subsection (d) as follows: "No tax shall be levied under this section on articles, or parts of articles, designed for use on children's playthings, juvenile articles, or vehicles."

If, for any reason, your committee finds it impossible to add this provision, then we ask that language be inserted in the proposed bill which will hold the tax on articles of the above nature at the present rate instead of 5 cents per pound, which we believe would be exorbitant.

SECTION 545

This section, amending section 3404, includes a tax on musical instruments (subsection (d)). This language standing alone, because of the difficulty of determining from the definitions what constitutes a musical instrument, should be made to apply only to those instruments which are used by adults for produc-

ing music. Years of litigation in the customs courts have produced almost absurd results in attempting to define identical language in the Tariff Act. Articles, such as we produced at the time of the hearing, were held to be musical instruments because they were capable of playing a scale, and to this extent capable of producing "music." We, therefore, ask that the new provision "section 3404 (d) Musical instruments" be amended to read "(d) Musical instruments except children's toys."

SECTION 552

Subchapter A of chapter 29 of the Internal Revenue Code, new section 3406

(a) (1) *Sporting goods.*—This section is the best example of our position before this committee. In drafting this section it is apparent that there was no intention on the part of the framers to tax articles designed for the use of children or juveniles, since care has been taken to exempt from the tax those articles which by designation might come within the provisions by limiting the taxable articles by size, thus levying the tax only on articles used by adults, for example, badminton rackets, badminton racket frames, baseball bats, billiard and pool tables, golf bags, golf clubs, hockey sticks, indoor baseball bats, softball bats, squash rackets, squash racket frames, tennis rackets, and tennis racket frames. All of these designations are broad enough to cover articles designed for the amusement of children and juveniles and are to be found on every toy counter and place of business dealing in juvenile articles. No dealer would carry the articles which are exempted by this section in his sporting goods department. However, the framers of this bill have overlooked similar designations in the same section (a) (1).

Baseballs.—Although the tax on baseball bats is limited to articles actually used in the sports, recognizing that there are articles of the same designation not so used, no exemption is provided for balls. Children's baseballs are stuffed, with the core made from compressed scrap felt, excelsion, or cottonseeds, which is a very different articles from the regulation baseball with its core of rubber and expensive winding and horsehide cover. This is true both as to cost and the use of the article. Because of the cost of the materials used in the child's baseball, the rate of tax in the bill is vastly in excess of the real article of sport, which we think Congress intended to cover, and thus penalizes the boy who has but a few cents to spend for his article of amusement.

Footballs. A clear line of demarcation as to the construction, workmanship and price marks the difference between a juvenile football and the article of sport. The real ball is made of pigskin and is commonly called in the world of sports a pigskin. The juvenile article is a cheaply constructed football with which it would be impossible to play one quarter of a high school, college, or professional football game. (See exhibits left at the hearing.) The same argument applies here that we made with regard to baseballs.

Skis and sleds. Sleds are manufactured chiefly for the use of juveniles or for the amusement of children, in fact about 95 percent of sleds are used by children. We do not believe that it is the intention of Congress in levying a tax on a luxury, sporting goods, at a time when the parent is making every effort to pay his share of the cost of defense, to render it harder for him to provide articles of amusement for his family. Small skis up to 5 feet in length are also manufactured almost entirely for children's use. Since sleds of a character for adults are negligible in quantity, we feel the cost of collection of the tax would be greater than the tax and hence the word "sleds" should be eliminated. As to skis, some line of demarcation should be drawn either as to cost or length to exempt children's or juvenile articles.

Softballs.—Softballs come under the same category and are made in the same manner, cover the same range of materials, workmanship, and cost as baseballs. This article for children's use because of its construction would no more withstand the abuse of an adult game than would a baseball or football of the sporting-goods type. We do not believe that the framers of this provision had in mind a tax on softballs of the type for children's use any more than for badminton, tennis, or other real sporting goods from which they have segregated the articles of real sports and those of children's amusement.

As to all of the above articles specifically referred to, we respectfully ask that the provisions be so changed as to limit their scope to real sporting goods and exempt children's articles.

SECTION 552

New section 3406 (7), Internal Revenue Code—Rubber articles

This section was evidently written to cover articles of rubber of a character that would conserve the use of rubber. Rubber toys have found a definite place in every household where there are children. The total consumption of rubber through this avenue, as determined by a recent survey, was less than 2,500 long tons. A great majority of this is sold through the 5-, 10-, and 25-cent stores. They would not come within the provisions of any other section of this law and their inclusion here, we think, would only increase the cost and deprive many children of cheap amusement at a time when it it difficult to substitute articles of different materials at anything approaching the same cost. For instance, let us cite toy balloons, toy soldiers, bath babies, rattles, and many other articles which have never been taxed. We, therefore, request that the proposed draft be amended so as to insert after the words "surgical use," the word "toys,".

In the light of the foregoing, we respectfully submit that wherever the framers of this bill were aware that the language of the proposed sections covered articles of children's or juvenile amusement, they exempted them from tax. That policy should be carried throughout and a new section added at the end of part V to cover all such articles or each of the sections we have referred to herein amended so as to exempt the articles described.

Respectfully submitted.

TOY MANUFACTURERS OF THE UNITED STATES OF AMERICA, INC.,
By LAMB & LERCH, *Attorneys.*

AUGUST 1941.

CHAIRMAN, SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

Re: H. R. 5417, Revenue Act of 1941.

SIR: During the hearing on the above-entitled bill on Wednesday, August 20, 1941, permission was granted us by the committee to embody in writing our suggestions relative to the amendment of section 552 (9). In our brief filed on that day we suggested amendments of section 535, section 545, and section 552, and we respectfully request that the suggestions which follow be considered as supplementing the suggestions contained in said brief.

SECTION 552

Subchapter A of chapter 29 of the Internal Revenue Code.

New section 3406

(a) (9) *Optical equipment.*—Enumerated in this section are particular instruments which it is proposed shall be assessed with a tax equal to 10 percent. The instruments thus enumerated belong to a highly technical and expensive class. Among these items appear microscopes and telescopes, both of which are used in this specialized optical field. However, there are also microscopes and telescopes which are designed for the amusement of and which are actually used only by children. These are cheap reproductions of the genuine articles and generally constitute parts of children's chemistry or mineralogy sets. We believe it to be self-evident that it is not the intention of Congress to include children's articles within the provisions of section 552 (9). However, that will be the actual result unless an amendment is introduced which will exempt microscopes and telescopes which are for children's use only.

Respectfully submitted.

TOY MANUFACTURERS OF THE UNITED STATES OF AMERICA, INC.,
By LAMB & LERCH, *Attorneys.*

AUGUST 1941.

The CHAIRMAN. Mr. Spalding.

STATEMENT OF H. BOARDMAN SPALDING, NEW YORK, N. Y., REPRESENTING A. G. SPALDING & BROS.

Mr. SPALDING. Mr. Chairman and members of the committee, I have a prepared memorandum here which I would like to have extended on the committee's report and I will hand it up. I am not going to read it; I am going to speak extemporaneously.

I am an attorney. My firm is counsel for A. G. Spalding & Bros., one of the largest manufacturers of athletic goods. I am a director of that company and I am a fairly large stockholder in that company. Therefore, what I have to say is, I believe, in the interest of my client; on the other hand, I am appearing here as an individual, not as a spokesman for the industry, and with complete freedom to express my personal views, rather than be bound by the expediencies incident to speaking for the industry.

I am, of course, addressing my remarks primarily to the proposed tax on sporting goods, but what I shall have to say has some bearing on many of the other new manufacturers' excise taxes that are proposed in the tax bill. There are several spokesmen for the industry who will follow me and who, I believe, will urge the inexpediency of a tax on athletic goods and other articles of sporting goods.

That, in my opinion, is primarily a matter of legislative policy. You gentlemen have before you today one of the most serious crises this country has ever been in. You have before you the problem and duty of raising revenues larger than ever raised in the past, and you have the great difficulty of determining the sources from which those revenues are to be raised. It must be perfectly obvious to you, as you have studied the problem, that whatever form your taxes may take, you have got to reach that large amount of national income which is received by individuals and families having incomes of $5,000 a year and less.

Mr. Houston, of the National Association of Manufacturers, who appeared before you yesterday, I believe, presented charts showing that 75 percent of the national income was going to people in that class. There is where the increased revenues have got to come from.

Now, the question is the forms these taxes are going to take. There have been a number of proposals before you which I do not need to touch on, such as a general sales tax, and a gross income tax, as it has been called, and other proposals.

The House has seen fit not to adopt as far-reaching measures as that, and to have sought, in part, perhaps to reach these sources of income through these miscellaneous excise taxes.

Now, of course, they are manufacturers' sales tax, we call them excise tax, because that has been the nomenclature used for decades, but they are, nevertheless, manufacturers' sales taxes.

I have never been quite able to understand why those industries that are proposed to be, and have been in the past, subject to a manufacturers' sales tax, always recommend a general manufacturers' sales tax. The only possible excuse is that they assume it will be at

also much smaller rate than the rate when they have a special tax on their industry, that they will have a less burdensome tax with which to deal.

Of course, obviously the lower rate of the tax, the less difficulty in handling it, but all the problems, at least in theory, that exist in the case of these special manufacturers' taxes also exist in the case of a general manufacturers' tax, with the sole exception that you might not have to determine whether a particular item was within the tax. Of course, if it was a general tax, it would include everything.

Another thing that may have puzzled members of this committee is to have an industry appear before you and argue, on the one hand, that this tax is an intolerable burden to the industry and, on the other hand, that it is an unfair burden to the consumers of the industry's product. In the case of sporting goods, they are going to talk to you about the health of the Nation and the necessity for physical education. The gentleman who just preceded me told you that consumers' toys should not be subjected to this tax and, at the same time, talked about the burden that it is on the toy industry.

Now, obviously, if the tax is paid entirely by the consumer, it is not a burden on the industry; conversely, if the tax is paid by the industry, it is not a burden on the consumer. That argument cancels itself out.

It is my purpose to explain how that confusion comes about and what the difficulties are. It is, of course, always conceded that excise taxes are intended to be passed on to the ultimate consumer. No one ever imagines that you can impose upon a manufacturing industry a tax of 10 percent of its sales when its net profits rarely exceeds 10 percent, and often is very much less than 10 percent, and have that industry survive. It is supposed to be passed on. The difficulty is you cannot be sure it will be passed on. That is why the industries that come in here fearful that they won't be able to pass it on, are all urging they should not be taxed, and they try to give you the various reasons which they think will have the most appeal, sometimes a political appeal.

Now, the question of whether a tax can be passed on or not, is dependent upon a wide number of economic factors which impinge upon the particular industry at any given time; factors which change from time to time. Also it is easier, usually, to pass on a tax to the ultimate consumer who is supposed to bear it, if that tax is imposed at the nearest point to that consumer. The retailer cannot always, but he can as a general rule, more effectively pass on a tax which he is called upon to pay upon his sales to the consumer, than can the manufacturer, removed two or three points back, see that that tax is passed on through the wholesaler, and on down to the final consumer.

The experience of the athletic-goods industry with this tax which was imposed under the 1932 Revenue Act, and which continued until repealed as of July 1, 1938, was that, of course, in the first instance, the manufacturers sought to add the tax to their prices. Now, let us assume they increased their price by 10 percent. Immediately, the forces within the distributing field of the indutsry, added to that increased price their customary percentage of mark-ups. If it was 33⅓ percent, one-third was added on to the total cost. The retailer, in turn, had his customary percentage of mark-up which he added on, so that, if that process had worked through without other economic pressures

impinging upon it, the consumer would have wound up paying an increase in the price of double the amount of tax which the manufacturer had originally paid and which the Government had collected; obviously, an undesirable economic result, both from the standpoint of the public required to pay the tax, and from the standpoint of the Government entitled to receive the tax.

Senator VANDENBERG. You say it is impossible to avoid that?

Mr. SPALDING. If you place a manufacturers' tax on the manufacturers' selling price, in most cases and in the athletic goods' industry, for instance, that tax will pyramid through the customary mark-ups of the wholesaler and retailer to the final consumer. Now, if you will bear with me for one moment; let me come back to that because it is a complicated economic problem which I am talking on this morning, a very technical subject.

We have a number of different types of excise taxes in our revenue laws today, leaving out those not pertinent to this discussion.

You have the type of excise tax such as the old tobacco and liquor tax and the gasoline tax and, incidentally, on tires which you have imposed on units, or quantities, irrespective of the selling price. You have these proposed taxes on manufacturers, which are a percentage of the manufacturers' selling price, and then you have proposed taxes on the retailer. I say "you"—I mean the House—have proposed taxes on the retail sale in the case of jewelry, toilet articles, and furs.

Now, the pyramiding of the tax in those classes where the tax is paid back by the manufacturer or producer is not the same in the various industries. Curiously enough, one of the very heavy taxes, percentage-wise to the final consumer price, is the tax on cigarettes, a tax of 6 cents on a package retailing at 15 cents. I don't think that tax is pyramided to the consumer. Of course, more accurate testimony on that you can get from the people in the tobacco industry, but the general evidence indicates that the custom in that trade has been for the wholesaler and retailer to take so many cents, not percentage mark-ups, and do that irrespective of whether the price is 15, 12 cents, or lower. In the case of liquor, the contrary takes place.

I was talking with the treasurer of one of the large wholesalers of liquor just 2 or 3 weeks ago and I asked him the specific question. There the custom is for the wholesaler and retailer to add a percentage mark-up on his cost and, if you observed—I only did it rather casually—retail liquor prices last summer when there was added 75 cents a proof-gallon tax on liquor, which amounted to something like $2.25 per case, you found that the retail price per case went up $4 or $4.50, showing the effect of that taking place.

The industry that probably handles these taxes the best of all is the automobile industry, probably due to the fact that the automobile manufacturer exerts a more powerful economic control over the whole industry than do manufacturers in other industries. Everyone who has bought an automobile has seen added to his bill for the automobile the precise amount of the tax the manufacturer has paid. For some reason or other, the dealer hasn't had any objection to disclosing either the amount of that tax or what the cost of that

automobile was to him, but you come into these other industries, this athletic-goods industry, and you cannot get the distributing branch of that industry to disclose to their customers their costs by simply passing the tax on at its precise figure.

Senator VANDENBERG. Why can't you require the disclosure of that tax?

Mr. SPALDING. By legislation?

Senator VANDENBERG. Yes.

Mr. SPALDING. To the consumer?

Senator VANDENBERG. Yes.

Mr. SPALDING. I presume you could, but there is no such provision in the law.

Senator VANDENBERG. No; but we are talking about a possible manufacturers' sales price.

Mr. SPALDING. Yes.

Senator VANDENBERG. Are you familiar with the discussion of the staff of the Joint Congressional Committee on Internal Revenue of this subject of pyramiding and their belief that it can be entirely or substantially corrected?

Mr. SPALDING. I am not.

Senator VANDENBERG. I don't think it is insurmountable.

Mr. SPALDING. You propose to put such a provision in the law, that is a provision that the final retailer would have to disclose the amount of tax paid by the manufacturer on that article at the time of his sale to the consumer; that is what you have in mind?

Senator VANDENBERG. Yes.

Mr. SPALDING. I know that you would certainly introduce a very great disturbance in the distributing end of the industry. The wholesaler doesn't want to disclose to the retailer what his cost is.

Senator VANDENBERG. All he has to disclose is the cost of the tax?

Mr. SPALDING. But when it is a percentage, it discloses the cost.

Senator VANDENBERG. No; it discloses the price where the transaction occurred.

Mr. SPALDING. No, Senator; that is not it. A manufacturer sells an article to a wholesaler at 50 cents. If there is a tax included in that, the tax is one-eleventh of that price, something about 4½ cents.

The wholesaler, in turn, sells that article to the retailer at 65 cents. He doesn't disclose to the retailer that his cost was 50 cents. If, however, he said 65 cents, of which 4½ cents was tax, the retailer, in a moment's time would say, "Oh, yes; but you paid 50 cents for that article."

In turn, when the retailer sells that article to the consumer for $1 and the consumer knows there is a 10-percent tax, but is disclosed that the tax is 4½ cents, he could very readily say. "The manufacturer sold this to you for 50 cents; why should I pay a dollar for it?"

The whole distributing trade would be up in arms. They don't want that disclosure made at the time of their sale. However, if, of course, you put it in the law they will have to comply, but they won't like it. I don't want to take the time to develop some of the other technical arguments which I have set forth in this memorandum, because I think I may assume that the members of the committee will read it. The memorandum is set forth more logically than I am able to talk extemporaneously.

There is one point that I would like to mention, however. You will recall that in the 1932 law, you had a section—I think it is 3447 of the code—which provides that if a contract for sale was made prior to May 1, 1932, for delivery or for the sale to be completed subsequent to the time when the tax went into effect, and the contract didn't permit the vendor to add the amount of the tax to the selling price, the vendee was made liable for the tax, the tax to be collected from him by the vendor, or if he refused it, that the matter be reported to the collector of internal revenue.

There has been no similar provision in the House bill. Of course, it seems to be obviously only fair to protect those manufacturers who are subjected to a new excise tax to provide a similar provision, having effect from July 1 when the bill would become law.

Thank you, Mr. Chairman. I have nothing further.

The CHAIRMAN. Thank you, sir.

(The memorandum referred to by Mr. Spalding is as follows:)

MEMORANDUM OF H. BOARDMAN SPALDING

MANUFACTURERS' EXCISE TAXES

This memorandum relates to the new excise taxes imposed by section 552, H. R. 5417. Although this memorandum in its general aspects is applicable to all of the subdivisions of that section, it is concerned in particular with the manufacturers' excise tax on sporting goods which, if enacted, will be subsection (a) (1) of section 3406 of the Internal Revenue Code.

In making the statement before the Senate Finance Committee, and submitting this memorandum, I am representing my individual opinions. I am not acting as a spokesman for the industry. I am, however, an attorney, a member of the firm of Kelsey, Waldrop, Spalding & Parker, of 55 Liberty Street, New York, and my firm is general counsel for A. G. Spalding & Bros., Inc., one of the principal manufacturers in the sporting-goods industry. I am also a director and stockholder of that company. While, therefore, they would be, if adopted, beneficial to the interests I represent, I believe they will likewise help the entire sporting-goods industry add to the Government revenues, and be in the public interest.

Excise taxes are of several different types. Disregarding those which are not germane to the present discussion we have, with respect to existing taxes and the new taxes proposed by H. R. 5417, the following types:

A. Excise taxes of the type of those imposed on liquor, tobacco products, tires, and gasoline. On these the tax is a specific amount per unit, or per physical weight or volume. Taxes of this type, although usually payable by the manufacturer or producer, are the same in amount irrespective of the manufacturer or producer's selling prices.

B. Another type of manufacturer's excise tax is that which becomes effective on the sale of the product by the manufacturer or producer and is measured by a percentage of the manufacturer's selling price. Taxes of this character are the manufacturer's excise taxes on automobiles and the new taxes imposed on sporting goods and other classes of articles under the proposed new section 3406 (a) of the Internal Revenue Code.

C. A third type of excise tax is that imposed on retailers measured by the retailer's selling price, such as the taxes imposed under section 553 of H. R. 5417 upon jewelry, furs, and toilet preparations.

For convenience, I shall hereinafter refer to these separate and distinct types of excise taxes by the letters A, B, and C, as above defined. It is necessary to distinguish between these three types of excise taxes because of differences in their respective economic effects.

I believe it is generally assumed that the economic incidence of all three excise taxes will be borne and ultimately paid by the users and consumers of the products subjected to them, the manufacturer or retailer being, in the economic sense, only a collector for the Government. If the ultimate incidence

of these taxes is not wholly passed on to the ultimate consumer, and all or some part of the tax is absorbed by either the manufacturer or other elements of the industry, the tax becomes unfair, discriminates against, and may be ruinous to the businesses affected thereby. It is quite obvious that with margins of net profit which rarely exceed 10 percent, and in many instances are very much less than that rate, a tax equal to 10 percent of the selling price, unless passed on in its entirety, may be equal to or very much greater than the net profit of the enterprise. This being so, it is clearly the duty of Congress to impose excise taxes in such a manner and form that they may be passed on to the ultimate consumer with the highest practical degree of certainty.

It is frequently difficult to determine with statistical accuracy the extent to which a tax has been passed on. Therefore, in all statements made on this subject, there is some element of judgment which necessarily enters. There are, moreover, two elements which affect this question and which are often confused in discussions regarding it. The first element is measurable with a fair degree of accuracy; that is, the effect of the tax upon the percentage margin of gross profit of the entity legally liable for payment of the tax; that is, if it is an excise tax of type B and prior to the tax the manufacturers' margin of gross profit has been 25 percent, and after a tax of 10 percent has been levied on the manufacturer's sale, the gross margin on the articles, the sales of which are taxed, is reduced to 15 percent, it is reasonably safe to assume that no part of the tax has been passed on. This element is reasonably easy to measure with a fair degree of certainty.

There is another element, however, which frequently comes into discussions of this subject, and that is the effect of the tax upon sales volume. A net profit is the result of a gross profit which exceeds the expenses of the enterprise. The percentage of gross profit is only one factor. Volume is the other factor and frequently the more important factor. Perhaps an illustration will be helpful to make this point clear. Assume an enterprise which has a gross-profit percentage of 30 percent and has expenses of $200,000. If it does a volume of business of $1,000,000, it will have a resulting net profit of $100,000 at 10 percent. Assuming that it has a capacity of 50 percent greater volume and can secure that volume by reducing its selling prices to a point where its gross profit is only 25 percent and has an increase of $50,000 in its expenses due to the larger volume, it then shows the following result:

Sales	$1,500,000
Gross profit 25 percent	375,000
Expenses	250,000
Net profit	125,000

or a greater net profit than it had with the higher percentage of gross profit.

On the other hand, if, by an increase in costs, an advance in prices is considered necessary, which has the effect of reducing its sales volume 30 percent to $700,000, even though the margin of gross profit remains the same, at 30 percent, the gross profit will be only $210,000, resulting in a net profit of $10,000 above its expenses.

Any excise tax which is reflected in a higher consumer price will have some effect upon sales volume. The extent of that effect depends upon the elasticity of the demand for the particular product, and upon other factors affecting the business economy at any particular time. This second element enormously complicates the problem of determining the extent to which the enterprise made subject to the payment of the excise taxes has succeeded or failed in passing them on to the consumer. The foregoing, however, is the reason why industries whose products it is proposed to subject to excise taxes or increases in the excise taxes are extremely apprehensive of the effect that it may have upon their prosperity or even their ability to survive.

Insofar as the imposition of an excise tax results in an increase of price to the consumer, the effect of the increase in price on the sales volume of the product will probably be substantially the same at whatever point the tax is imposed. This effect is an inevitable consequence of excise taxation and where, for social or other reasons, it is desired to reduce consumption of any particular commodity, imposition of an excise tax is a medium by which this result may be obtained. Such damage as it may cause to the industries affected is an inescapable consequence of the policy decision by Congress to impose taxes of this character.

The passing on, however, or the failure to pass on of the direct effect of the tax upon the percentage margin of gross profit is relatively more important and of more immediate concern to the industries affected. They may, in any event, have to adjust themselves to a decrease in profit or to a loss caused by a decrease in sales volume, but they should not be forced involuntarily to accept a smaller percentage margin of gross profit. The type of excise tax adopted is, therefore, very important when this factor is considered. A tax such as type C, imposed upon and at the time of a final retail sale, bears the most direct relationship to the party upon which the ultimate incidence of the tax should rest. It enables the retailer to acquire the merchandise without any increase in the cost thereof that results when the tax is imposed upon the manufacturer's sale. The retailer has only to add to his usual percentage mark-up on cost the exact amount of the tax and in the entire chain, the retailer, wholesaler, and manufacturer will, as far as the tax is concerned, have each maintained their accustomed margins of gross profit. The only price change which the tax will cause will be the final ultimate price to the consumer. In such a case, also, the price increase to the consumer will almost invariably be exactly the amount of the tax paid to the Government.

When, however, an excise tax of type B is imposed, the result is one of two things: Either the manufacturer fails to pass on the tax in its entirety, or, if he does, the wholesaler and retailer, in most cases, will add to the total cost (including tax) the customary percentage mark-ups so that the resulting price to the consumer will be increased about twice the amount of the tax paid to the Government. This result is undesirable, first, from the revenue standpoint; second, it will have a greater effect to reduce volume of sales than will a tax imposed upon the retail sale; third, while it may appear to enrich the wholesaler and retailer, the resulting curtailment of volume will probably more than absorb any increase they obtain by adding their percentage mark-ups on a higher cost. Experience under the 1932 manufacturer's excise tax on sporting goods shows that, in the first instance, this increase in prices took place. This advance in prices, coming at the bottom of a severe business depression brought about a very great curtailment in consumption in the 2 years following the imposition of the tax as contrasted to the 2 years preceding the imposition of the tax. The result was to intensify greatly the competitive forces with the result that instead of being paid by the consumer, the burden of the tax was forced back upon the manufacturing division of the industry. The distributors for the most part maintained their percentage margins of gross profit. The burden upon manufacturers was so great that the company for which I am counsel never succeeded in earning a net profit during all the years the tax was in effect, and shows a net profit for the first time in the year 1939, after the tax was repealed. Another interesting fact in the case of this company was that on the average the percentage of gross profit which it earned during the period the tax was in effect was less than the percentage of gross profit which it earned during the years of 1926 to 1930, inclusive, by approximately the amount of this particular tax.

Another difficulty with a tax which is imposed upon the manufacturer's selling price (type B) is that under the statutory definition of the price upon which the tax is levied, the tax must be paid upon the wholesae price, whether that wholesale price is a price to wholesalers or a price to retailers. It is a very well recognized fact that there will be a difference of 20 percent to 30 percent in a manufacturer's price to wholesalers in contract) the same manufacturer's price to retailers. Therefore, the manufacturer who performs entirely his own wholesale distribution will have a taxable price base 20 percent to 30 percent higher than his competitor whose distribution is through wholesalers. This introduces a serious competitive discrimination between manufacturers in the same trade and industry. This competitive discrimination is so serious that when the 1932 act was enacted, manufacturers sought to escape the discrimination by the organization of separate subsidiary sales corporations and will undoubtedly make use of this same means to avoid the discrimination if these new manufacturer's excise taxes are imposed. It is most unfortunate, however, to force the use of subsidiary sales corporations to escape what is otherwise an unbearable competitive discrimination. In the first place, it immediately introduces the difficult administrative problem for the Commissioner of Internal Revenue, because, instead of being able to audit the tax simply on the basis of the actual selling price by the manufacturing

corporation to its customers, it is obliged to check the intercompany prices to determine whether they are the prices defined by section 3441 (b) of the Internal Revenue Code. This leads to endless questions and disputes between the taxpayer and the Bureau of Internal Revenue, and there is reason to doubt that the individual cases can or will be decided on a basis uniform to all taxpayers.

A further serious objection to use of subsidiary sales corporations is that under the income-tax law, separate income-tax returns have to be made for the parent and the subsidiary sales corporation. Since these sales corporations are not separate business enterprises, but are, in effect, merely sales departments of a single enterprise, there is no objective basis by which the Commissioner of Internal Revenue can determine that the income between the companies has been properly apportioned, and yet that is what he is required to do pursuant to section 45 of the Internal Revenue Code. To force manufacturers, by the imposition of these manufacturer's excise taxes, to organize separate sales companies in order to avoid an unfair competitive discrimination and, at the same time to refuse to permit consolidated income-tax returns of such companies, is capable of and will inevitably produce unjust results wherein income taxes will be assessed upon what in a business sense are wholly nonexistent and purely fictitious profits.

A further difficulty arising from the imposition of the manufacturer's excise tax of type B, which is of considerable importance in the sporting goods industry, is the exemption from tax of sales to States and political subdivisions. This means sales of athletic goods to State universities and all schools supported by public funds, all parks and playgrounds, all purchases by the Government for the use of the Army or Navy. If sales to these various governmental bodies were all made direct from the manufacturer, little difficulty would arise. The fact is that only a small percentage of such sales are made direct, and most of them are made by dealers and distributors who may be either once or twice or more removed from the manufacturer who pays the tax. The paper work involved, under such circumstances, is itself a serious burden. But the more serious question to the industry is the allowance to be made to the school or college for the tax exemption. As a matter of business policy, because of unwillingness to disclose their cost prices, dealers under the 1932 law, in general, allowed such institutions one-eleventh of the purchase price. Inasmuch as one-eleventh of the purchase price was, in most cases, about twice the tax that had actually been paid to the Government, there was an endless source of friction, leading to creation of ill will between manufacturers and their dealers and distributors respecting which was to absorb the other 50 percent. In some of the items which are subjected to these taxes, such as football and baseball equipment, a large proportion of the products sold ultimately go to such tax-exempt institutions.

It is believed that the foregoing are the considerations which led the Ways and Means Committee to impose excise taxes upon the retailer's sales (type C) in the case of jewelry, furs, and toilet preparations. In the case of the tax on toilet preparations, which was previously subject to a manufacturer's excise tax, it is proposed to repeal the manufacturer's excise tax and impose the tax on the retail sale in its place. As the majority of the Ways and Means Committee stated in this report, the "tax is placed on the retail sale rather than on the manufacturer's or importer's sale because of administrative and equitable considerations." The report does not go into the detail of these administrative and equitable considerations, but it is believed that considerations of the character above set forth led them to make this change in the character of the tax on toilet articles and to impose the tax on the retail sale in the case of jewelry and furs. If that is sound for those industries, it is equally sound for sporting goods.

Excise taxes have in the case of liquor and tobacco products long been an important source of Federal revenue. At times such as the present, when there is needed a great increase in revenue, it is to be expected that one source of that increase will be found by subjecting to excise taxes a large number of items in the luxury and semiluxury class. Those advocating such taxes, lacking experience regarding their economic effect, lose sight of the importance of the form of such levies and of the point at which the taxes are assessed. The purpose of my statement before the Senate Finance Committee and of this extension of my remarks has been to demonstrate the harmful economic

effects and the administrative difficulties resulting from the imposition of such a tax upon the sale by the manufacturer and measured by the manufacturer's selling price. These economic effects and administrative difficulties may be overcome when the tax is imposed upon and at the time of the retail sale. It is true that to tax the retail sale increases the number of companies and individuals required to render reports. This, however, is only a matter of administrative routine. Certainly, if the Bureau of Internal Revenue can administer a retail sales tax in the case of jewelry, furs, and toilet preparations, they will find no difficulty in administering a similar tax in the case of sporting goods. The need today is to collect the largest amount of revenue possible without undue hardship or economic injury. A retail tax on sporting goods at a rate of 6 percent will, in my opinion, produce as large, and possibly even larger, revenue than will a 10-percent tax on the manufacturer's selling price.

CONTRACTS MADE PRIOR TO JULY 1, 1941

I also strongly recommend that there be added to the Revenue Act a section similar to section 3447 of the Internal Revenue Code. This section of the Internal Revenue Code, which was part of the 1932 Revenue Act, provided that, in the case of contracts made prior to May 1, 1932, for sale after the tax takes effect, and where such contract did not permit adding the tax to the amount to be paid, the vendee should, in lieu of the vendor, pay so much of the tax as is not permitted to be added to the contract price. If manufacturers have, with respect to the new manufacturers' excise taxes, made contracts of the character above described, they are entitled to be protected by the addition of a similar provision in the pending revenue law.

Respectfully submitted.

H. BOARDMAN SPALDING.

AUGUST 20, 1941.

The CHAIRMAN. Maj. John L. Griffith.

STATEMENT OF MAJ. JOHN L. GRIFFITH, CHICAGO, ILL., REPRESENTING THE ATHLETIC INSTITUTE

Major GRIFFITH. Mr. Chairman, I have copies of my remarks that I would like to file with the committee, if I may, and with your permission, I would just like to address myself to two or three provisions of the bill.

My name is John L. Griffith; my address, Chicago, Ill., care of the Hotel Sherman. I am commisisoner of athletics of the Big Ten Conference, secretary-treasurer of the National Collegiate Athletic Association, and president of the Athletic Institute.

I am appearing for the Athletic Institute. It is an organization whose purpose is that of trying to extend wholesome recreation and athletics throughout the country. Our directors all serve without pay. Some of them are:

Fielding Yost, football coach and long prominent in athletics;

Mr. Frank McCormick, director of athletics, University of Minnesota;

Mr. Charles Robbins, of Mr. Spalding's firm;

Mr. L. B. Icely, who is to follow me, and so on.

May I say first, that personally, I feel that we should pay taxes; we should pay as we go and everybody who is capable of making a living ought to pay his fair share of the cost of government. What I want to bring to the attention for the consideration of this committee is my view that we should not tax the implements used by our children in the pursuit of their academic or physical education.

The Senate Finance Committee in other years has frowned on the advisability of taxing athletic goods used chiefly by children. I need not remind the Ways and Means Committee that we have had a number of tax bills; one in 1918 taxing athletic goods, which was repealed in 1921; another one was introduced in 1932-33 and repealed in 1938. I recall that the Senate Finance Committee in 1933 eliminated the tax on athletic goods and then the joint committee put it back in.

You are familiar, too, no doubt, remember no doubt, that the Subcommittee on the Ways and Means Committee that was appointed and functioned from November 1937 to January 1938 reported that a tax on athletic goods was a tax on the children of the country, and it is to that point, Mr. Chairman, I would like to chiefly address my remarks.

Specifically, we are interested in seeing and hoping at least that a tax will not be imposed on such articles as baseballs, soft balls, basketball equipment, footballs, tennis balls, and rackets, because those articles are used almost exclusively by boys and men under 21. We are apt to think of baseball in terms of the professional leagues, but only about 5 percent of the manufactured goods are used by professional players.

I think I need not develop the point that these are the games of youth, and if we don't wish to tax our children's activities, we should not tax those. We do not tax their books; why, then, should we tax the implements they use in their physical education?

Following the last war 38 States passed compulsory physical-education laws. It is generally recognized that our physical activities are a part of the pedagogic program, so I am suggesting that we relieve the children of this burden, whatever it may be. We are going to leave them a debt of a hundred billion dollars or something like that, I am told; we are going to draft them to fight our wars; we might show them the consideration of not taxing what they need in developing the strong, live, healthy bodies necessary to enable them to do this.

Senator LA FOLLETTE. Is it not a fact that the physical-education departments of the universities, colleges, and high schools have grown tremendously in recent years?

Mr. GRIFFITH. Yes; there is no question about that. You may recall that, after the last war, when Germany could not carry on her military training because of the Versailles Treaty, they organized sport clubs and continued that even after Hitler came along when they had these labor camps. England, following the last war, also appointed a committee to consider this thing and have carried on along that line in terms of community recreational activities ever since. I read the other day that in Vichy, France, they are soon to set up labor camps. We tried the other idea after the last war with, as I have stated, 38 States passing compulsory laws on the subject.

Our educational institutions got into the business and built adequate plans. They said we could not take care of such a program because we did not have trained personnel to do the work—men and women. The institutions got busy on that. In our Big Ten Conference that I represent I figured that we had trained 10,000 men and women to go into institutions to carry on this program which the Government found out was very necessary. So you are correct in saying that these educational institutions have done a great deal and that physical education has grown tremendously.

Senator LA FOLLETTE. And as far as the young man and the young woman who elects that as a major course and hopes for a degree; it is just as logical to tax the test tubes and other instruments and equipment used in chemical engineering schools as it is to tax the tools by which they must come into their education, is it not?

Mr. GRIFFITH. Very well, indeed. That is true, and the point I am trying to make is this: For some reason or another, we don't believe in taxing schoolbooks; academic education is not so burdened but it is proposed to tax physical education which latter may be more important when you are fighting for your existence. If we are going into a world war—and Senator Pepper says we will be at war for the next generation, or maybe——

Senator VANDENBERG. Don't take Senator Pepper too seriously.

Mr. GRIFFITH. I believe anything any Senator says must be correct; but seriously, isn't that true that we must place a greater emphasis on that sort of thing when we are threatened, than perhaps in peacetime, and that is what I would like to try to develop for my next point; namely, these activities are part, or form the basis of military training.

We are either going to develop our children in labor camps as in other countries, and God forbid that that will happen here, or develop them as we are trying and have been trying to do, in public schools and colleges; and if we are going to recognize the importance of this work, certainly we are not going to place any more burden on them than necessary.

You may say that the parents will buy these, yes; and the parents might also buy their schoolbooks but we feel it is a burden if such a tax is applied.

Senator BROWN. Isn't there some danger of discrimination in this tax?

I take it universities, such as the University of Michigan, University of Illinois, and most of the institutions you represent would not pay this tax, but that the University of Notre Dame, Yale College——

Mr. GRIFFITH. Stanford.

Senator BROWN. Yes; and institutions, not State institutions would pay the tax. It seems to me that is a rather unfair distinction to make in a tax bill.

Mr. GRIFFITH. I was going to say that. In our conference, we have 8 tax-supported and 2 endowed institutions. The 8 tax-supported institutions would be exempt under the bill.

Senator TAFT. Why are they exempt?

Senator BROWN. There is an exemption in the bill as to political subdivisions of a State government.

Senator TAFT. Why should they be exempt; this is a manufacturers' tax?

Senator BROWN. The exemption is there and I take it if Spaulding & Co. sold equipment to the University of Michigan, that institution would not pay the manufacturers' sales tax nor would A. G. Spaulding be required to pay it.

Mr. GRIFFITH. I think it is discriminatory and I think it is, as you suggest, this exemption is part of the bill.

One other point and I am through. We should encourage in times such as these activities that will help to develop a strong citizenry, and that applies not only to the physical side, but to our moral and intellectual viewpoints.

Athletics, especially football, develop a fighting spirit, a sense of loyalty, and the benefit to the country generally of such physical education is most evident from the significant statistics in connection with the matter of training our officers. In our group of 10 institutions 47 percent of our athletic men in the service were commissioned officers; only 33 percent of the general student body were.

Seven-tenths percent of all the men in service were commissioned. So, we believe there isn't any question this training has something to do—we may not be able to put our finger on it—in the making of the type of men needed where the Nation goes to war.

I would close with an illustration contained in a story recently told me: When God, in His infinite wisdom, created the universe, He endowed each living thing in it with certain attributes and means of existence. To the oyster He gave a shell and economic security; the oyster's shell is his house. He doesn't need to worry about a housing problem; and, as for food, all the oyster needs do is open his shell and the food flows in. And then the American eagle, and gave him no guaranty of home or food, but the whole wide world and the opportunity to fight his own battle.

Gentlemen, the oyster is still our national emblem, and the point I am trying to make is in our athletics we are trying to develop the eagle rather than the oyster. I believe we should do something to develop these activities.

Senator DANAHER. I would like to ask the gentleman a question, if I may.

The CHAIRMAN. Yes.

Senator DANAHER. Is there any reason why a person could not play soft ball with a bat 25¾ inches long instead of 26 inches?

Mr. GRIFFITH. I don't think there would be any reason why not.

Senator DANAHER. And the same thing would apply to tennis rackets, wouldn't it? And badminton rackets; if they shortened them a quarter of an inch all the way down the line, they could use them and they wouldn't be taxable, anyway. Isn't that correct?

Mr. GRIFFITH. Yes; that is an idea; that is something I might bring to the attention of some of these people.

Senator DANAHER. Well, I think the point has already been conjured up; hockey sticks, squash rackets, all wooden frame rackets are given a definite measurement and exempted if below that definite measurement.

Mr. GRIFFITH. That is correct.

The CHAIRMAN. They were given a definite measure for the one purpose of taking out what children use because it is impossible to define what is a child's toy or adult's toy or sporting article of any kind.

Mr. GRIFFITH. We have 30,000,000 children in our educational institutions and they are, for the most part, being given some kind of physical education. They go back into the grades; they would be listed as children. Perhaps high-school students also would be listed as children, but they use the standard equipment quite generally.

Senator DANAHER. Who makes these wooden frames, one or two manufacturers?

Mr. GRIFFITH. I wouldn't say that. It is my understanding that there are five or six manufacturers.

Senator DANAHER. I notice there is no tax on darts.

Mr. GRIFFITH. Yes. Well, I am speaking primarily of these four activities where large numbers play. This year one-fourth of a million will play football and, at the end of that season, they will be in splendid physical condition, probably in as good condition as these German parachutists who landed in Crete. I am told that they are in such fine physical condition that they are able to descend from a parachute, run a mile or two with a machine gun in their hands and start firing. Well, I will put our boys up against them from the standpoint of physical condition at the end of the football season.

Then there are probably two or three million more who, at the end of the basketball season, will be in splendid shape. There can be no question about it. If we aren't interested in that phase of the national-defense program, we can do a job with the boys before they go to camp by proper sports, and these details, such as darts and so forth, would not enter into our problem. As we see it, this is true, first, from the standpoint of athletics—the advantages to be gained generally by our boys and young men—and, secondly, its value in terms of national defense.

The CHAIRMAN. Thank you very much.

(The prepared statement by Mr. Griffith is as follows:)

MEMORANDUM SUBMITTED BY MAJ. JOHN L. GRIFFITH, PRESIDENT, ATHLETIC INSTITUTE; COMMISSIONER OF ATHLETICS, INTERCOLLEGIATE CONFERENCE; SECRETARY TREASURER, NATIONAL COLLEGIATE ATHLETIC ASSOCIATION

PROPOSED EXCISE TAX ON ATHLETIC EQUIPMENT

This memorandum is respectfully submitted in an attempt to set forth particular views having to do with the proposed excise tax on what is termed in section 3406, Internal Revenue Code, paragraph (1) of the Revenue Act of 1941, as "sporting goods."

Specific articles are listed therein, as well as "including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof." An analysis of those articles enumerated will show two types of merchandise to be taxed—sporting goods and athletic goods. The distinction between the two can be summarized as follows:

(*a*) *Sporting goods.*—Articles used largely for personal recreation and very little physical exercise and very seldom in games of physical contact. Such articles are fishing tackle, billiard and pool tables, balls and cues, bowling balls and pins, clay pigeons, deck tennis, and croquet balls and mallets.

(*b*) *Athletic goods.*—Articles used in games or contests combining physical exercise and contact, as well as a certain degree of individual skill. Such as baseball, football, basketball, golf, tennis, boxing, wrestling, track and field games, etc.

Those articles listed in (*a*) as sporting goods can be considered more or less as luxury items and we are not speaking for them.

The industry engaged in the manufacture of those articles in (*b*) above—athletic goods—realizes the necessity of additional taxes on luxury items, but it respectfully contends that athletic equipment is not a luxury. With the exception of golf equipment, which is used only to a limited extent by schools and colleges, all of the athletic equipment referred to is sold largely to schools and colleges and other eleemosynary institutions carrying on organized athletics.

I. Athletic equipment is essential to the defense program

Following World War No. 1, a number of major generals stated in substance that they had come to believe that athletic training was an integral element in the training of the youth for war.

Marshal Foch, following the last war, witnessed a football game played between two teams of officers and soldiers of the American Expeditionary Forces at St. Nazaire. Marshal Foch had never seen a football game but, according to the story, he witnessed with amazement the way the two teams tackled and blocked each other. When the game ended, it was reported that Foch, with his eyes aglow with delight and amazement, said, "Any country that has a game such as football for its national pastime need never worry about preparing its young men for the rigors of war."

It was also very evident during the last war that enlisted men who had participatd in some form of competitive athletics in school or on the sandlots had a much higher degree of coordination of mind and body than the nonathletes and, due to this early athletic training, they were able to faster learn the Army routine of drill and the art of warfare.

The British officers who were assigned to certain American regiments for infantry training during the last war were amazed at the accuracy with which the American infantrymen handled hand grenades. They attributed this to the fact that baseball was the outstanding game of the American youth and, while the throwing of a hand grenade required a slightly different technique than a baseball, the general characteristics were the same and this early training in the throwing of a baseball was very beneficial to the armed forces.

You may recall that immediately following the last war, when Germany was not allowed under the Versailles Treaty to engage its youth in military training, German authorities instead promoted a national sports program. Military authorities have stated that undoubtedly at least a part of the success of the German Army in its conquests of Europe is due to the fact that the highly trained German soldiers are in every sense physically fit.

If we are to survive as a nation we must be physically fit. Moki, the great Finnish athlete who visited this country last winter, was asked how Finland had been able to put up such a splendid resistance against the Red Army of Russia, and he instantly replied "because Finland is an athletic nation."

It is common knowledge that the War and Navy Departments have provided funds out of which to purchase athletic equipment, particularly baseball and football, for use in the various camps throughout the country, since it is realized that the games to which this equipment is devoted are beneficial to the development of the members of the armed forces.

II. Athletic equipment is necessary in the physical and character development of the youth of America

Leading educators have come to believe that athletics as conducted in the educational institutions of this country are and should be considered a definite part of education. Dr. Clarence E. Dykstra, president of the University of Wisconsin, former Selective Service Administrator and former Chairman of the National Labor Mediation Board, has defined education in the following terms:

"It is the process which makes a mature adult out of a child. It is life itself. Everything contributes to the process—observation, experience, association with others, thinking processes, formal and informal schooling, games and recreation, and the inspiration which comes from nature, from art and music, and from every impact with the whole universe. The more sensitive one is to all of these influences the riper and richer is his education."

In the past 22 years the schools and colleges have done more in the way of providing physical training for the youth of the land than is commonly realized. Speaking for the Big Ten Conference, its members since the last war have spent more than $19,000,000 for athletic grounds and buildings. That equipment has not been primarily for intercollegiate athletics but for thousands of boys and girls now attending those institutions and the hundreds of thousands who will follow. The cost of these plants, by the way, was contributed primarily by those people who voluntarily purchased tickets for football and other contests and from generous donations by alumni and others.

The larger universities provide the athletic equipment for the boys who compete in intercollegiate sports. They do not buy the equipment for the lads who participate in intramural athletic activities. In one of our midwestern universities a year ago there were approximately 50 boys on the freshman and varsity basketball squads. These lads received equipment purchased by the university athletic department. In that same institution there were 120 intramural basketball teams. The 1,200 to 1,500 boys who were members of these intramural teams and squads purchased their own equipment.

Carrying the thought further there are, roughly speaking, 1,100 educational institutions above high-school rank. In more than 1,000 of these institutions athletics for the year are conducted at a loss, which means in very many cases the boys have to buy their own athletic equipment.

Tremendous sums have been expended by the States and the political subdivisions thereof in providing playgrounds, baseball fields, tennis courts, gymnasiums, golf courses, and other facilities to encourage the participation in athletic games. Some 38 States have compulsory physical-education laws made applicable to their public schools. Likewise large sums have been provided by denominational schools and colleges—not supported by public funds—to encourage the student body to engage in athletic contests.

In many schools it is compulsory that all male students participate in some form of intramural athletics or military training. The National Collegiate Athletic Association—composed of the leading colleges and universities of the United States—last summer recommended that its members do everything possible by way of contributing to the military-preparedness program that our Government is now promoting. In response to that appeal several of the leading universities have made physical education compulsory for all students for the 4 undergraduate years. Further, a surprisingly large number of the institutions of higher learning are conducting teacher-training courses. The purpose of these is to train men and women to carry on health education, physical education, and recreation activities in the public schools and colleges.

It is believed that physical development through athletics is as important in the development of youth as mental training.

III. Athletic equipment is essential to the physical and mental welfare of the civilian population

Athletic equipment used in developing the youth of this county and assisting in training for the defense program consists mostly of those articles used in group games.

Other articles, such as golf and tennis, are used by individuals, and it is essential that these individuals be able to purchase the necessary equipment to permit them to take advantage of every opportunity for exercise. Particularly is this true in defense industries, where the men are working overtime and require relaxation over the weekends.

Golf and tennis are not rich man's sports. For instance in Chicago there are 100,000 individuals registered in tennis, but less than 5,000 of these are members of tennis clubs. Most of these young boys and girls play their tennis in the public parks or on the school and university tennis courts.

As regards golf, there are approximately 2,000,000 players, but only about 25 percent of whom belong to golf and country clubs. The member of the private club is already taxed on his dues. The majority of the golf players are found on the daily fee and municipal courses; they carry their own bags and most of their play is on Saturday and Sunday. To impose a tax on this type of equipment is to restrict the playing of a game that is essential to the health of a great number of people.

Conclusion

In conclusion, the American Legion, the National Collegiate Athletic Association, and the Athletic Institute, together with the thousands of young men and women who are conducting physical-training activities in the schools, are doing what they can by way of improving the health, virility, and stamina of the young men of this Nation by and through athletic activities of various sorts. Young men have fought the wars of history and young men will fight our future wars. It is our sincere hope that the Congress in its wisdom will decide not to make more difficult the task of those who are endeavoring to prepare our young men for what lies ahead, be it peace or war.

I trust you will believe me when I say that no selfish interest on the part of any individual connected in any way with the amateur athletic work of the Nation prompts the request that the Congress give careful consideration to the request that such athletic goods as basketball, baseball, football, tennis, golf, and soft ball be exempted from the excise tax which is now being considered by this committee.

May we recapitulate by enumerating the reasons why we have taken the time of this committee of Congress:

First: We feel that the principal part of the tax on the goods enumerated would fall not upon those best able to pay it but rather on those least able to pay.

Second: The tax on such athletic goods as have been enumerated is in no sense of the word a luxury tax.

Third: It cannot very well be contended that athletic equipment should be classified as a luxury, but is as essential in the physical development as textbooks and other literature is in mental training. In the present emergency the value of athletic training to youth cannot be doubted. It must be acknowledged as a proven necessity for physical and mental fitness.

Fourth: Athletics should be encouraged to the fullest extent possible. It should not be burdened by taxation of the necessary equipment. The youth of America need athletic training today more than ever to help provide physical and mental fitness for the great task ahead.

Fifth: To impose a tax on athletic equipment is to tax athletics and the youth of America at a time when the pursuit of athletics will most benefit America. In their effort to qualify, they should not be taxed.

The CHAIRMAN. Mr. L. B. Icely. Give your name to the stenographer, please.

STATEMENT OF L. B. ICELY, CHICAGO, ILL., REPRESENTING THE WILSON SPORTING GOODS CO.

Mr. ICELY. Mr. Chairman and gentlemen of the committee; my name is L. B. Icely; I am president of the Wilson Sporting Goods Co. I appear for the Wilson Sporting Goods Co. and other athletic goods manufacturers.

The CHAIRMAN. Are you a manufacturer, also, Mr. Icely?

Mr. ICELY. Yes. I am planning to leave a brief with the committee and it covers most of the points that we have in mind to submit for this committee's consideration. I will not take your time to go into that brief; I would like to have it passed around and read by the committee members.

I have only a few points upon which to touch. Much of my argument has already been used by Major Griffith, particularly what I had to say with respect to youth.

There is no use of further emphasizing on that but the fact is that athletic goods are used by the young man and young lady of this country. We think in terms of athletic goods more as physical education in the same sense that you think of academic education, and we think therefore that those articles, implements—balls, rackets, and so forth—used in those sports should not be taxed. There is another angle to this tax we want to dwell on a moment. As I read the bill, the House has submitted, it covers the heading called "Sporting Goods."

Now sporting goods is not the proper term, in our opinion, for the items we manufacture such as baseballs, soft balls, footballs——

Senator CONNALLY. What do you call yourselves the Wilson Sporting Goods Co. for then?

Mr. ICELY. It is true that is our name, but we got it when we handled a good many articles that we did not manufacture, including fishing tackles and such items. We are now strictly an athletic goods organization, and the firms for whom I am talking are strictly athletic goods houses. In the athletic goods, we find in this bracket, sporting goods, are those of two types: One that requires very little

physical exercise and not used in physical combat games. Among those are fishing tackles, billiard and pool tables, balls and cues; bowling balls and pins, clay pigeons; deck tennis and croquet balls and mallets; they are not athletic games.

Senator CONNALLY. You think a fellow on the creek fishing ought to be exempt from taxes while some boy is in the Army for $21 a month?

Mr. ICELY. I am saying as to him, we are not appearing for him. I say that is a sport; that is not a physical combat sport. There is no game in that and that is not the implement we are representing. I am talking more for athletics, athletic goods, football, basket ball, golf——

Senator CONNALLY. You think the fellow out playing golf, he ought not pay any tax?

Mr. ICELY. I would like to come back to golf.

Senator CONNALLY. All right. I won't ask you any more questions.

Mr. ICELY. I said a moment ago, we are talking on games of combat, baseball, football, tennis, soft ball, and that type of activity, wrestling and boxing, and we don't think they are the same as the other types of sports I have mentioned where there is no physical combat and no keen participation; it is the softer type of recreation.

We think along this line that our youth, who are the ones we are depending on in the next few years, should not be taxed on the implements used in these games any more than they should be taxed for their school books, or anything else used in an academic education.

The other point I had in mind to touch on briefly is the question of our industry and where we stand with respect to our own markets. We know that this defense program is going to take 1½ to 2 million of our young men out of our commercial or civilian market and, therefore, a great deal of athletic goods used, from a civilian standpoint, a much larger amount than in the past. We know, in addition to that that all of our costs of raw material are going up, and if we add this 10 percent, in addition to that, it is very evident that our prices are going to be at a point where sales are stopped; people can't afford to buy.

Senator LA FOLLETTE. Did you have that experience in the last war? Did the sales of goods go down?

Mr. ICELY. There were a number of factors affecting our industry then which are not present now. In 1918 our business fell off, civilian lines, over 50 percent because 2½ millions of our boys were not and could not be users of our products and later the Army commenced to buy things for athletic purposes and then, of course, there was no tax and no revenue for the Government. Now, developing that point just a moment brought out by the Senator over here.

When you speak of discrimination, all the goods to be bought by the armed forces will not carry any tax, so no tax will be collected from them. The civilian market is going down. All these schools, high schools and colleges, will qualify to buy without payment of tax. Beyond that, since we are having a shrinking or smaller market with our civilian business, if we put a tax on, it will be still smaller. We feel it is very unfair to tax athletic goods, thereby raising the price with the attendant results.

We are not speaking for anything except the 4 or 5 items mentioned in our brief. Let us take a look at the amount that might be gotten

from such a tax. The total amount that can be gotten, minus exemptions, is about $2,300,000.

Senator LA FOLLETTE. The Treasury estimates $2,800,000.

Mr. ICELY. That includes a great many articles I am not speaking of, such as billiard equipment and fishing tackles, and a great list of sporting goods not athletic goods in the sense I am describing them.

We figure there will be 2½ million, $2,300,000. On this basis, first, golf clubs and bags which will probably collect $1,000,000. Tennis figures $400,000; football, baseball, and basketball, five or six hundred thousand. After you put your exemptions against them—and that has been compiled very carefully and is in my brief that is what may be gotten. The common opinion of most all people is that athletic goods are sporting goods.

What I would like to have you do is to see the difference between athletic goods and sporting goods as such and the type of people who will be taxed and who they are under this proposed bill, and with that in mind I will develop the golf situation briefly.

There are today in the United States two and one-half million golfers. There are 2,000 golf clubs with an average of 200 members, all paying taxes on their dues. The other 2,000,000 golf players play on public links, paying a fee, because they don't even have a caddy. They are the young people working in factories and offices. In our own company two-thirds of our people do just that. These are the people who get up at 4:30 in the morning and go out and play golf before going to work. You are not taxing the rich men when you tax golf. Three-fourths of them are working people with incomes of $40 to $50 a week. That is the type of people playing golf.

Then go to tennis. In the United States there are probably less than 25,000 members of tennis clubs, whereas in reality there are 700,000 to a million who play tennis, and where do they play? On the public courts, including those here in Washington. They are the working type of people. If you tax them you are simply making it more difficult for them to keep physically fit. If I had anything to do with the responsibility of preserving the moral standards of the people, I would sooner have them out playing tennis than to have them congregating around, talking about the overthrow of our Government, or something else of that kind. In fact, it is my opinion that you folks should not tax athletic goods as such. You have all this story about juvenile articles, items within the borderline, and it is very difficult to justify some of the distinctions which would have to be made. If there were any merit at all in the point I am making, I would say it would be even wise, rather than to tax our young people, to attempt to devise some way under which a bounty or bonus might be given to get people to play, rather than to have their tax raised.

The CHAIRMAN. Your time has expired.

Mr. ICELY. And I thank you gentlemen.

(Mr. Icely's memorandum referred to is as follows:)

MEMORANDUM SUBMITTED BY L. B. ICELY, PRESIDENT, WILSON SPORTING GOODS CO., CHICAGO, ILL.

THE PROPOSED EXCISE TAX ON SPORTING GOODS

This memorandum is respectfully submitted in connection with the proposed excise tax on articles specified in section 3406 Internal Revenue Code, paragraph (1) of the Revenue Act of 1941, as "Sporting goods."

When the Treasury officials proposed excise taxes on a number of commodities, their recommendations were (hearings No. 1, pp. 50, 51)—

1. To avoid excises which would increase business costs and result in price increases.

2. To avoid experimentation and stay within the scope of previous experience by taxing carefully selected commodities or luxury articles which will produce revenue commensurate with the expense of administration.

3. To tax commodities not essential to the defense program.

A review of those articles specifically listed in paragraph (1) will show two distinct types of merchandise which is considered in this industry as "sporting goods" and as "athletic goods."

This distinction can be summarized as follows:

(*a*) *Sporting goods.*—Articles used largely for personal recreation and very little physical exercise and very seldom in games of physical contact, such articles are fishing tackle; billiard and pool tables, balls, and cues; bowling balls and pins; clay pigeons; deck tennis, and croquet balls and mallets.

(*b*) *Athletic goods.*—Articles used in games or contests combining physical exercise and contact, as well as a certain degree of individual skill, such as baseball, football, basketball, golf, tennis, boxing, wrestling, track and field games, etc.

Those articles in (*b*) Athletic goods, can be divided into two classes of equipment, one for group use and the other for individual use.

The company I represent is engaged in the manufacture of athletic goods—those articles defined in (*b*) above. With the exception of golf equipment, all of the athletic equipment referred to in the proposed bill is sold largely to schools and colleges and other institutions carrying on an organized athletic program.

We realize the necessity of additional taxes to pay the cost of national defense and do not wish to imply that we welcome a tax on every industry except our own, but the articles of athletic equipment as specified in the proposed bill are essential to national defense and are not luxury items and, therefore, should not be taxed. We do not manufacture "sporting goods" and, therefore, are not speaking for that industry.

I. "Parts and accessories" should not apply to "sporting goods"

One part of subdivision (a) of section 3406 of the code in the proposed bill reads:

"(Including in each case parts of accessories of such articles sold on or in connection therewith, or with the sale thereof.)"

Under the 1932 law, which was repealed in 1938, there was considerable confusion as to what articles were taxable and what were not taxable. The above paragraph will immediately raise the question as to what is a "part" and an "accessory" for athletic equipment. For example, a boy purchases a football. After the ball has been used a while, the bladder becomes punctured. He needs a new bladder and to remove the old bladder he cuts the leather lace. We do not believe it is the intent of Congress to say there should be a tax on the new lace and the new bladder.

Administration difficulties were numerous under the 1932 law because of the question as to taxability of certain items. This was recognized by the Treasury Department and also the Committee on Ways and Means as this committee is commenting upon those excise taxes proposed for elimination in the 1938 revision stated:

"Fourth. It is proposed to eliminate the tax on sporting goods, which consist chiefly of athletic equipment. This tax presents much administrative difficulty because the taxability of an article depends upon the purpose of its manufacture and use. It is extremely difficult to apply even the exemption provided for children's toys and games * * *. The 10 percent rate of tax bears severely upon the youth of the country, especially in the use of baseball and football equipment."

It is, therefore, suggested that this part of section 3406 of the Code—

"including in each case parts or accessories or such articles sold on or in connection therewith, or with the sale thereof"

should not apply to paragraph (1) of the proposed law, as this would cause considerable administrative difficulties.

II. Sales and exempt to state and political subdivisions

Section 2406 of H. R. 5417, page 79 of printed copy, applies to tax-free sales as follows:

"Under regulations prescribed by the Commissioner with the approval of the Secretary, no tax under this chapter shall be imposed with respect to the sale of any article—

"(a) For the exclusive use of the United States, any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia;

"(b) For export, or the shipment to a possession of the United States, and in due course to exported or shipped."

The athletic equipment mentioned in this bill can be grouped into three divisions:

(1) Those articles purchased by individuals for their personal use.

(2) Those articles purchased by boards of education, city park boards, etc., for playground and school use.

(3) Those articles purchased by schools and teams for group use of teams, etc.

All of those articles in group (2) will be purchased on exemption certificates, and no tax will be realized thereon. Also 80 percent of the articles in group (3) will be purchased by schools who can qualify under the exemption. This leaves only such articles as skates, golf, tennis, etc., that cannot be purchased on an exemption certificate.

Tax-exempt sales like taxable sales require the keeping and filing monthly of special reports, statements and returns of sales, classification and special certificates and other transactions to comply with the Internal Revenue Regulations. Exemption certificates on tax-exempt sales have to be prepared and filed; also applications for credits and refunds. Thus, on account of the large volume of tax-exempt sales the additional cost of clerical work required would in many cases more than equal the amount of revenue on taxable sales and impose an additional burden upon both the taxpayer and Government disproportionate to the revenue received.

III. The tax discriminates between public and denominational schools

The denominational schools and societies are discriminated against in the purchase of athletic equipment because they cannot purchase on an exemption certificate such as a State university and public high school.

It is needless to say that were there no denominational schools in existence, the present public-school facilities could not adequately care for the students of this country. Accordingly the operation of denominational schools results in a tremendous saving in general taxes which would be necessary to provide free learning for the entire student body.

In view of the importance these denominational schools have in the education of the youth of this country, there should be no discrimination in the price these schools pay for their athletic equipment when such equipment is used in the development of the health of the students of America.

IV. The proposed tax does not avoid experimentation, previous experience led to its elimination

At the hearing the Treasury officials proposed to tax certain luxury articles "consumed in sufficient quantities to bring in revenue commensurate with the expense of administration" and proposed "to avoid experimentation and stay as nearly as possible within the scope of previous experience * * *." (Hearing No. 1, pp. 50, 51.)

The imposition of a new tax on sporting goods would not accomplish those purposes. On the contrary it would be experimenting with a tax which both the Treasury and the committee discarded because the tax did not produce revenue commensurate with the administrative cost.

The 1938 subcommittee on Revision of Revenue Laws which made an exhaustive study of several so-called nuisance taxes recommended (Recommendation No. 60) that the tax on sporting goods be eliminated (p. 81). The Committee Report (p. 63) stated:

"The taxes * * * on sporting goods have caused administrative difficulties out of proportion to the revenue received, and in many cases fall upon articles in general use."

V. The small amount of revenue to be obtained

The previous experience under the 1932 law, which tax on sporting goods was repealed in 1938, was that there was a very small amount of revenue obtained which was not commensurate with the expense of administration.

After making allowance for the athletic equipment which will be purchased tax-free on exemption certificates, it is estimated that the net revenue received from athletic goods will be $2,300,000, made up as follows:

Golf equipment	$1,300,000
Tennis equipment	400,000
Baseball equipment	400,000
Basketball equipment	40,000
Football equipment	100,000
Boxing, wrestling, and other miscellaneous equipment	60,000
Total	2,300,000

From the above schedule it is apparent the revenue from a tax on such equipment as football, baseball, and basketball will be very small and will not justify the expense of handling the exemption certificates on which the majority of this equipment will be purchased.

Golf and tennis are purchased mostly by individuals and very few sales will be made on exemption certificate.

This is not enough revenue to cover the expense of the defense program and is a small amount to the Treasury but a large amount to tax on the youth of this country.

Conclusion

It is, therefore, submitted that the careful thought and study given this excise tax by the 1938 subcommittee and the Treasury should be given great weight and that the reasons for discarding the tax in 1938 should now serve as a well established precedent for the elimination of an excise tax on sporting goods in the proposed bill. And, in this connection, the observations of the committee in 1938 are of even greater significance in the present emergency:

"The 10 percent rate of tax bears severely upon the youth of the country, especially in the use of baseball and football equipment."

It is also contended that the renewal of the tax this year will result in a recurrence of the past administrative difficulties and that these and the other reasons which led to its elimination in 1938 are still applicable this year.

The expense of administering this proopsed tax will be burdensome to both the Government and the taxpayer, and in view of the small amount of revenue to be derived, it is urged that the athletic goods specified in paragraph (1), section 3406, of H. R. 5417, be entirely eliminated from the proposed bill.

The CHAIRMAN. Mr. Boland?

STATEMENT OF FRANK A. K. BOLAND, NEW YORK, N. Y., GENERAL COUNSEL, AMERICAN HOTEL ASSOCIATION OF THE UNITED STATES AND CANADA

Mr. BOLAND. Mr. Chairman and gentlemen of the committee, my name is Frank A. K. Boland. My office is 500 Fifth Avenue, New York City, and I am general counsel of the American Hotel Association of the United States and Canada.

On this occasion I appear before you in reference to the proposed section 452 of the law, applicable to the cabaret tax.

Now, under the proposal, this bill changes the base of the tax. Heretofore it has been based on 20 percent or one-fifth of the bill charged where food has been served in connection with entertainment as that is defined under the rules and regulations of the Department pursuant to the law.

The CHAIRMAN. You say 20 percent or one-fifth of the bill?

Mr. BOLAND. Twenty percent or one-fifth; yes; but it must be, under any circumstances, 50 cents; that is to say, if any of us went to a cabaret the tax would be—that tax would be applicable to us if the bill was $2.50. Now, this proposal eliminates altogether that feature and provides for a straight tax of 5 percent of the total charge. In other words, the tax was indirect in its application in the first instance, and amounted to only 4 percent approximately, of the bill. Now it is 5 percent, to which we have no objection. We do object, however, to any change of the law which proposes to fasten the obligation and the liability of that tax, to transfer it from the shoulders of the patron, as it has been in the past, to the pocket of the hotel proprietor.

Therefore, we are here now before you in protest and ask you to relieve us indirectly. As to those who might have some doubt as to the contention I am pressing, namely, that this proposal requres us to pay this tax directly, I can only refer you to the report of the Committee on Ways and Means.

The CHAIRMAN. Weren't you required to pay it directly under the other law?

Mr. BOLAND. No.

The CHAIRMAN. The proprietor paid it?

Mr. BOLAND. No; he didn't pay it; he collected it and returned it.

The CHAIRMAN. Won't you do the same under this?

Mr. BOLAND. No, Mr. Chairman.

The CHAIRMAN. Why not?

Mr. BOLAND. Because, for two reasons: (1) As a matter of fact, we are of the opinion that where a tax is specifically imposed on one person, it cannot be imposed for collection on another person unless he is willing; that is the point; that is the crux of the situation.

The CHAIRMAN. I think you must be wrong about that.

Mr. BOLAND. I hope I am.

The CHAIRMAN. It is contemplated that you pass along this tax.

Mr. BOLAND. That is right; it is just that—it was so contemplated. I will get to that in a moment, but let us read four lines of the Committee on ways and Means.

Senator BROWN. What page is that, Mr. Boland?

Mr. BOLAND. The one I have, mine is page 26, Mr. Senator. In your report it is 31.

Here is what the committee says, 3 lines:

> Under existing law the tax is upon the patrons, but the owner of the establishment is charged with its collection and payment into the Treasury.

And here is the blow that kills father—just this short sentence:

> The bill places the tax directly on the owner—

Now, if this is so, this becomes a gross receipts tax and when you in the first instance, attempt to impose a tax of 5 percent on the basis of gross receipts, and that is all it is, it is unfair.

Now, can we pass this tax along? It can only be done by absorbing it in the charge.

Senator TAFT. Here is what it says:

> The tax imposed under paragraph 1 shall be returned and paid by the person receiving such payment.

Isn't that clear that it is to be paid by the patron?

Mr. BOLAND. Payments of what? Payments for charges of admission, food, refreshments; that is under subdivision 1.

Senator TAFT. It doesn't imply the payment be made by you?

Mr. BOLAND. No, sir. And, all I am asking here today is a simple provision which will clarify this whole issue. I have prepared, and we have sent to you gentlemen, this provision:

"The tax imposed under paragraph 1 shall be returned and paid by the person receiving such payments," and this is our proposal:

"Collected by the proprietor of the establishment from the person paying for admission, refreshment, service, and merchandise."

Now, this is a consumers' tax, and in all consumers' taxes it is customary that the ultimate consumer pay the tax. We want to follow the custom. That is the way it is as to the direct admission charge with respect to theaters, motion-picture theaters, and so forth.

What we want in appropriate language is some provision which will make it mandatory that the payment of the tax in the first instance be charged to the patron. There shouldn't be any objection to that.

The hotels should not be picked out especially for tax treatment under a scheme inconsistent with the plan heretofore in existence. We are satisfied with the 5 percent; we are satisfied to go along without any objection except we want the status quo to be maintained with respect to these charges as it has in the past. A simple provision—I drafted that provision—any other provision would settle the case. We don't want the competition, gentlemen, which our hotels are subjected to and will be subjected to, under this provision; it should be eliminated by this suggested change.

Senator DANAHER. Let me ask you a question: Suppose a concession for hat-checking privileges is rented by the hotel or cabaret for $25,000 a year, or up?

Mr. BOLAND. Or up? Those are good figures.

Senator DANAHER. Yes; or up. Who pays the 5 percent tax there, under your theory?

Mr. BOLAND. Is that another provision; is that a new provision? Would you repeat that?

Senator DANAHER. Do you have a copy of the bill before you?

Mr. BOLAND. I have a reprint of it in the report of the Ways and Means.

Senator DANAHER. Don't you think the operator of the establishment that is charging for admission, refreshments, services, and merchandise, should have to pay the 5 percent, the tax levied on this entire service?

Mr. BOLAND. No; I am right here objecting to it.

Senator DANAHER. I am limiting it to services.

Mr. BOLAND. Well, I hadn't thought of that.

Senator DANAHER. That is in the bill.

Mr. BOLAND. I feel that these excise taxes should be passed along. I don't think we should adopt any innovations with respect to the identity of the person who has heretofore paid the tax. This general trouble has come about for the reason and as indicated in the report of the committee.

Senator TAFT. It seems to me perfectly clear, without a legal provision, that the 5 percent is on the patron's bill.

Mr. BOLAND. How?

Senator TAFT. By adding it to the bill.

Mr. BOLAND. You can't add it as a tax; that is my opinion, as it were. Suppose you go into my hotel—assuming I have one—and the bill is $5, let's say, and I give you a bill for $5 and then I add the tax. Suppose you would resist and say, "I won't pay you."

Senator TAFT. I can't resist. It is $5.25.

Mr. BOLAND. Wait a minute; I can't agree that you would have to pay it. As a lawyer——

Senator TAFT. Yes, as a lawyer; you can charge that additional tax and you can write it on the bill separately or put it in any way you like.

Mr. BOLAND. That is a comforting statement of yours. I would like to be assured that the court would stand behind us.

Senator TAFT. There is no way of preventing it.

Mr. BOLAND. That is all I want—that provision be inserted that in the first instance, the tax be collected from the guest.

Senator TAFT. It was never intended otherwise.

The CHAIRMAN. It was not intended that you should pay it.

Mr. BOLAND. I don't think it was; I am sorry as a lawyer I cannot agree with Senator Taft.

The CHAIRMAN. They are simply carrying the tax from the other over to this, and here is the general tax on the whole service you render, taking charge of his hat, furnishing music, furnishing food, and they simply say you shall pay a tax of 5 percent on that. It was not intended that it could not be passed along.

You want that made clear?

Mr. BOLAND. Yes.

Senator TAFT. I think there is a doubt about Senator Danaher's question about the hat-check feature because I don't know how you are going to pass that along.

Mr. BOLAND. Senator, we are going to pay the tax. We, the hotel proprietors, are going to pay the tax; there shouldn't be any question about it.

The CHAIRMAN. The hat-check is a subcontract?

Mr. BOLAND. I don't care whether it is; it is an integral part of the operation and the tax applies. Do you like my proposed amendment or shall I get busy and whip something else into shape?

Senator TAFT. That raises a question and the reason that amendment may not fit it comes up. How are you going to pass on the charge on the hat-check, by charging 11 cents?

Mr. BOLAND. Now listen, Senator; there is a charge made in some institutions for checking property. The rule is that there is not, and I supose there is in that business figured something. It is better to work under the old provision because they depend on the generosity of the patron.

Senator TAFT. But your amendment says that the tax shall be returned and paid by the person receiving such payment, which means you would have to charge 11 cents if your regular charge was 10 cents, and I don't think you can, or want to do it. It seems to me that, for that reason, your amendment may not be exactly appropriate.

Mr. BOLAND. Senator, that is a matter of regulation with the Department; we get along with them all right. I am worried about the statutory law, that is all.

The CHAIRMAN. I think we will take care of that.

Mr. BOLAND. Shall we address you further?

The CHAIRMAN. Not on that subject.

Senator BROWN. I think this gentleman is the first witness who has appeared here who said he was in favor of paying taxes.

Mr. BOLAND. Thank you, gentlemen.

(The proposed amendment referred to by Mr. Boland is as follows:)

PROPOSED AMENDMENT TO SECTION 542, REVENUE BILL OF 1941, CABARET TAX
H. R. 5417—1941

In accordance with our memorandum herewith submitted we recommend:

That section 1700 (c) of the Internal Revenue Code, subdivision (2) as presently proposed in subdivision (a) of section 542 of the revenue bill, be amended as follows:

"(2) By whom paid.—The tax imposed under paragraph (1) shall be [returned and paid by the person receiving such payments."] *collected by the proprietor of the establishment from the person paying for admission, refreshment, service, and merchandise."*

That section 1716 (a) of the Internal Revenue Code as presently proposed in subdivision (c) of section 542 of the revenue bill, be amended as follows:

"(a) Requirement.—Every person required under subsection (a) of section 1715 to collect the taxes, or required under section 1700 (c) *or* (d) [or (e)] to pay the taxes, imposed by this chapter shall make returns under oath, in duplicate, in such manner and containing such information as the Commissioner, with the approval of the Secretary, may, by regulation, prescribe."

NOTE.—Matter presently contained in revenue bill, to be omitted, in brackets; new matter recommended printed in italic.

AMERICAN HOTEL ASSOCIATION OF THE UNITED STATES AND CANADA,
FRANK A. K. BOLAND, *Counsel.*

(A letter by Mr. Boland is as follows:)

AMERICAN HOTEL ASSOCIATION,
OF THE UNITED STATES AND CANADA,
New York, N. Y., August 22, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

In re suggested amendment to section 1700 (c) of the Internal Revenue Code, subdivision 2 as presently proposed in subdivision (a) of section 542 of revenue bill (H. R. 5417).

DEAR SENATOR: You will recall that I appeared before your committee last Wednesday, on behalf of the American Hotel Association of the United States and Canada, with respect to an appropriate amendment to the proposed admissions tax on cabarets and roof gardens, so that hotels might be permitted to continue to pass this tax on to the patron as now provided in the present law. At the hearing you, as well as the other members of your committee, intimated that in the drafting of the bill there was no intention to preclude the hotel proprietor from passing such tax on to the patron. I previously learned that this understanding was supported by representatives of the Treasury Department and the Internal Revenue Department. You will recall that I expressed the opinion that under the present wording of the bill this tax could not be passed along and that it would practically amount to a gross-receipts tax. In this latter contention I am supported by the advice of many eminent lawyers who have clients to whom this issue is a matter of concern. You intimated that your committee would give the matter consideration with respect to some form of amendment to accomplish our desired objective.

After having given the matter further consideration since the hearing, I suggest the following amendment consisting of an insertion (printed in italic) in subdivision 2 of section 542 of the revenue bill, so that such section would read as follows:

"By whom paid.—The tax imposed under paragraph 1 shall be *collected from the patron and* returned and paid by the person receiving such payments."

You will note that under our suggested amendment, the proprietor still has the obligation to pay the tax but the amendment permits of collection of the tax from the patron.

As I stated to your committee, the hotel men of the United States have no fault to find with the change of the base of this tax, for we do know from actual experience that the enforcement of the present law has been the source of serious administrative difficulties on the part of the Internal Revenue Department. Nor do we object to the increase of the tax from approximately 4 percent to a straight 5 percent of the total bill. All that we ask is the permission to pass the tax along to the patron under some form of statutory mandate and hoping thereby to prevent any form of unfair competition on the part of hotels and restaurants, for as a practical matter we can well understand that while some proprietors may assume to pay the tax directly because of the advantage of their financial overhead structure, others not so fortunately situated may seek to impose it upon the patron directly or, as an alternative, through stress of circumstances, may attempt to absorb it by increasing the cost of the food and other entertainment where they can do so, to the disadvantage of competitors.

In closing I wish to thank you and the members of your committee for the very courteous treatment which I received from you at the hearing.

Respectfully yours,

FRANK A. K. BOLAND, *Counsel.*

The CHAIRMAN. There is another matter we might bring up at this time, because Mr. Murphy this morning presented a very forceful statement suggesting the imposition of a tax on what I believe was the commercial mutual companies, the large insurance companies, and I would like to make this statement about it.

There may be much merit in Mr. Murphy's suggestion, but, obviously, if we are going to consider the proposition of a new tax of that kind we would be compelled to give the other people, the mutual insurance company people, an opportunity to be heard, and my information is—and I think it is correct—that the Treasury is giving thought to this very problem now and is not yet ready to make a recommendation.

And, in order to prevent the appearance before the committee of people on the other side of the question, if it is agreeable with the committee, I would like to be able to announce that the comittee will not go into the question at this time and not until the Treasury is ready to submit its recommendations.

Senator CLARK. That would not be before the passage of the bill?

The CHAIRMAN. No; and it would be only fair to the people on the other side of the question, and they have a right to do so, to appear and be heard, which would probably prolong this hearing after this week.

Senator CLARK. I think that question ought to be dealt with; I don't know whether it ought to be dealt with in connection with this bill or later; I do not think it should be treated hastily, but I do think it is a very important matter. I may say that a method is in my mind for consideration on this bill or the other, reaching such underwriters as Lloyd's of London, who do business in every State in the Union and who pay no taxes in any State or Federal taxes, with the exception of the State of Kentucky, and they do business in competition with insurance companies all over the United States. I have such an amend-

ment, but I am not disposed to press that if it is felt that the whole matter should await the report from the Treasury and considered in the future.

Senator LA FOLLETTE. It is a very complicated question; not one that can be gone into hastily and unless the committee is ready to take up the matter at this time, I think we ought to make some statement about it, otherwise the mutual-insurance people would naturally want to be heard, and they are entitled to be heard.

The CHAIRMAN. Yes; that is the reason I brought it up now. I don't think, Senator Clark, that your suggestion would be precluded by this particular suggestion. It is only with respect to these mutual-insurance companies.

Mr. Sullivan, does the Treasury wish us to go into that at this time?

Mr. SULLIVAN. Our studies are practically completed, and we will be ready to submit our report and take up the matter at the pleasure of the committee. I think, as you suggested, if the question is to be opened up, the Treasury would want a complete hearing on both sides, and whereas in arriving at our conclusions we think we have given adequate hearings to both arguments, we feel easier about it after a full public hearing, because it is quite likely that we may have missed something, although we tried not to. We will be ready whenever the committee wishes to hear from us, either now or in the technical amendment bill.

The CHAIRMAN. It could be considered in connection with that legislation.

Mr. SULLIVAN. We should think so.

The CHAIRMAN. What is the pleasure of the committee?

Senator LA FOLLETTE. This falls in the same category with a great many others which the House committee has considered. We might find, after giving our consideration to it that there had been developed in the House something which would render our action of little value.

Senator CLARK. It seems to me, in view of the very large loss of revenue entailed in the untoward delay of this bill, it should be disposed of as early as practicable.

Senator BROWN. We could make this tax effective March, 1942.

The CHAIRMAN. It occurred to me it would be well to let it go over for consideration in the bill dealing with the administrative and technical matters.

Senator CLARK. I move the Chair be authorized to make the announcement originally suggested.

The CHAIRMAN. Any objection to that?

(No response.)

The CHAIRMAN. Without objection then, we will not open up this question at this time but will reserve it for consideration when the subsequent bill dealing with technical and administrative details is before the committee, probably this winter.

We will now recess until 2 o'clock.

(Whereupon, at 12.30 p. m., a recess until 2 p. m. was taken.)

AFTERNOON SESSION

(Pursuant to adjournment, the committee reconvened at 2 p. m.)

The CHAIRMAN. Mr. Marsh.

STATEMENT OF BENJAMIN C. MARSH, WASHINGTON, D. C., EXECUTIVE SECRETARY, THE PEOPLE'S LOBBY

Mr. MARSH. Mr. Chairman, and members of the committee; for the record, my name is Benjamin C. Marsh. I am executive secretary of the People's Lobby, with headquarters here in Washington.

The CHAIRMAN. You can sit down, if you would rather sit.

Mr. MARSH. I would rather stand, if you will let me, Senator. You see, my father was a preacher and he found he could deliver his exordium better standing in the pulpit than sitting down and I think I inherited that trait.

I have been following the hearings of this committee and I have reached the conclusion that the American people are almost solid behind having the other fellow pay the costs of defense. I have never seen such unanimity on this, and I have been appearing before the Senate Finance Committee for 24 years; I have never seen such unanimity in the proposal to "let George do it." I am unable, naturally, to state whether that indicates the American people's desire not to get involved in this war, or what it does indicate. I am going to represent, and do today, a group which is not connected with this great mass who want to let the "other fellow do it."

I want to suggest to this committee that you can, and in our judgment, should raise $20,000,000,000 by taxes. Most of the members of our organization, the People's Lobby, will pay considerably more taxes under this proposal, and they are ready to.

This morning one of the witnesses suggested to you that you were going to hand on to the next generation a debt of $100,000,000,000.

Well, I think I am older than any member of this committee, with possibly one or two exceptions, and I respectfully suggest to this committee that the next generation will refuse to honor any such bill as that, and it will be repudiated with rather difficult results.

This tax bill is a test bill this year. Hitler is watching it; hundreds of thousands of young men in concentration—I will take it back—in training camps are watching it; and the people throughout the world know perfectly well what every member of this committee knows, that it is not the enunciation of 8 Points either synthetically in midocean or individually by the President of the United States, which will determine what our policies are to be following this war. Those policies will be largely determined by the economic system and economic conditions and the fiscal policy of the United States during the war.

That was the case in the World War, you remember, Mr. Chairman, I am sure.

The CHAIRMAN. Yes, sir.

Mr. MARSH. The 14 Points turned into 41 disappoints and the thing went to smash.

I am going to be specific in suggesting how this money can be raised, and, frankly, you are going to be terribly criticized if you adopt our program and you are going to be in a devil of a situation if you do not, but I am going to try to reinforce the aspirations of the Members of the Congress to put through a just tax bill by sending to about a thousand papers in the next few days some facts I will give you. I know perfectly well the Boston Herald, the New York

Times, the Chicago Tribune, and the San Francisco Chronicle will not publish them, but thousands of little papers will. Also, I am going on a 6 weeks' speaking trip shortly, from here to the coast, to speak on how this war should be paid for.

I am going to ask permission to file a supporting brief instead of reading it, because I know your time is very valuable.

A citizen is merciful to the Senate Finance Committee by doing that instead of trying to keep them up all night.

We shall have a national income of about $90,000,000,000 this year and probably $95,000,000,000 next year, and assuming State and local tax collections next year will not exceed $8,000,000,000 the Federal Government can, next year, collect $20,000,000 in taxes.

The Treasury Department has recently issued a statement that the total tax collections up until July 1, this year for the preceding year were in round figures—and I will use only round figures for the record—$7,370,000,000.

We suggest the following additional taxes and yield:

Increase in new corporation income taxes	$2,148,000,000
Increase in personal income taxes	3,582,000,000
Increase in the excess-profits tax	798,006,000

The August bulletin of the Federal Reserve Board states that during the first half of this year the net income of major corporations was 25 percent larger than for the same period in 1940—of course, it was only for the first half of the year—and that dividend payments were 15 percent higher during that period than the first half year of 1940.

We suggest an increase in the capital stock tax of $33,400,000 in the estate tax of about $145,000,000 in the gift tax of some $48,000,000 and in liquor taxes of about $380,000,000.

I am not as much of an expert as one of the witnesses this morning as to what taxes on liquor do, because I have not tested the subject sufficiently, but I do not object to a reasonable increase.

We ask you, in all sincerity, to forget all about these other fool taxes which the House committee wrote in. When I saw that tax bill from the House, allegedly of Representatives, I was reminded of the tariff bill which the Democrats put through when Grover Cleveland was President, which he described as an "act of perfidy." I can only so describe the House committee bill, because it puts upon the majority of the people who cannot afford to pay much, if anything more, something like a billion dollars extra taxes.

I studied economics. I wasted 4 years during my attendance in the graduate schools of Chicago and Pennsylvania Universities. I was earning my way, but you do not have to waste that time and money to know there are only three taxes that cannot be shifted, except in a totalitarian government, and we haven't that yet. You cannot shift the income tax, either the personal or corporate income tax. If you could nobody would object to it. That is pretty good proof. When a fellow objects to a tax, it is a sign that he cannot shift it.

Second, you cannot shift the estate tax, or, for that matter, the inheritance tax, onto someone else.

Third, you cannot shift a tax on land values. Every other tax, nearly, you can shift, but those you cannot.

Let me give some figures as to new taxes. We suggest an excise tax on land values, with an exemption so that no little home

owner and no little farmer, small fellow, I mean, that is working his farm, will pay 1 cent additional tax through this excise tax on the value of land. We know you can raise about $494,000,000 or $495,000,000 by such a tax. Whom will it fall upon?

Well, it will fall upon the Roosevelt, the Morgenthau, and Astor tribes and the rest of big-land owners primarily. It should fall upon me. I have been very much more successful, Mr. Chairman, in the 20 years past in skinning the people than in saving them. About 3 years ago I bought a piece of land over in Virginia. I thoroughly believe, as Ambassador Josephus Daniels remarked in 1935, in Mexico City, "You will never have freedom as long as you have speculation in land." He made that statement at a Thanksgiving Day service and also, "You will never have freedom as long as you have private ownership of natural resources."

I sold this land after holding it a little over 2 years and I sold it at a profit, minus a few expenses, of about 200 percent. I did not earn it. In fact, what I made by acts of Congress and the State legislature, pardon me, was about a year's net salary. I could not have done that if we had imposed a fair tax on land values.

It is strange, but the increase in net rents and royalties from 1932 to 1940 was more than the total reduction in the total interest payments.

Now I come to the source of the largest revenue you can get, and that is taxing the surplus and undivided profits of corporations. You can get next year $5,000,000,000. And it will not be a precedent. I told you I will not take time to give you the detailed figures which I have in this statement, but I would like to read on that point these figures, and all of my figures, Mr. Chairman and members of the committee, are from our Government reports; none of them are imported from Moscow, not one.

At the end of 1937, surplus and undivided profits of 416,902 corporations were $58,524,000,000. Their cash on hand was $24,346,300,000. I will use round figures. The details are in the statement. Their holdings of Government obligations largely tax-exempt were nearly $24,000,000,000.

In other words, at the end of 1937 their liquid assets were about $48,500,000,000.

I am suggesting what this Congress has got to do to save America from Hitler or perhaps we might say, save the administration from an economic collapse—it comes to the same thing. What they have got to do is make the corporations do what they did in each of 3 years in the past decade. In the 3 years from 1931 to 1933, inclusive, incorporated business reported an aggregate loss of $5,900,000,000, but paid dividends amounting to $9,200,000,000, so that they paid out of something besides profits, because they had not any profit; they had a deficit, mind you, of $5,900,000,000—they paid out each of the 3 years an average of over $5,000,000,000 a year.

To whom? To their stockholders, and 20,000 people got roughly one-third of that.

I should say there is not an industry in America which has the slightest fear of Hitler, judging by the way they have come to you and said, "For God's sake, give the other fellow the privilege of paying for defense and give us the privilege of making the profits."

because that summarizes practically all the testimony you have had. When I see your scheme for excise taxes, which the House put up to you, I reach the conclusion that the House Committee on Ways and Means have decided the only way to reemploy those put out of non-defense industry is collecting excise taxes, and they are planning to make jobs for 2,000,000 more such people collecting excise taxes. That may be Americanism, but I doubt it. It is not intelligent.

The corporations can pay $5,000,000,000 a year for the next 3 years, for each of the next 3 years. They did it for 3 years from 1931 to 1933. Did they go broke? No. I have shown you the figures, and these figures, by the way, that I am giving you are from the statistics of income of the Internal Revenue Bureau for 1937.

After going broke that way, 4 years later they had surplus and undivided profits of $58,500,000,000. They are probably larger today. I could not get any later figures; your experts can.

Incidentally, not to go into details, out of that 416,000 corporations, 394 had about two-fifths of all the surplus and undivided profits.

Which leads me up to my next suggestion, Mr. Chairman and members of the committee, and that is this: I do not know whether corporation executives are liars congenitally or as an acquired trait, or whether they are just scared, but I got from the O. P. M. the other day this list of contracts awarded, supply contracts only, totaling $25,000,000 and over, because anything under $25,000,000 now is not worth mentioning. Six corporations received 31.1 percent of all the contracts given through May 1941 from June 1940. Then they give a list of fifty-odd additional corporations. These 56 corporations, some of them having in their contract that they would not subcontract, these 56 corporations—let me read it:

Fifty-six corporations having defense-supply contracts with the War and Navy Departments have contracted for almost three-fourths of the total dollar volume of such contracts, according to a compilation made by the Bureau of Research and Statistics, Office of Production Management.

I am going to make this request of this committee in order that we may have a record of it—I know you can get it, I have talked to some people in the Treasury—I will give you this list and ask you to let it go into the record, and ask that your committee request the Treasury Department to ascertain what the net profits of these corporaions, over and above any increase in taxes you contemplate, are for the current half year, the first half of this year, as compared with 1940, and on the basis of that information, that you determine which one of these corporations is to pay the major part.

I think it is fair to say that corporations that get most of the Government contracts should pay the major part of the profits tax. It is nonsensical for me to talk percentages to you because you have experts that are very capable to determine those—Mr. Stam, Mr. Parker, Mr. Sullivan, and others, who can get you all of these facts.

You have been seeing the story in the papers about the lack of morale in the Army, and that lack of morale, gentlemen, I expect in the Army was due to the lack of morale in the country.

Well, it would be natural.

Let me repeat, if I may, as some more members have come in——

The CHAIRMAN (interposing). Your time is over.

Mr. MARSH. I will not repeat then. I will let them read the record. I will get right down to two or three more points.

May I read into your record a statement I got the second of this month from the Department of Agriculture showing farm-land values, exclusive of buildings—5 States have about two-fifths of all the farm-land value in the 48 States. I would like to enter into the record just this last column, if I may.

The CHAIRMAN. Yes, sir.

Mr. MARSH. Now, the other day you had the astounding suggestion from a good friend of mine, who I hope will learn economics later, Mr. Alvord, about the 3-percent withdrawal tax. Of course, he appeared for his employers, the United States Chamber of Commerce, whose patriotism has never been put to the test by being applied. He suggested a universal 3-percent withdrawal tax. Well, that will probably save the rich fellows over $100,000,000. I figured it out, and I will tell you why.

This year the net income of people getting over $5,000 will be approximately $9,000,000,000. They are to pay a 3-percent tax under the Chamber of Commerce suggestion. What does that mean?

Three percent of $9,000,000,000 is $270,000,000. By a little payment, about $270,000,000 will be withdrawn from a tax rate in the upper brackets of 80 percent. It is a very slick scheme. I do not think there is much danger of its going through, but I want to warn you it will be pushed. Taking the 1939 figure for the $5,000 people, their total income was $7,800,000,000. Their property income was $4,700,000,000. So you see that scheme for withdrawal at the source really means that the property interests would be exempted from very heavy surtaxes, and that would naturally increase the deficit or put it over on somebody else.

Also, you have had several buckets of tears shed in your presence over the terrible taxes on the rich. Let me give you the Government figures for the poor people who had an income of a million apiece in 1939; 43 of them.

The CHAIRMAN. You will have to put your figures in the record, Mr. Marsh. Your time is up. You have taken twice as long as you were allotted.

Mr. MARSH. May I put them in later, then?

The CHAIRMAN. Yes, sir.

(The figures submitted by Mr. Marsh are as follows:)

FIFTIETH OF FAMILIES GET NINTH OF INCOME

The report on incomes and taxes for 1939 shows about one-fiftieth of American families got about one-ninth of the national income and paid very little income taxes.

National income was $68,600,000,000. Income from ownership or control of property was $21,832,000,000. The 674,265 persons or married couples making returns of over $5,000, received a total net income of $7,814,000,000, and their income from ownership or control of property was $4,192,000,000.

About one-fiftieth of the families of America received in 1939 over one-ninth of the total national income and almost one-fifth of the income from ownership or control of property. Almost 54 percent of their net income was from property.

ONE-THIRD PERCENT OF FAMILIES GET ONE-SIXTIETH OF INCOME

The 12,034 net returns of incomes over $50,000 reported total income of $1,211,000,000, including income from property of $840,000,000.

About one-third of 1 percent of the families of America received over one-sixtieth of the national income, including almost one twenty-fifth of all property income.

The $5,000-plus people paid in Federal income taxes and surtaxes $820,541,000 and had left an average of $10,373.

Even the 467,337 people making humble returns of $5,000 to $10,000, whose total net income was $3,139, had left, after paying $81,500,000 of taxes, an average of $6 541, and incidentally paid on the average in Federal income and surtaxes only $177, or 2.6 percent.

INCOMES OVER A MILLION DOLLARS

The 43 returns of net incomes of over $1,000,000 deserve careful consideration.

Their total reported net income was $74,100,000, and they allowed themselves an average of $39 700 as salaries, commissions, etc.

This left them $73,393,000 income from ownership or control of property, which must be worth about $2,000,000,000.

Their average income from property was $1,706,810.

They paid in Federal income and surtaxes only $47,969,000, which is not the 85 percent of net income to which it is often asserted they are subject, but was only 64.7 percent—less than two-thirds, and had left on the average after paying all direct taxes, $607,464.

Returns of incomes under $5,000 were estimated at $6,813,439, or 91 percent of all returns, with total estimated net income of $14,475,500,000.

This averages $2,124 per return, not per family. The total Federal income tax paid by these 6,813 439 families was $89,972,000, which was 9.88 percent—nearly one-tenth of all Federal income tax collected—compared with the 5 27 percent of all tax collections paid by the 43 persons with net incomes over $1,000,000.

Mr. MARSH. I will just make two requests in closing. First, that during this war no member of Congress represent any corporation, or make an argument for the reduction of taxes of any corporation until we scuttle Hitler, and then we will have to tackle our own jobs.

The second suggestion is this: I know the temptations to which Members of Congress are subjected. I think you should adopt a resolution which has been before you for years, for a public record of all stock holdings of all Government officials, because, mind you, not all of them are above the temptation to be patriotic, spelled their way, and what land they own, so that you can down the growing feeling in America that things are not going right. People have a reason to feel that.

After 8 years of the New Deal, property got a larger proportion of the national income than under the wicked Old Deal, and humanity cannot survive that much longer by being told to hate Hitler. You have got to change that system.

Thank you for your patience. Might I give you a paraphrase from the Scriptures?

Since ye know these things, happy are ye if ye do that, and unhappy are the people if ye do not.

(The supplemental statement of Mr. Marsh is as follows:)

FEDERAL GOVERNMENT CAN RAISE TWENTY BILLIONS

The estimated actual cash outlay for armaments next year, in 1942, will probably be about $18,000,000,000, while nonarmament expenditures can be held to about $7,000,000,000—a maximum total of $25,000,000,000.

The estimated national income this year, 1941, is $89,000,000,000 to $91,000,000,000, and for next year about $95,000,000,000.

Twenty billion dollars is only a little over one-fifth of the national income.

State and local taxes in 1942 will not much exceed $8,000,000,000.

Combined Federal, State, and local taxes in 1942, assuming Federal taxes at $20,000,000,000, will amount to only 35 to 40 percent—under two-fifths of the national income.

Two basic principles ignored by the House, must be observed scrupulously in the revenue bill to finance a major part of defense and armaments costs:

1. There must be substantial parity of real income of draftees, officers, professional people, stockholders, entrepreneurs, farmers, and wage earners.

2. Taxes must not curtail production, nor add to costs.

This is just another way of putting the principle of ability to pay, approved in the Democratic Party platform in 1932, and rigorously ignored.

The tax bill should not attempt to limit consumption so as to conserve raw materials needed for defense and armaments.

If certain products, such as automobiles, refrigerators, and gadgets, use material needed for vital purposes, they should not be manufactured. It is folly to attempt to limit consumption of goods which should not be produced by excise taxes.

As our experience has also shown, it is folly to let manufacturers of defense material bloat costs, and then take back most of excess profits in taxes.

This pyramids costs.

For the current year 1941:

Total income of persons, not families, receiving net incomes of over $5,000 will be about $9,000,000,000, and there are about 700,000 of them.

Total income of persons receiving net incomes of $3,000 to $5,000 will be about $6,000,000,000, and there are amout 1,250,000 of them.

This represents about 1,850,000 families.

Total income of persons with net incomes of $2,000 to $3,000 is this year about $4,600,000,000, and there are about 1,700,000 of them.

These 3,650,000 persons representing probably about 3,475,000 families—or approximately one-ninth of all families will get this year around one-fourth of the total national income, including the major part of income from ownership or control of property.

In addition the total income this year of persons receiving net incomes of $1,000 to $2,000 is from $3,750,000,000 to $4,250,000,000. People in this income class paid Federal income tax in 1938 of only $15,202,000.

The Treasury Department reports that from July 1, 1940, to June 30, 1941, total individual income-tax collections were only $1,417,655,000, which was an increase over the preceding year of $435,637,000, or about 44 percent.

If America is to get adequate defense or armaments, within 2 years, the Government will have to take over all basic industries, as well as all defense industries, since they are all involved in the defense program.

It will not be practical to bank on largely increased receipts from corporation profits under Government control, since elimination of profits and getting down costs of the armaments program is quite as effective a method of preventing inflation, as taxing incomes, cradles, clothing, shoes, food, and drinks.

The armaments program is costing at least one-third more than it should, but this cannot be changed in the eighth month, to affect this year vitally.

It can be done for next year, now.

The following table gives receipts in main classes and in millions for fiscal year 1940 to 1941, possible yield in 1942 calendar year, and increases, and new taxes proposed.

[In millions of dollars]

	1940 to 1941	1942	Increase
Corporation income taxes	1,852	4,000	2,148
Individual income taxes	1,418	5,000	3,582
Excess profits, etc., taxes	201.4	1,000	798.6
Capital stock tax	166.6	200	33.4
Estate tax	355.1	500	144.9
Gift tax	51.8	100	48.2
Liquor taxes	820	1,200	380
Tobacco taxes	698	698	.....
Documentary and stamps taxes	39	39	.....
Manufacturers excise taxes	617.3	617.3	.....
Other miscellaneous taxes	225.1	225.1	.....
Employment	925.8	925.8	.....
Total	7,370.1	14,505.2	7,135.1

New taxes:	
Excise tax on privilege of holding land based on value, with small exemption	$494.8
Tax on surplus and undivided profits of corporations with assets over $100,000,000	3,000
Tax on surplus and undivided profits of corporations with assets under $100,000,000	2,000
Total	20,000

This table shows how to get an increase of $7,135,000,000 from existing taxes, without any increase in consumption taxes, and how to obtain $5,495,000,000 additional revenue from new taxes—on land values and on corporation surpluses, and undivided profits.

The exemption for an individual will have to be reduced to about $750, and for a couple to $1,500—with allowance for dependents.

Monthly payments will help in collections.

The Department of Agriculture reports that April 1, 1940, the value of farm lands, exclusive of buildings, was $23,230,200,000, of which 5 out of the 48 States—Illinois, Iowa, Kansas, Texas, and California—reported $8,017,000,000, or 39 percent—nearly two-fifths—of the total for all farm lands.

A large part of farm lands in these States is in rather valuable holdings.

Government's farm programs have benefited chiefly land owners since higher prices for farm products, as the Department admits, result in higher selling prices of farm lands.

The assessed value, that is the untaxed selling price of land in American cities is about 40,000 million dollars, and much of it is owned, in every major city by 5 to 10 percent of the people.

Suburban land tends to be more widely owned.

Just as the Government's farm policies increase the selling price of farm lands, so its housing and relief programs increase the selling price of nonfarm lands.

The public-housing program reserves to economic royalists the privilege of plucking those whose income makes plucking profitable, and reserves to Government the privilege of bailing out landowners of sites needed for housing for people too poor to be attractive victims.

Both the Roosevelt and the Morgenthau families are successful and congenital land speculators, which has rendered them incapable of urging that the Government can get half a billion dollars a year by taxing their racket.

Congress may escape such blindness.

Such an excise tax on land values will effectively prevent speculation in farm lands, which the Vice President in 1934 declared "was worse than the plague, and almost as bad as war."

It will materially reduce the price the Government pays for land, for housing, cantonments, airfields, and other purposes connected with the armaments program.

At the end of 1937 (the last date for which figures are available) the surplus and undivided profits of the 394 corporations having assets of over $100,000,000 amounted to $22,713,200,000.

Their financial position was quite strong. They had cash assets of $10,418,800,000 and held Government obligation amounting to $13,715,400,000.

Many of these mammoth corporations are well represented in Government defense agencies (or were till recently), and have gotten rather juicy war contracts. They include most of the large motor companies, which were able to stall off priorities and pile up profits on their almost record output of motors in the past year.

They include the Aluminum Trust, steel combine, oil octopus, and Food Trust—with bloated capitalization and ballooning profits.

The $3,000,000,000 suggested tax on the surplus and undivided profits of these corporations to "save the system of private enterprise"—of which they have been such beneficiaries, would mean taking considerably less than one-eighth of their liquid assets at the end of 1937—and probably a smaller proportion of their present liquid assets—cash on hand and Government obligations.

Their capital assets at the end of 1937 were $50,035,700,000.

At the end of 1937 the surplus and undivided profits of the 416,508 corporations with assets of less than $100,000,000 were $35,810,800,000.

Their cash on hand amounted to $13,027,500,000; their holdings of Government obligations to $10,272,000,000—together their liquid assets were $24,195,000,000—only $44,000,000 less than those of the 394 mammoth corporations.

A tax of $2,000,000,000 means taking only about one-twelfth of the liquid assets of these corporations at the end of 1937, and probably about the same proportion of their present liquid assets.

Payments out of surplus and undivided profits would not be a precedent.

In the 3 years 1931, 1932, and 1934 incorporated business reported an aggregate loss of $5,885,000,000 but paid dividends amounting to $9,200,000,000.

This means incorporated business paid, out of something it had, and presumably out of surplus and undivided profits, $15,085,000,000 or an average of slightly more than $5,000,000,000 each of the 3 years.

In spite of this, total surplus and undivided profits of incorporated business were at the end of 1937 almost $58,524,000,000.

Such a tax on surplus and undivided profits would make Government acquisition of basic industries much more practical, for it would cut the selling price of stocks quite materially and would doubtless enable bondholders to see the wisdom of accepting some composition as to principal and interest rates.

In 1937 incorporated business paid in interest $2,025,900,000.

About 20,000 stockholders collect about one-third of all dividends paid.

The Government's policy of increasing the national debt by 10 to 15 billion dollars a year, even for 2 or 3 years, will produce such inflation as will cause most small stockholders much larger loss of purchasing power than the reduction in their claim upon the production of the Nation involved in the proposed tax upon surplus and undivided profits.

Government cannot ethically or safely attempt to pass onto the next generation any appreciable part of the cost of armaments and defense necessitated largely by the stupid, or worse, policies of this administration.

(Mr. Marsh also submitted the following report:)

OFFICE OF PRODUCTION MANAGEMENT

Fifty-six corporations having defense supply contracts with the War and Navy Departments have contracted for almost three-fourths of the total dollar volume of such contracts, according to a compilation made by the Bureau of Research and Statistics, Office of Production Management. The balance of one-fourth of the total volume of defense supply contracts was divided among several thousand contractors.

Under supply contracts the Government is provided with ships, airplanes, tanks, guns, other equipment, food, and fuel, in contrast with construction contracts under which cantonments, bases, depots, arsenals, and factories are built.

Bethlehem Steel Corporation, at the end of May, held the largest volume of supply contracts—a total of $927,000,000. The next largest volume of supply contracts was held by the New York Shipbuilding Corporation, the total being $507,000,000. General Motors Corporation ranged third with $490,000,000, and Curtiss-Wright Corporation fourth with $444,000,000. Fifth in order was Newport News Shipbuilding & Dry Dock Co., with War and Navy supply contracts totaling $389,000,000, and sixth E. I. du Pont with $318,000,000.

The combined defense supply orders of these six companies total $3,075,000,000, or 31.3 percent of $9,839,000,000, representing the total volume of all defense supply contracts at the end of May. Tabulations of these are given in the following three tables:

Distribution of War and Navy supply contracts of $10,000 and over by volume of contracts held, June 1940 through May 1941

Dollar volume of contracts held by company (in millions of dollars)	Number of companies	Dollar volume of contracts	Dollar volume of contracts held by company (in millions of dollars)	Number of companies	Dollar volume of contracts
600 to 1,000	1	$927,000,000	50 to 100	12	$832,000,000
500 to 600	1	507,000,000	25 to 50	22	751,000,000
400 to 500	2	934,000,000	Up to 25 [1]	(2)	2,569,000,000
300 to 400	2	708,000,000			
200 to 300	5	1,131,000,000	Total	(2)	9,839,000,000
100 to 200	11	1,480,000,000			

[1] From $10,000 to $25,000,000.
[2] Not available.

Cumulated distribution of War and Navy Department supply contracts of $10,000 and over by volume of contracts held, June 1940 through May 1941

Dollar volume of supply contracts held by company	Number of companies cumulated	Dollar volume of contracts cumulated (in millions of dollars)	Percentage of dollar volume cumulated
Over $600,000,000	1	927	9.4
Over $500,000,000	2	1,434	14.6
Over $400,000,000	4	2,368	24.1
Over $300,000,000	6	3,076	31.3
Over $200,000,000	11	4,207	42.8
Over $100,000,000	22	5,687	57.8
Over $50,000,000	34	6,519	66.3
Over $25,000,000	56	7,270	73.9
Over $10,000	(1)	9,839	100.0

[1] Not available.

Companies with War and Navy Department supply contracts totaling $25,000,000 and over, June 1940 through May 1941

	In millions of dollars
$600,000,000 to $1,000,000,000: Bethlehem Steel Corporation	926.9
$500,000,000 to $600,000,000: New York Shipbuilding Corporation	507.3
$400,000,000 to $500,000,000:	
General Motors Corporation	489.9
Curtiss-Wright Corporation	443.9
$300,000,000 to $400,000,000:	
Newport News Shipbuilding & Dry Dock Co	389.2
E. I. du Pont de Nemours & Co., Inc	318.5

Companies with War and Navy Department supply contracts totaling $25,000,000 and over, June 1940 through May 1941—Continued

	In millions of dollars
$200,000,000 to $300,000,000:	
Glenn L. Martin Co	249.1
Consolidated Aircraft Corporation	226.4
United Aircraft Co	224.5
Douglas Aircraft, Inc	221.2
United States Steel Corporation	209.9
$100,000,000 to $200,000,000:	
Seattle-Tacoma Shipbuilding Co	179.6
Boeing Airplane Co	170.1
Bath Iron Works	166.5
General Electric Co	152.5
Ford Motor Co	128.5
Electric Boat Co	126.1
North American Aviation, Inc	123.9
Cramp Shipbuilding Co	114.8
Sperry Corporaton	108.0
Bendix Aviation Corporation	107.3
Western Cartridge Co	102.9
$90,000,000 to $100,000,000: Consolidated Steel Corporation	98.2
$80,000,000 to $90,000,000:	
Los Angeles Shipbuilding & Dry Dock Corporation	83.4
Baldwin Locomotive Works	82.6
American Car and Foundry Co	81.2
$70,000,000 to $80,000,000:	
American Woolen Co	74.3
Chrysler Corporation	74.0
$60,000,000 to $70,000,000:	
Packard Motor Car Co	63.8
Tampa Shipbuilding Co., Inc	62.1
$50,000,000 to $60,000,000:	
Republic Aviation Co	57.3
Grumman Aircraft Engineering Corporation	53.9
American Locomotive Co	51.3
Ingalls Shipbuilding Co	50.0
$40,000,000 to $50,000,000:	
White Motor Co	48.4
Lockheed Aircraft Corporation	46.5
Vultee Aircraft, Inc	41.8
Fairbanks Morse & Co	40.3
Continental Motors Corporation	40.2
$30,000,000 to $40,000,000:	
Gulf Shipbuilding Corporation	39.7
J. P. Stevens & Co	38.2
Western Electric Co., Inc	38.1
Moore Dry Dock Co	38.0
Atlas Powder Co	36.0
Diamond T Motor Co	35.3
Studebaker Corporation	35.1
Manitowoc Shipbuilding Co	30.5
$25,000,000 to $30,000,000:	
Hercules Powder Co	29.9
Lake Washington Shipyards	29.0
Savage Arms Corporation	27.2
Bell Aircraft Corporation	27.0
Todd & Brown, Inc	26.8
Northern Pump Co	25.8
Willamette Iron & Steel Corporation	25.7
Crucible Steel Co. of America	25.5
Arma Corporation	25.1

Value of specified farm land, by States, census of Apr. 1, 1940 [1]

State:	
Maine	$56, 117, 595
New Hampshire	22, 551, 581
Vermont	44; 724, 568
Massachusetts	91, 232, 745
Rhode Island	11, 833, 550
Connecticut	94, 584, 184
New York	408, 416, 397
New Jersey	108, 662, 712
Pennsylvania	363, 337, 506
Ohio	819, 044, 149
Indiana	827, 790, 280
Illinois	1, 896, 965, 980
Michigan	458, 095, 306
Wisconsin	596, 070, 686
Minnesota	897, 364, 224
Iowa	1, 895, 842, 351
Missouri	762, 918, 416
North Dakota	349, 659, 932
South Dakota	371, 700, 325
Nebraska	881, 054, 215
Kansas	1, 163, 555, 692
Delaware	26, 838, 904
Maryland	144, 698, 703
District of Columbia	5, 349, 200
Virginia	394, 591, 653
West Virginia	164, 060, 651
North Carolina	488, 888, 707
South Carolina	225, 172, 887
Georgia	319, 588, 215
Florida	255, 151, 867
Kentucky	520, 112, 424
Tennessee	450, 529, 442
Alabama	291, 661, 227
Mississippi	345, 493, 866
Arkansas	340, 534, 608
Louisiana	263, 079, 881
Oklahoma	690, 592, 280
Texas	2, 173, 068, 101
Montana	283, 567, 586
Idaho	266, 903, 658
Wyoming	129, 635, 810
Colorado	303, 496, 434
New Mexico	159, 272, 358
Arizona	130, 585, 238
Utah	118, 301, 474
Nevada	38, 254, 027
Washington	438, 846, 309
Oregon	362, 479, 771
California	1, 786, 899, 592
United States	23, 239, 177, 267

[1] Preliminary.

Source: Division of Statistical and Historical Research, Bureau of Agricultural Economics. Compiled rom reports of the Bureau of the Census.

The CHAIRMAN. Mr. Forstall.

STATEMENT OF JAMES J. FORSTALL, REPRESENTING MICKELBERRY'S FOOD PRODUCTS CO., CHICAGO, ILL.

Mr. FORSTALL. Mr. Chairman, my name is James J. Forstall, of Chicago. I am representing Mickelberry's Food Products Co., a Chicago company. I am one of its directors.

Our interest here is to see that there is in the law a definition of excess-profits taxes which will be fair to rapidly growing corporations such as ours. Now, I realize that excess-profits tax laws are not simple. I have had a little experience myself in that regard. I was one of the lawyers on the Internal Revenue Staff in 1918 and 1919. There were only 12 of us in the Solicitor's office at that time, when the Revenue Act of 1918 was adopted, and since then I have spent a good deal of time on these taxes, so I know it is not easy to find something simple. That is why I and some of my friends have been delighted in finding the formula which has been suggested by Mr. Stiles for use in the determination of excess profits, which seems to be fair, just, and at the same time very simple.

I want to give, first of all, just a few facts about our company to let you know what our problem is and then see if you do not think that that formula would be very fair for companies in our situation.

We process and sell pork products. We sell them by refrigerated trucks from store door to store door—only to retailers. We have no Government orders at all. Our business is mostly in Chicago and Detroit and the suburbs. The company was incorporated in 1926. We had a very stable and good income from 1936 to 1930, earning close to $120,000 each year, after Federal taxes. Then we went into an unfortunate side venture; we bought out a cookie company with 10 plants all over the United States, and we began losing money right and left on it, and then finally, in 1935, our company was practically insolvent and almost passed out, but by strenuous efforts the company was saved. In 1936 we lost only $3,400; in 1937 we made $27,000; in 1938 we made $68,000; in 1939 we made $90,000; and in 1940 we made $118,000—all before Federal taxes.

Now, under the terms of the First Revenue Act of 1940, we would have been subjected to a very heavy excess-profits tax on those 1940 earnings, even though those earnings were less than what we were earning normally until we got into this outside business which cost us so much, and even though in the last 10 years the dividends on the common stock have amounted, in all, to only 45 cents a share, which is only three-fourths of the amount paid each year as dividends in 1930 and before.

There is also the fact that we have never done any defense business. We just sell to retailers. Then there is this additional fact to make it all the stronger: While our income in 1940 was just about up to the 1926–30 level, our profit margin was very much lower. We simply had the larger income because we had increased the number of outlets and increased the territory. We were employing more people, paying more wages.

It hardly seems fair, under those circumstances, that we should pay a substantial excess-profits tax. Of course we are paying for 1940 a 24-percent income tax and will pay a 30-percent one for this year, but I think you will agree that a substantial, drastic excess-profits tax on top of it would not be fair if "excess" means anything.

Now, there are several different ways that our situation could be helped. I am glad to say that fortunately this committee, in its wisdom, proposed an amendment to the Frst Revenue Act of 1940. This amendment was enacted as part of the Second Revenue Act of 1940, and it very greatly helped our situation, but we did have some

excess-profits taxes to pay even then. The trouble with the amendment is that it does not carry the relief forward. This year's earnings will be greater than last year's earnings, and we hope that the 1942 earnings are going to be greater still, but the additional growth is not taken care of at all.

Of course, we will pay heavier excess-profits taxes anyway. There is a 10-percent increase in all the rates, and no income-tax deduction is granted.

We feel that a formula which takes care of a company such as ours, which really has no excess earnings at all, so that it does not have to pay, on top of heavy income taxes, heavy "excess-profits taxes," taxes that we submit are not excess-profits taxes at all, is fair and just. That is why we are so strong for the formula of Mr. Stiles.

Mr. Alvord and Mr. Stiles have both discussed it at length. I will not go into details, but I will say just a few words about it.

A formula which adds to your excess-profits credit base pro rata with your increases in pay roll certainly seems just as fair as the rule, where the excess-profits credit is based on invested capital, that if you double your invested capital, you double your base.

Certainly this administration does not want to discriminate against the workingman as compared with the capitalist. Under your invested-capital base, if you put up twice as much money and buy that much additional stock, you double your base. If the company is expanding, giving more employment and more wages, it certainly seems fair that they should get a larger base on which to determine their excess-profits tax. If they put in additional capital, that may well go into labor-saving machinery, so there may not be anywhere near a pro rata increase in pay roll or any help to the general prosperity of the country, and yet they will double their base. Unless you adopt such a formula as this, if we double our pay roll, we do not double our base even though we are giving those additional wages.

I submit that our case is a splendid example of a company that seems to need the benefit of that formula to escape unjust taxation.

There are a couple of my friends in Chicago representing other companies that would like to join us in supporting the Stiles formula. I am not through yet, but with your permission, when my testimony is concluded, I want to put a paragraph or two in the record in their behalf. Will that be all right?

The CHAIRMAN. Yes.

Mr. FORSTALL. There is one other ground on which I would like to support this Stiles formula. The chairman of this committee was quoted in the papers some time ago—I would not want to say I remember it accurately—as saying of the Revenue Act of 1942—and we all know there will be one—that it was important that in it there should be a comprehensive simplification of our tax laws. Certainly, if he was quoted correctly, it strikes a sympathetic chord in my breast, because all the way back in 1918 to 1920, when I was working on these laws, it always seemed to me that the most terrible thing about them was the waste of intellectual power and time of the leading corporate executives caused by their having to devote so much time and thought to fussing with the corporation-tax laws. For the board of directors

of a company, or for the executive committee, to spend their time on the details of the tax laws—what sort of tax return they would make, what their depreciation policy should be, what their depletion policy should be—always has seemed to me just a terrific economic waste. If that were true in the twenties, when things were going well, when we were not in any crisis, what about now when we are in a great crisis, when, as Senator Byrd says, the defense program seems to be lagging terribly? Would not it be well if we could simplify the tax laws? I know it is not easy, but the British have always kept their century old income-tax laws relatively simple, so why cannot we greatly simplify ours? If we really could simplify the tax laws we could release a large amount of invaluable intellect and time for increasing the defense production. Therefore, in conclusion, I want to urge that this Stiles formula be adopted this year as a first little start in a step toward simplification of the tax laws. While its adoption as an alternative this year will add one more provision, this simple provision, to the act, experience the next year or two may well show that a lot of other relief provisions may be dropped out, because this simple provision will take care of them.

Mr. Arthur C. Nielsen, president of A. C. Nielson Co., of Chicago, who was unable to appear before the Senate Finance Committee but who did testify on May 15 and May 28 before the Committee on Ways and Means, has requested that I include in my remarks the following statement for him:

The nature of our business is such that we are brought in close contact with many growing companies and are convinced that they have and will continue to play a very important part in the future progress of the economic welfare of our country. It is my opinion, therefore, that the retention of the average earnings method as amended by Congress in March of this year is absolutely necessary for the continuation of such companies.

I believe, however, that their future growth should be encouraged by the provision of an additional yardstick for the purpose of determining normal profits. The suggestion which has already been submitted to your committee and is known as the Stiles formula for determining normal profits of a growing company appears to me to be a very equitable method. Its simplicity makes it easily understood and its adoption as an additional alternative or relief measure is highly desirable.

The CHAIRMAN. Thank you very much. You may put into the record what you wish to.

Mr. FORSTALL. I submit for incorporation in the record the following letter from the chairman of the tax committee of the Illinois division of the National Small Business Men's Association.

(The letter submitted by Mr. Forstall is as follows:)

ILLINOIS DIVISION, NATIONAL SMALL BUSINESS MEN'S ASSOCIATION, INC.,
Chicago, Ill., August 19, 1941.

Mr. JAMES J. FORSTALL,
Chicago, Ill.

DEAR SIR: Please incorporate in your testimony before the Committee on Finance, United States Senate, the following:

The tax committee of the Illinois division of the National Small Business Men's Association is convinced that growing companies have and will continue to play a very important part in the future progress of the economic welfare of our country. It is their opinion, therefore, that the retention of the average-earnings method as amended by Congress in March of this year is absolutely necessary for the survival of such companies.

They also recommend an amendment incorporating the principles of the Stiles formula as an alternative method of computing the excess-profits credit as it gives growing enterprises an opportunity and incentive to keep on growing.

It is simple to apply and relieves the small businessman using this method of the costly burdens of the computation of the excess-profits credit which the preparation of returns under the existing law involves.

Yours very truly,

NATIONAL SMALL BUSINESS MEN'S ASSOCIATION,
THOMAS F. SEAY, *Tax Committee Chairman.*

The CHAIRMAN. Mr. Sommers.

STATEMENT OF HOBART H. SOMMERS, CHICAGO, ILL., REPRESENTING NATIONAL EDUCATION ASSOCIATION OF THE UNITED STATES AND MUSIC EDUCATORS NATIONAL CONFERENCE

Mr. SOMMERS. For the record, Mr. Chairman, my name is Hobart H. Sommers, of Chicago. I am principal of the Austin High School of that city, and I am representing here today the National Education Association of the United States as well as its department, the Music Educators National Conference.

We are interested merely in the proposed 10-percent tax on musical instruments that was presented to your attention this morning. The N. E. A., as you know, has a membership of 211,000 in the United States, and the Music Educators National Conference is composed of mostly public-school music teachers in the United States and has a membership of 45,000, and we, of both organizations, sincerely believe that this tax will affect detrimentally the development of the bands and orchestras in our schools.

Our instrumental music organizations are great contributors to good citizenship, high morale, and the unified community spirit in our schools. We have developed this as a public-school enterprise. It is not a private enterprise. It is run by the teachers.

I notice a good many of the people who testified before your committee testified from the viewpoint of the manufacturers. I might say I am representing the teachers and consumers that are interested in not seeing this tax passed.

We object primarily to the classification of musical instruments as luxuries, as we teachers in the schools know them to be as important to our educational plans as any of our textbooks.

I think that was a point made by Major Griffith this morning, as far as athletic equipment is concerned, and we are in favor of that also.

There are 30,000,000 young people in the schools of the United States, and almost every one of them has contact with public-school music daily.

The American boy and girl have found group expression through musical instruments in a movement that has no parallel anywhere or anytime in history.

Of the 7,000,000 youngsters in our high schools and junior colleges, between 30 and 40 percent would be vitally affected by this tax as new users of instruments.

This great development of public-school music is something that has grown up since World War I, when the school bands and orchestras gave great service in the Liberty-bond drives and showed the public what organized school music could do along that line.

I hope they will not be called upon again in such a great measure, but that is within the realm of reason.

During the depression the music program was often attacked as a passing fad; but the fact that it has grown during hard times shows its importance to the school program. In this year almost 100,000 boys and girls, picked people from their local organizations, took part in the national band and orchestra and solo contests, in the great regional festivals held at many places over the Nation. Educators are agreed that this is a worth-while activity from many viewpoints. This is not only the music teacher now, mind you, but we all agree that this activity is worth while. This new tax of 10 percent we believe will affect the professional musician little, if at all. We feel he has his instrument already, and that the people that will be affected by the tax are the youngsters that are coming up and buying new materials.

The high-priced articles, such as old violins or other expensive instruments, are not newly manufactured articles, but have gained in value on account of mellowness due to age.

Musical-instrument dealers, and I believe Mr. Smith testified this morning that the great bulk of the instrument business deals with amateurs who are customers of new and low-priced articles, about 80 percent. We wish to corroborate that fact from the school viewpoint.

My point is that this tax will put a great psychological burden on an educational movement that has taken 25 years to build.

If Congress labels these community activities of school bands and orchestras, and other materials, as luxuries to be highly taxed along with jewelry and other articles that you have here that are not pertinent to defense, we have been placed in a very embarrassing position. We believe that these things are just as important, the musical activities, the bands and orchestras, to our boys and girls as their learning geography and perhaps more so.

Senator TAFT. How far would there be any exemption as to high-school bands?

Mr. SOMMERS. I do not know as there would be any exemption. I noticed in the testimony of one person this morning where he mentioned the fact that boards of education could buy instruments and therefore, being representatives of the State, would get some exemptions; but I would like to point out that very few boards of education supply instruments to the school. That is done through what is called the school fund. For instance—I am from the city of Chicago—our board of education has not supplied any money for school instruments for years; they have been bought through the school. We raise that money through our concerts one way or another to buy the school instruments, and the children often buy their own after they become interested in the school musical program. It is a school fund and is not a fund created by the board of education, and we could not claim exemption for any instruments

that we might buy next year for the Austin High School, my own school. Does that answer your question, Senator Taft?

Senator TAFT. Yes.

Mr. SOMMERS. The music program in our schools should be left to develop unhindered. The American youth, we believe as educators, has enough of passive listening in the movies and the radio. He needs to do something himself that will help him undestand his community and teach him his place in a democratic society. This is a community activity program. He is doing something in his band or orchestra, he has an opportunity to serve his community in many ways through this musical group, and we feel it is very good for him in these days, or any days, as far as that is concerned.

This is the point that Senator Taft talked about: The money for instruments used in our school bands and orchestras seldom comes from board of education tax money but rather from the individual players or from money raised locally by the school itself.

The music organization of our schools will be keenly needed next year in the effort of American education to keep the citizens of the United States alive to the needs of the defense program.

I am quite worried about the statement made by Mr. Smith this morning, that with the lack of priority on some metals he will not be able to make as many instruments as he had made in the past. That alone is going to hinder us, but with this tax of 10 percent put on by Congress we feel it will hurt us no end.

You remember the tax bills passed after World War I that exempted musical instruments, and we feel little actual money will be lost to the Federal Government if this tax is not enacted, but many thousands of homes and people will be affected. Local tax budgets for education will be strained on account of rising Federal expenditures, and this 10-percent tax under luxury classification, together with the new installment-buying regulations, will do inestimable harm to the public-school music program in our schools.

The CHAIRMAN. Any questions?

Mr. SOMMERS. I will be glad to answer them.

The CHAIRMAN. Thank you very much for your appearance.

Mr. Scudder.

STATEMENT OF C. W. SCUDDER, CORDELE, GA., PRESIDENT, GEORGIA MUSIC EDUCATION ASSOCIATION

Mr. SCUDDER. My name is C. W. Scudder, of Cordele, Ga. I am president of the Georgia Music Education Association and representing the Music Educators National Conference.

The CHAIRMAN. You wish to speak on the same text?

Mr. SCUDDER. On the same subject.

The statements that I have for you represent the views of more than 45,000 music educators represented by the Music Educators National Conference, a department of the National Education Association.

In unparalleled expression, it has been said:

> Music, drama, painting, and pageantry—all the arts—are the means by which a nation may express emotionally its common ideals. The spirit of our Nation should speak through its art, and, as it speaks, its spirit will nourish its art; and, ultimately its art will exalt its spirit.

Education is the foundation of any State. Anything that we do today that weakens our educational program will tend to weaken our great country at a time when it needs to be strong in every respect. Modern educators believe that education has to provide not only knowledge, skill, and insight necessary to solve social and economic problems but also a means of developing aesthetic sensitivity. Opportunity must be provided for giving vent to emotions which will bring about emotional stability and mental health of our young people.

Music teaching in this generation is done as group work in the public schools in contrast to the habits of 25 years ago of having private teachers for violin, cornet, and piano, and so forth. Music is a regular school subject taught in school hours, in schoolrooms equipped as band, orchestra, and practice rooms, with teachers paid like teachers of algebra and geometry and with students receiving credit toward graduation, in band, orchestra, clarinet, or violin.

The public-school music teachers of the United States feel that this bill will definitely harm the growth of a great movement which has as its philosophy that music is essential in the lives of our young people and in the community. The music educators are offering one of the most vital voluntary contributions to the building of the country's morale.

The brightly uniformed high-school band found almost in every small town in America is not a luxury but an expression of the American way of living in harmony and unity. Bands and orchestras contribute greatly to every community enterprise. The great high-school band of Joliet, Ill., as well as many other school bands throughout the country, serenade at traintime every group of selectees on their way to camp. Every U. S. O. drive and defense bond drive in the coming year will call for the services of some school instrumental organizations.

It is not the purpose of this program of music activity to prepare thousands of professional musicians and artists. This is a citizenship program, giving a cultural background by actually living and working in the field of music during the school terms. Although every child in our schools does not play an instrument, yet every child in the school is benefited by the organization developed. If we tax these cultural activities in our schools by taxing the materials they work with, we will destroy the very way of living that we are attempting to defend by all of our defense measures.

The arts and our intellectual activities need to be kept alive. They are struggling today against a tremendous pressure of world events. It is always difficult for culture to live in turmoil.

This tax will bring in little money to the Federal Treasury in comparison to the effect it will have on the educational program. And the educational program cannot be valued in dollars and cents.

Many communities have few professional musicians and professional musical organizations and rely entirely for their music upon amateur groups that are constantly changing.

Finally, this plea is made by the music teachers and directors of bands and orchestras in the public schools of America who are interested in the music trade only as much as any teacher is interested in obtaining the necessary textbooks and laboratory material for his classes.

Our purpose is not to suggest what shall be taxed and what shall not be taxed but to make the plea that our educational program not be weakened by classifying and taxing one of the recognized essential departments as a luxury.

It is hoped that this tax, which we feel will tend to weaken our educational system through weakening our music program, will not be wished upon education.

The CHAIRMAN. Are there any questions, gentlemen?

(No response.)

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

Mr. O'CONNOR. I think Mr. Ungaro is substituting for Mr. O'Connor.

STATEMENT OF GERARD M. UNGARO, SECRETARY, THE MAGNAVOX CO., INC., FORT WAYNE, IND.

Mr. UNGARO. My name is Gerard M. Ungaro, and I am the secretary of the Magnavox Co., Inc., which is situated in Fort Wayne, Ind.

Our company manufactures radio parts, consisting largely of loudspeakers and condensers, which component parts are incorporated in household radio receiving sets and automobile sets. We also manufacture radio-phonograph combinations, which are sold under the name "Magnavox." We are also engaged in the development and production of highly specialized electric firing mechanisms for the United States Army and Navy and the British Air Commission. We presently employ about 1,500 people.

I am addressing myself to the excess-profits provisions of the Internal Revenue Act, and my appearance here is not alone on behalf of the Magnavox Co., but on behalf of the large number of businesses and industries throughout the country which find themselves confronted with a mutual problem, resulting from the passage of the excess-profits-tax law. This problem is intensified by the increased rates now being considered. I refer to the very large number of companies which, prior to the passage of the Excess Profits Tax Act, were reorganized under section 77B of the Bankruptcy Act or in the equity courts of the various States, and in connection with such reorganizations reaffirmed their debts and obligated themselves to make payments to their creditors either at stated periods or pursuant to a well-defined plan.

These corporations in charting their future course were forced to be realistic because of what had previously occurred, and I think it is safe to say that in each instance the plan of reorganization which was finally approved, either by a district court of the United States or a State court, was the result of considerable planning, much thought, and numerous conferences between all classes of creditors, both secured and unsecured, and between the creditors and the respective companies. Frequently new corporations were organized with a very limited capital, and consequently such corporations receive a small exemption under the invested-capital credit and may not be in a position to avail themselves of the income credit because of their recent incorporation. These obligations which were assumed and the agreements for payment which were entered into as a part

of the plan of reorganization undoubtedly represented the maximum which appeared probable according to the tax laws as were then in existence, and in each instance the payments and method of making the same were related to what appeared to be the anticipated net profits of such corporations.

Creditors, committees, lawyers, and courts were all anxious that liquidation of indebtedness be accomplished as quickly as possible, and debtors were forced to accept the best deal which they were able to make. In other words, it was and is very common for a company which is being organized to say to its creditors, in effect: "We should earn X dollars each year; a certain portion will go toward the payment of taxes and the balance (or a specified part thereof) will be available for the liquidation of our indebtedness or the forced retirement of the prior or preferred stock which we give to our creditors." Such agreement, as I say, was on the basis of a normal income tax, no excess-profits-tax law being on the statute books.

Now, the excess-profits-tax law has cut very deeply into the amounts which it was thought would be available for such payments to creditors, and performance under reorganization plans is becoming increasingly more difficult. As an example, the Magnavox Co. from August 1, 1940, to July 31, 1941, will show a net profit of approximately $470,000. The taxes of this company, based on the rates you are now considering, would amount to about 59 percent of the total.

Senator BROWN. That is both the normal and excess profits?

Mr. UNGARO. The normal and excess profits, Mr. Senator.

Deducting from the remainder the payments which we were forced to make to our creditors under the reorganization program during the same period and the additional amount which we would be obliged to pay, would leave less than $45,000 to be added to our working capital out of a total of $470,000 in net profit. In the meantime, we are obliged by prevailing conditions to carry an inventory which considerably exceeds our total net worth and borrow in the neighborhood of $500,000 for such purpose; which sums are available to us only by a pledged collateral. This figure becomes significant when it is realized that it represents two-thirds of our net worth.

I do not intend to be personal, but I think it dramatizes the situation that this corporation, and many corporations are confronted with, and gives you a picture of the thing I am talking about.

Accordingly, I respectfully suggest that in connection with the Revenue Act of 1941 consideration be given to extending to such taxpayers some relief in computing the excess-profits tax, so they will be enabled to fulfill the agreements which were undertaken at the time of reorganization.

The necessity for aiding reorganized companies arises from the fact that most of them suffer from insufficient capital, and if the businesses of this country are to be enabled to put forth the maximum of effort on behalf of our defense program and be in a position to withstand the unpredictable period following the present emergency, there should be no stifling of activity resulting from insufficient working capital. The need for new capital is recognized in the report of the Committee on Ways and Means of the House of Representatives

rendered in connection with this legislation. I quote from page 26 of said report.

> In order to encourage the investment of new capital in corporate enterprises your committee is impressed with the desirability of offering a special inducement in the form of a more liberal credit where new capital is present. To achieve this result, new capital is counted at 125 percent.

While I recognize that the House report dealt with new capital in its ordinary sense, yet I believe the ultimate result would be the same whether new capital was paid in or whether such new capital resulted from profits which remained in the business.

It might be argued that relief as I suggest would merely permit the taxpayer to pay out in dividends a greater sum than would otherwise be available for shareholders and that this might tend to defeat the purpose of the proposed amendment.

I answer by stating that in connection with most reorganizations the payment of dividends to the equity owners of the business already has been severely restricted and subordinated to the payment or liquidation of the obligations owing to the old creditors. In addition, in many, if not in most, instances the management of the reorganized corporation has either been retained by the creditors as a part of the plan of reorganization or has been subjected to supervision either by the court which approved the plan or by one or more directors or managers appointed by the court. Consequently, I think it is safe to say that in almost every instance the amount represented by such additional credit as this committee may see fit to recommend would result in an improved working-capital position.

With a view toward saving the time of this committee—and I know how busy it is in connection with these hearings—I anticipate another question which might logically arise. It has been said in connection with some reorganizations that the debtor scaled its obligation down to a point where no further assistance is necessary. While this may be true in some instances, it is not true in every case, and, if the personal reference may be pardoned, it is not true of the Magnavox Co. Our company was one of the large number of companies which sought relief under section 77B of the Bankruptcy Act only for the purpose of extending the time within which our obligations might be paid. We did not ask nor did we encourage the suggestion made by many of our creditors that our obligations be scaled down to an amount less than that which was owing at the time of the reorganization, and we undertook to pay the same in full. As a means of achieving the relief suggested, I should like to urge that reorganized companies be permitted to make an adjustment of their normal-tax net income which would permit such companies to deduct from the normal-tax net income the payments made to creditors on obligations assumed as a part of a reorganization program. The present tax law offers a precedent. It provides for the stipulated tax on the adjusted excess-profits net income, permits the deduction of certain exemptions and credits in section 710, and then in sections 711 and 712 permits certain adjustments of the normal-tax net income for the purpose of arriving at what is defined in the law as the "adjusted excess-profits net income."

I suggest another deduction also, I should say in passing, if the chairman please, that the old undistributed-profits tax law made a provision for relief such as I talked about, one which offered or permitted

a dividends-paid credit on amounts which were used to pay certain indebtedness.

The adjustments are enumerated in the act and I urge that this committee might include an additional adjustment as the following amendment to H. R. 5417:

On page 23 at line 11 (Senate print) the word "subparagraph" should be changed to "subparagraphs."

On page 23, between the lines 18 and 19 add the following:

SEC. 711 (a) (1) (H). *Payments required to be made by reorganized corporations.*—There shall be excluded in the case of any taxpayer all amounts used to pay or retire evidences of ownership or indebtedness where such amounts are paid pursuant to a plan for corporate reorganization confirmed under section 77-B of the Bankruptcy Act as amended or approved by some other court of competent jurisdiction. As used in this subparagraph, "evidence of ownership or indebtedness" shall mean only preferred or prior stock of the corporation and bonds, notes, debentures or certificates of indebtedness which have stipulated maturities or provide for payment, redemption, or retirement at stated periods or under definite conditions, and provided further that the plan of reorganization under which the said evidence of ownership or indebtedness was issued or given was confirmed by a district court of the United States or by some other court of competent jurisdiction prior to October 8, 1940.

The Internal Revenue Code treats the computation of excess-profits credit under two subsections—one relating to "income credit" and the other to what is termed "invested capital credit."

Accordingly, the same amendment proposed for section 711 (a) (1) should be made to section 711 (a) (2). And this amendment to H. R. 5417 would be made as follows:

On page 23, at line 21, the word "subparagraph" should be changed to "subparagraphs." On page 24, between the lines 4 and 5 add as section 711 (a) (2) (J) the same language quoted above as section 711 (a) (1) (H).

The proposed amendment is self-explanatory. It permits the allocation of profits to the payment or retirement of debts and obligations incurred during the depression days and it was a faith in the future which caused many taxpayers to avail themselves of the opportunity of survival offered by section 77B of the Bankruptcy Act as amended.

I select October 8, 1940, because that was the date of the passage of the present Excess Profits Tax Act, and corporations whose plans of reorganization were approved subsequent to that date presumably took into account this law (if not the amounts presently being discussed) in arriving at the amount which they obligated themselves to pay. Companies which were reorganized prior to such date had no similar opportunity.

To summarize, I respectfully submit that the inclusion in the present pending legislation of a provision such as I have proposed will tend to cure an unfortunate situation resulting from the passage of the Excess Profits Tax Act. I am not complaining about the law, believing, as most businessmen do, that the present requirements of the Government must be financed from day to day to the maximum of our ability. Equitable relief, however, is necessary because many corporations when reorganized under section 77B of the Bankruptcy Act or under the equity powers of State courts, undertook, in good faith, obligations to their creditors when there was no Excess Profits Tax Act. Now, many of them are unable to carry out such obligations unless some additional adjustment is permitted them in arriving

at the adjusted excess-profits net income and unless this Congress assists such corporations their continued existence is imperiled.

Senator TAFT. Why should a corporation in debt under such a plan be treated any differently from one which just was in debt and did not go through 77B? What is the logical distinction?

Mr. UNGARO. The reason, Mr. Senator, is that 77B, if you please, was passed in the first instance to extend relief to corporations which otherwise would either be obliged to fold up or go into complete bankruptcy.

Senator TAFT. Supposing we had a corporation that was struggling along all these years, was still owing a large amount of money, why is not that a company in exactly the same position as one under 77B? It may well have made a settlement without having gone through 77B with many creditors, providing for annual payment, such as you suggest here.

Mr. UNGARO. I would have no objection, Senator, to extending the relief that I talk of to a larger number of corporations if they can be brought into a certain category. I feel you have to stop somewhere, and the reason for taking the corporations which have gone through 77B is because all these corporations assume their obligations and enter into a plan of reorganization, pursuant either to absolute dictation or by approval of a court of competent jurisdiction.

Now, borrowing that program, these corporations entered into agreements under which they intended to carry on on the basis of the tax law as it then existed.

Senator CONNALLY. Right there, does not everybody else do that, whether they are in 77B or not?

Mr. UNGARO. Yes.

Senator CONNALLY. You cannot make a contract now and say, "Well, I thought the taxes would stay like they were." You know very well that taxes change from time to time. Those 77B corporations are in no different attitude than anybody else. They made commitments and contracts as everybody else. You are in better shape because you have got your capitalization scaled down, you got rid of a lot of debts. Why should you be treated better than anybody else?

Mr. UNGARO. Not all corporations had their debts scaled down.

Senator CONNALLY. You were supposed to have gotten some relief or you would not have gone into a 77B.

Mr. UNGARO. The relief, if you please, Senator, was, as I pointed out, in many instances merely the extension of the time of payment.

Senator CONNALLY. That is pretty good. If the extension was long enough, you would never have to pay. I did not mean to divert you from Senator Taft's question. You go ahead and answer him.

Senator TAFT. He answered me. The suggestion was if you make any distinction, it seems to me it should be a reduction in the payment of debt, or leave the company with impaired capital, or something of that kind. It is a difficult thing to work out. I do not see the distinction.

Mr. UNGARO. The distinction, Senator, is largely one of degree. A corporation which went through 77B has entered into a stipulated program which, probably, proportionately to the total number of corporations, does not exist in as large a measure as the number of other corporations which have not availed themselves of it.

Senator TAFT. I know several corporations that we reorganized without 77B.

Mr. UNGARO. That is right, and I would not have the slightest objection to elaborating the provisions such as I suggest to include corporations, basing it on some ratio, either of obligations to capital or obligations which had matured prior to a certain date, or anything else, and that was what we had in the old undistributed-profits law. There they made a distinction, permitted a dividends-paid credit, as it was then called, in favor of corporations which they could charge against dividends, or the profits, rather, the indebtedness which occurred prior to, as I remember the date, December 31, 1937.

The CHAIRMAN. Did you have a reorganization?

Mr. UNGARO. Yes; we did.

The CHAIRMAN. Was it a tax-free reorganization?

Mr. UNGARO. It was a reorganization under 77B, and those reorganizations, Mr. Chairman, do not involve a tax problem at all. It was not a voluntary reorganization; it was a reorganization under 77B.

Answering your question specifically, there was no tax involved in the reorganization.

The CHAIRMAN. I understand that, but did you have the basis of the old corporation? Are you on invested capital or on prior earnings?

Mr. UNGARO. Invested capital.

The CHAIRMAN. You are on the invested-capital base?

Mr. UNGARO. Yes. That was reduced.

The CHAIRMAN. That was reduced?

Mr. UNGARO. Yes; Mr. Chairman.

The CHAIRMAN. You did not have the base of the old corporation?

Mr. UNGARO. No, Mr. Chairman; that matter is up right now for discussion with the tax authorities, but we do not have the same capital base now that we had before.

The CHAIRMAN. At least they have not allowed it?

Mr. UNGARO. That is quite right.

The CHAIRMAN. All right.

Senator BROWN. You are not making any complaint about the normal corporation income tax?

Mr. UNGARO. Not at all.

Senator BROWN. You are complaining exclusively about the excess-profits tax?

Mr. UNGARO. Yes.

Senator BROWN. Therefore, the basis of your complaint is that you have no proper basis for calculating the base period, 1936 to 1939?

Mr. UNGARO. Our complaint arises from that; yes.

Senator BROWN. Your experience was very unfortunate during those years because of the depression, and you had to adopt the invested-capital method as your base, and that has to be reconstructed because of the difficulties that you went through?

Mr. UNGARO. Quite right.

Senator BROWN. I think you made something of a case.

Mr. UNGARO. Specifically, to translate it into another aspect, if I may, at the time we entered into an agreement, when we obligated ourselves to pay our past indebtedness to the tune of 100 percent, we were looking at a tax of 16 percent on corporation profits, and we obligated ourselves to pay 50 percent of the remaining 84 percent, thinking we could carry your 42 percent of net profit to added work-

ing capital, which was insufficient. We now find ourselves today looking at a tax that is not less than 60 percent.

Senator BROWN. And, of course, you made the commitments to pay 50 percent of your profit at a time when you did not have in contemplation any excess-profits-tax law.

Mr. UNGARO. As to the amount, that is correct, sir, and made it with the blessing of a court of competent jurisdiction, if you please.

The CHAIRMAN. If you were given your old base of invested capital, of course, you would get considerable relief?

Mr. UNGARO. We do not ask for that, Mr. Chairman. We are not objecting to the excess-profits-tax law at all, we are not objecting to the increase in corporate rates. We stand herein the position that I think most business of the country does, that is, we are in favor of paying for this defense program as we go along from day to day. The thing I am asking that this committee give earnest consideration to is relief which will permit us, when we get around to calculating excess profits, and calculating the base for excess profits, that we be permitted to deduct from our normal taxed net profit the amount which we have paid to our creditors, under a prearranged program, and I have no objection, Mr. Chairman, to extending that relief to the type of corporation the Senator from Ohio speaks of. Unfortunately I have no way of knowing what a difference that would make in dollar amount. I am discussing the equities of the situation, rather than the amount which might be lost or the amount which might be gained from some substitute.

Senator CONNALLY. You mean deduct from your income the amount paid on debts; is that right?

Mr. UNGARO. Right.

Senator CONNALLY. A very distinguished man in my State has been writing me about a similar plan that he has advocated, former Gov. W. C. Hobbie, the former Governor of Texas, and it was in the Houston Daily Post. Probably there would be some objection to allowing you to deduct it all, because you are paying on a debt, you are just improving your position, in a way, and yet you are just discharging an obligation. If you did not owe the debt, you would have that much more profit.

Mr. UNGARO. That is right.

Senator CONNALLY. There must be some merit in your proposition, but I doubt if there is enough merit in it to allow you to deduct all of the payments.

Mr. UNGARO. Senator, we are here—not in any wise to minimize the force of what I have said here—frankly, I like every other person that has appeared here, is in the nature of someone pleading for some relief. I should like to ask you and urge you to give us 100 percent relief, but if you do not want to do that, then it is for you gentlemen, in your wisdom, to find the spot at which such relief should be granted.

Senator CONNALLY. Here is the thing about it; you might owe a lot of debts, some of which were not pressing. If you go to figure up your excess profits, you might say "Well, I made more money than I thought I would. We might pay off all the debts, so we will not have any tax loss," and you might hunt up some debts.

Mr. UNGARO. I can tie that up, button it up so it will not happen. That will not be a problem. The people in the Treasury Department are smart enough to close that loophole.

Senator CONNALLY. We had a man here the other day that was advocating not exactly that proposition, but something similar. He told us privately he was in the newspaper business, that he made so much money on some of the papers that he could hunt up old broken-down papers so he could take them down from his income tax, and then later on rehabilitate them and get them in shape.

I can see the objection to allowing a total deduction for debts. I think it is a good idea to urge you fellows who owe debts to pay them. I have several creditors that I would be glad to pay, I have that urge, that to allow the whole amount that you pay on the debt, when, as a matter of fact, you are benefiting yourself, you are getting rid of an obligation, that is a pretty big order.

Mr. UNGARO. I admit that, but does not it resolve itself down to this—I mean the portion at which you find the balance here between equities among the taxpayers and obligations that you gentlemen have upon you of raising some money.

Senator CONNALLY. Would you make it a long-term debt or a bonded debt? Every big company, the more prosperous they are, the more money they borrow. Would you deduct everything they pay on a debt?

Mr. UNGARO. No; Senator, I would not.

Senator CONNALLY. How would you limit it?

Mr. UNGARO. To begin with I would put a time within which the obligation should have been incurred, and the precedent for that is in the undistributed profits tax, the old law.

Senator CONNALLY. Yes.

Mr. UNGARO. I select here October 8, 1940, which was the date of the passage of the Excess Profits Tax Act. That date is largely arbitrary in my mind. It could be any other date prior to that, but if there is any merit in my contention that the relief should be granted because the taxpayer honestly assumed his obligations and said he, or it, wanted to pay it, then the relief ought to be given to an obligation which was taken at a time when the excess-profits tax was not in contemplation. I do not mean no one thought about it, but it was not being discussed, and it was not on the statute books. That is the reason I select that date.

The CHAIRMAN. Have you got anything else you wish to put in the record?

Mr. UNGARO. Nothing; Mr. Chairman.

There was a question over here that I think the Senator wanted to ask, Mr. Chairman. I would be glad to answer it.

Senator CLARK. Senator Connally stated exactly the proposition I wanted to mention. The testimony we heard the other day on behalf of certain newspapers, the witnesses appearing on behalf of one certain newspaper, it is a fact that the same affiliations, the same corporation, corporate and family affiliation has been making so much money out of certain other newspapers and a certain magazine they had been going around looking for a place to buy up dead horses and assume a very small equity by assuming a very large indebtedness, and at the same time had the affrontery to come here

and ask this committee to permit them to deduct all their indebtedness on the excess-profits tax which, at the worst, resulted in making 3 percent profit for them, the difference between 4 or 5 percent which they would have to pay on this indebtedness and 8 percent that they would have the right to deduct. I simply intended to call attention to the same situation that Senator Connally has already mentioned.

Senator JOHNSON. You are permitted now to deduct your debt service charges?

Mr. UNGARO. Beg pardon?

Senator JOHNSON. You are permitted now to deduct your debt service charges, your interest on debts?

Mr. UNGARO. Yes, we are. The expense of doing business.

Senator JOHNSON. What you want to do is deduct the principal.

Mr. UNGARO. Get some relief for the principal which we pay under that kind of obligation which we assume; yes, sir.

The CHAIRMAN. As I see it, your whole case is a question of whether you have a proper base for your excess-profits credit, or whether you have an exceptional case that is entitled to some special relief.

Mr. UNGARO. Quite right, Mr. Chairman.

Senator BROWN. Have you pursued your remedy under this hardship statute, section 722? Do you feel you have done everything you can under that?

Mr. UNGARO. Our accountants tell us everything has been done; yes, sir.

Senator BROWN. You cannot get relief?

Mr. UNGARO. That is right, sir.

Senator BROWN. I think generally that section 722 has got to be revised.

Mr. UNGARO. That is what I have been told. I am not an accountant so I am not in a position to speak from personal knowledge on that, but that is what our accountants tell us.

Senator DANAHER. One question before you leave, please.

In this prearranged plan of paying your outstanding indebtedness after your reorganization, did you agree to pay a given amount over a given number of years?

Mr. UNGARO. We agreed two ways, Senator. We agreed to pay half of our indebtedness on a fixed rate of amortization without regard to profit; we agreed to retire the stock which we gave for the remaining half of our indebtedness by applying toward a forced retirement of that stock 50 percent of the net profit.

Senator DANAHER. At your present rate how many years do you expect it would take to liquidate that investment?

Mr. UNGARO. If we were able to continue and make some money in the next couple of years without relief under this tax law, it would take us about 3 years more. That is purely an estimate you understand.

Senator DANAHER. Without relief under the tax law?

Mr. UNGARO. That is right.

Senator DANAHER. Thank you.

The CHAIRMAN. Very well. Thank you, sir.

The CHAIRMAN. Mr. Melville Clark.

STATEMENT OF MELVILLE CLARK, SYRACUSE, N. Y., PRESIDENT AND REPRESENTING THE NATIONAL ASSOCIATION OF MUSIC MERCHANTS

Mr. CLARK. I represent the National Association of Music Merchants of America, composed of about 700 members and about 9,000 music dealers. I manage a music store at Syracuse, N. Y., and manufacture Irish harps and play the harp professionally.

Senator CONNALLY. You are speaking of the music, not the instruments?

Mr. CLARK. The instrument, the musical instrument.

Senator CONNALLY. How about the printed music?

Mr. CLARK. We sell that also, but it is not taxed.

We ask your sympathetic consideration of our opposition to the proposed tax of 10 percent on musical instruments.

With the Supreme Court, you represent the most important group of men in the Nation, and I am grateful that music men can have the thoughtful consideration of so intelligent a body.

Outside of certain very limited number of purchasers of high-priced instruments, most musical instruments are sold at moderate prices within the reach and purchasing power of the masses. The logical prices are very well established for these instruments, and if prices were advanced to absorb the 10-percent tax, it would place them beyond their purchasing power.

Senator CONNALLY. You figure in your business there is just a little 10 percent, and if you go beyond that 10 percent the business would close up?

Mr. CLARK. I would make it pretty difficult.

Senator CONNALLY. Why not drop it down 10 and get all the business; make a lot of money?

Mr. CLARK. There is a logical limit beyond which people will not buy.

Senator CONNALLY. Then drop it 10 percent and sell it at prices the public will accept.

Mr. CLARK. As I was going to say, the price to the public—there is always a logical price.

Senator CONNALLY. You fix the price at all the traffic will bear?

Mr. CLARK. That is right.

Neither the manufacturer nor the dealer makes enough profit to absorb the proposed 10-percent tax.

The rich are not the ones to play musical instruments. They listen to the radio. The rich and the children of the rich do not want to struggle with the study of music—don't need to train themselves.

A low estimate is that 80 percent—or a high estimate of 85 percent—of all those who play musical instruments would be classed as limited-privilege people. Witness that the children of the underprivileged follow the organ grinder and the circus band in the street, and dance to their tunes, and the adults who listen to the Salvation Army bands.

Would not taxing the things that produce music called "musical instruments" be like "taxing a smile in the time of sorrow?"

Senator CONNALLY. If they all produced music, yes, but a lot of them don't produce music.

Mr. CLARK. I agree with you, Senator, you are right.

As the last war was coming, I was asked to play at the White House for President Wilson. Following the evening concert, after all had gone, the President asked me to come out on the portico and play his accompaniment on the Irish harp as he sang the old-time tunes, his favorite tune being "Drink to Me Only With Thine Eyes." He sang until after midnight. After he had finished, I could see that he was much refreshed and happier, for the experience of doing this singing; and gentlemen, it is probably not very well known that President Wilson had a very lovely lyric voice and enjoyed singing very much.

Music is the safety valve of human nature.

A brief story of music is that in about 6,000 years the art of music had never been taxed until 1917, when only pianos, records, and rolls were taxed 5 percent.

When lawmakers in Ireland years ago were trying to decide about taxes and other problems, music went untaxed, but in the Brehon laws the harpers were even given free taxes on their lands.

You all know, of course, what Shakespeare has said about music:

He that hath no music in his soul, nor is moved by the conquest of sweet sound, is fit for stratagem, treason, and spoils.

Why, taxing music at this time would be like "taxing the rain in time of drought." So great is the strain of the draft on the people you no doubt have read the recent article in Life, What the Soldier Complains About. If this tax goes through, it seems to me like running your car with the brakes on.

What is the power of music? No one can tell,
But all can feel the magic spell of its appeal—
Rich and poor and old and young
From every land, from every tongue
Can be united, swayed, controlled,
Refreshed, by the power of music.

—Author unknown.

I say with that great Scotch patriot and parliamentarian, Andrew Fletcher, of the seventeenth century—

Give me the makings of the songs of a nation and I care not who makes its laws.

Everything in nature stirs to the sound of music—the song of the bird, the hum of the bees, the rustle of leaves, the murmur of the brook, the roar of the waves, the crashing of thunder. Each proclaims its part and has individuality in the harmony of the universe.

I thank you.

The CHAIRMAN. Thank you, sir.

Mr. Edwin Hughes, will you give your name to the reporter?

STATEMENT OF EDWIN HUGHES, NEW YORK, N. Y., PRESIDENT, NATIONAL MUSIC COUNCIL

Mr. HUGHES. My name is Edwin Hughes; I am president of the National Music Council; my address is 338 West Eighty-ninth Street, New York City.

A good deal has been said about music here and at the hearing yesterday. In fact, I think you can see how keenly we musicians feel; how interested we are in this thing. The fact is, we are represented by—I believe there are nine of us, who have come from all parts of the country. I believe there are almost as many of us as there are of the excess-profits-tax people.

As president of the National Music Council, I represent 34 national music associations, with a combined individual membership of over 600,000.

All the musical professions and industries in the United States are represented on the National Music Council.

The following organizations comprise the council:

American Academy of Teachers of Singing.
American Composers Alliance.
American Guild of Music Artists.
American Guild of Organists.
American Musicological Society.
American Society of Composers, Authors, and Publishers.
Associated Glee Clubs of America.
Columbia Broadcasting System.
Intercollegiate Musical Council.
League of Composers.
Mu Phi Epsilon.
Music Library Association.
Music Publishers Protective Association.
Music Teachers National Association.
National Association for American Composers and Conductors.
National Association of Band Instrument Manufacturers.
National Association of Music Merchants.
National Association of Musical Merchandise Manufacturers.
National Association of Musical Merchandise Wholesalers.
National Association of Performing Artists.
National Association of Piano Tuners.
National Association of Schools of Music.
National Association of Sheet Music Dealers.
National Broadcasting Company.
National Federation of Music Clubs.
National Guild of Community Music Schools.
National Guild of Piano Teachers.
National Music Camp.
National Music Printers and Allied Trades Association.
National Piano Manufacturers Association of America.
Phi Beta.
Sigma Alpha Iota.
Song Writers Protective Association.
Standard Music Publishers Association.

On May 8, at its annual meeting, the National Music Council passed a resolution opposing the proposed 10-percent tax on musical instruments. A copy of the resolution is appended herewith, and it is requested that this be printed in the official report of this hearing, along with the present statement. Our organizations, representing all phases of musical activity in America, are united in opposing this proposed tax.

I may say that the organizations composing the National Music Council are largely professional organizations. We have some industrial organizations among our members, but two-thirds of them are professional and lay organizations. I want to insist about the importance of music in the national crisis and that it not be looked on as a luxury. Music, I believe, is one of the essentials of our national life, not only in normal times but in such times as these.

A tax on musical instruments would strike a blow at culture, education, and religion. It is futile to believe that manufacturers of musical instruments could and would absorb such a tax. It would be passed on to churches, schools, colleges, and to all the purchasers of musical instruments, including those used in the strengthening and preservation of military and civilian morale in the present national emergency.

Senator BROWN. I am informed that the same exemptions which we have discussed here with reference to athletic goods apply to musical instruments and that schools and colleges supported by the State would be exempt from the payment of this tax, which is a little contrary to what you have just stated.

Mr. HUGHES. I think that matter was discussed by the gentleman from Chicago, Mr. Sommers, if I am not mistaken, who said that most of these instruments are purchased by contributions and otherwise and were, therefore, not exempt. Mr. Alfred Smith said yesterday that almost all instruments used in school bands and orchestras are purchased by the children, mostly poor children, or their parents.

The National Music Council has been working in cooperation with The Adjutant General's office since last October and has given it what they consider valuable assistance in the use of music for the national defense.

Music is an essential in the national defense. Military men recognize music as one of the four necessities in the maintenance of the soldier in the field, the other three being food, clothing, and shelter.

The Army maintains a Morale Branch, with a special music department, in charge of the use of music as a morale builder in the camps.

May I say that not only the Army and Navy but also another department of the Government has taken to employing music as part of its activities. I was very much astonished to receive this post card from the Treasury on Monday morning last before I left New York, and I found that the Treasury is now using music for national defense.

Senator TAFT. Mayor LaGuardia has been conducting, as part of the activities, hasn't he?

Mr. HUGHES. Yes. And on this card which I received is [reading]:

A new song by a famous composer—Any Bonds Today?

This sparkling new melody, composed by Irving Berlin and copyrighted by Henry Morgenthau, Jr., Secretary of the Treasury, is now available for general use in connection with the sale of defense savings bonds and stamps.

Any reasonable number of song sheets will be gladly sent without charge, on request. Simply tear off and mail back the attached card.

I am sure we will all be glad to do that. Remember, you have to have an accompaniment to sing, and to have the accompaniment you have to have instruments, and if you tax instruments the number of them will be less as time goes on.

Music is the handmaiden of religion. It is not too much to say that if there is a decline in the use of music in religious services there will be a decline in religion itself.

Music forms one of the most important branches of education in our public-school system, colleges, and universities. To tax musical instruments would be to tax one of the most essential tools of public education.

Music, far from being a luxury, is one of the prime essentials of our national life and should therefore be exempt from luxury or other taxes.

Without music and musical instruments some of the most important industries could not possibly function, such as the motion-picture industry, the theater, the radio, and the phonograph industry.

As a tax on religion and education this proposed levy would set a dangerous precedent in national legislation.

Speaking for the 34 nationally active organizations which compose the National Music Council, I ask that the proposed 10-percent tax on musical instruments be stricken from the tax bill.

(Mr. Hughes submitted the following for the record:)

RESOLUTION PASSED AT THE ANNUAL MEETING OF THE NATIONAL MUSIC COUNCIL

NEW YORK CITY, *May 8, 1941.*

Whereas the Treasury Department has recommended to Congress the inclusion of a 10-percent tax on musical instruments in proposed new tax legislation; and

Whereas the performance and hearing of music is a most important factor in the preserving of morale in the national defense, both in the military forces and among the civilian population; and

Whereas any added financial burden in the purchasing of musical instruments would react unfavorably on the use of music in the national defense; and

Whereas musical instruments now form one of the most important tools of education in the public-school system and in higher institutions of learning, and as such should not be subject to taxation any more than should books, maps, charts, laboratory and home economics equipment, and other essentials, all of which, in addition to musical instruments, are indispensable tools of education: Be it hereby

Resolved, That the National Music Council is definitely opposed to the levying of a tax on musical instruments, except coin-operated instruments, and urges that all musical instruments, except coin-operated instruments, be not included in the list of taxable items presented to Congress.

The CHAIRMAN. Thank you.

Mrs. Guy P. Gannett. You may proceed. You may sit down, if you wish.

STATEMENT OF MRS. GUY P. GANNETT, PORTLAND, MAINE, PRESIDENT, NATIONAL FEDERATION OF MUSIC CLUBS

Mrs. GANNETT. I am Mrs. Guy P. Gannett, of Portland, Maine, president of the National Federation of Music Clubs.

Mr. Chairman and members of the committee, it is my privilege to come before you today representing the largest musical organization in America, cultural and nonprofit, with a membership of one-half million men and women—the National Federation of Music Clubs—organized in every State of our Union, including 5,000 music clubs with many special members.

Our program is very broad, and whereas for 43 years we have worked to support the American artist and the American composer—in fact, to promote American music along all lines—in times in which we now find ourselves, faced with warring nations on every side, we believe, while not neglecting these, the more important issue is for a strong national defense.

We are convinced that our Army and Navy should be strengthened, that our air force should be brought up to supersede that of any country in the world. We are taking our places with all defense committees wherever we can find a place to serve. We have offered every facility within our organization to U. S. O., to the Army, and to the Navy. But with this building up of our material defenses we are convinced that we should strengthen our cultural defense, in order that life in our Nation may be stabilized and rightly balanced.

Music is a spiritualizing force which touches our inner life, lifts us above the tragedies so forcibly impressed on us all each day through press and radio. It keeps our thinking and living more normal. It is because I believe this so sincerely, not unmindful of the great revenue needed to build up this defense, that I come before you today to ask you to reconsider including a 10-percent tax on musical instruments.

Music is not a luxury but a greater need than ever before in our lives, because it helps keep up the morale in all our people. This tax would not greatly increase the revenue, so much needed; it would cripple our public-school musical programs and definitely hamper the plans we are trying to carry out with relation to bands in the Army and Navy camps, so very necessary now, which we are trying to stimulate and promote.

This is no time for relaxing our efforts to bring music to the whole people; rather, we should increase them. It is my belief that if music could be introduced into industrial plants, it might lessen strikes and increase production.

This was demonstrated in England very recently, where music was used in a munitions plant and the output thereby increased 15 percent.

The larger proportion of buyers of musical instruments come from the lower income groups, and large numbers of small instruments are used by settlement music schools and public-school bands and orchestras.

Thousands of people make untold sacrifices that their children may realize the educational and cultural advantages from music. They do not consider in any way that this is a luxury, but a real necessity.

In view of the facts that have been brought before you today, with the realization of the small revenue derived from such a tax, I cannot believe the fair-minded men representing our country will allow this to pass.

I wish I could make a stronger appeal. I feel so keenly, but I can only ask of you to please give this your very fair and kind consideration. If you do so, I am convinced that from my viewpoint, all will be well.

I thank you very much for giving me this opportunity to be heard.

The CHAIRMAN. Thank you very much.

Mr. Emerson Richards.

STATEMENT OF EMERSON RICHARDS, ATLANTIC CITY, N. J., REPRESENTING THE PIPE ORGAN INDUSTRY

Mr. RICHARDS. Mr. Chairman and gentlemen of the committee, I am a lawyer by profession, but an expert on certain acoustical phenomena as an avocation, and specifically upon the tonal design of pipe organs.

I have been requested by the various pipe-organ builders to appear before this committee, representing the pipe-organ industry.

This section that taxes musical instruments will, of course, involve pipe organs as well.

Now, I think this was hardly intended. This section started out originally as a tax upon radios and now there have been added other things to it, including musical instruments.

I think it has been overlooked that practically all pipe organs—I would say 98 percent of pipe organs built today—go either into churches or educational institutions. That is divided about 80 percent to the churches and 18 percent to the schools, and the other 2 percent miscellaneous.

There was one time in 1925 when a large business was carried on and when a large number of pipe organs went to the moving-picture theaters, but that was killed by sound pictures, and today the industry has shrunk from about a $10,000,000 industry to last year, $1,800,000, so it is chicken feed in this matter, even if you got the tax.

My first point is that so far as future collections are concerned, the tax would have to be paid by the churches of the United States, and I am afraid that is a point that has been overlooked, and I doubt very much if Congress intended to set such a precedent.

As to the balance, we have this situation: The Senator has spoken about the exemption of public schools. The difficulty with that is that in many cases the public schools have raised the money for organs from contributions and by passing the hat and what not, and have made a direct purchase, and then even where you get a case where the instrument itself is to be used by the institution, your trouble is still not over. For instance, I am sorry Senator Connally has gone, because there is a deal pending down in his State, in Texas, for a $35,000 organ, which, under the contract, is to be built into a music building, and although the organ is being selected by the university, it is covered by the contract for the building, with the result that the contract is now laying on the desk unsigned, because the contractor doesn't know whether he is going to have to pay the tax on it.

There is another thing the matter with this bill, which is very serious.

Pipe organs are built just as you build a house. I design an organ, a particular organ, to be put into a particular place, depending on size and on the amount of money you raised. The organ, therefore, is first designed, then it goes out to competitive bidding, and the business is highly competitive, although small.

There are a dozen firms all trying to get business to keep their plants going, and the result is that the price gets shoved down to the very last penny. Finally the contract is awarded and then a period must elapse of 6 months or a year before the pipe organ is built in.

Now we have this section here, which has reference to installments, so that if a down payment was made in 1940, it will cause the tax to be assessed when the organ is delivered, even if that is next year.

I know of a case in Columbus, Ohio, where a contract was let in 1939, down payment made, and the church is not yet completed. The organ is boxed up in the factory, awaiting directions for installation, probably this fall. Now then, the major part of the purchase price of that would be subject to this tax, although the contract was made 2 years ago, and a lot of the 1940 business which now is in the course of erection, most of it for fall and winter season, would be subject to this tax, and if this is done in the cases of several manufacturers I have talked to, it simply wipes out their profit for the year. The most profitably operated company in the industry made less than it would lose if it had to pay this retroactive tax.

Senator BROWN. I suppose there would be some dispute as to who should pay it?

Mr. RICHARDS. I don't think there would be. You couldn't put it on the purchaser. The manufacturer would have to pay, and if he does, the results are obvious.

Senator BROWN. There would be a $3,500 tax on that transaction.

Mr. RICHARDS. Yes; and in that case, 2 years ago they were terribly anxious for business to keep their factories going, and the price was very low.

There just comes to my mind another illustration of what happened about the payment of this tax. The Government built a wonderful chapel at West Point and there was installed there a very fine organ. Now that organ has been built piecemeal by contributions made by friends, relatives, or members of clases of officers who have died in the defense of their country. Now, every dollar of that would be taxed.

The CHAIRMAN. Title has already passed to that?

Mr. RICHARDS. The organ is still in the process of completion. It has been going on for 20 years. Every time an officer dies and they want to do something up there for him they buy another stop for the organ.

The CHAIRMAN. You mean a new part?

Mr. RICHARDS. Yes. Now, a great many organs aren't new organs. A lot of old organs that are still very good are rehabilitated—reconditioned. There is no way of computing what the tax is on that. Changes and additions are made to organs. It is a little difficult to find out just where that stands. Your Honor—I am so used to addressing the court, you will have to pardon me—but Mr. Chairman, I have no doubt about the situation that is confronting the industry.

It is a fact that the industry is small and the greater part of the costs are in labor. It is all hand labor. Organ building is a craft, and anybody with a good set of carpenter tools can build an organ.

As a matter of fact, there is a convict in one of the penitentiaries who has built an organ, so I would say at least 85 percent is in wages, and in that particular case, due to the fact of the depression, and what not, no young men have entered the business, and practically all the men who are working in these factories—and there may be altogether 500 in the whole country—are older men; I would say, over 50. If some of these factories have to shut down, or if this tax frightens people off from buying organs, these men have no other place to go; they don't know very much except this sort of work, so that this industry would suffer a great deal and it seems to me rather unjust that the retroactive feature of this bill should be retained.

The CHAIRMAN. That is a very harsh provision on any installment transaction.

Mr. RICHARDS. Yes; and it seems to me that could be easily changed.

Now, if you decide to continue the tax on musical instruments, an exception could be made which could be inserted right after musical instruments, "except those purchased by churches and religious institutions"—whatever wording you wished to use—"or educational institutions." Remember also, there are the sectarian institutions, private schools, parochial institutions, which would not come in under the exemption in this bill.

I doubt very much if Congress ever intended to levy a tax on the churches of the United States, and this is a direct tax, if there ever was one. I don't know whether the churches are doing all they might for the people of the country, but I have an idea that a little old-fashioned religion would be beneficial.

The CHAIRMAN. I call your attention to a matter, namely, that in order to enjoy the exemption it is not necessary that the article be purchased by the Federal Government or State or municipality, if it is for the exclusive use of the agency of the Government, State, or municipality, the exemption prevails.

Mr. RICHARDS. That is one of those things.

The CHAIRMAN. It is not clear, and in the case of West Point, the organ there, it isn't clear, but I am inclined to believe that there would be a tax for resale.

Mr. RICHARDS. The difficulty about this is you cannot litigate it. By the time you pay the tax and bring the suit it has cost more than the tax amounts to.

The CHAIRMAN. You are undoubtedly right about that.

Mr. RICHARDS. Yes. That is the great trouble about many of those taxes, that you are licked before you start, because it costs so much to litigate.

Senator BROWN. I was going to say that about 10 or 12 years ago when we enacted the revenue tax in Michigan, there was included a tax upon charitable corporations, and it was considered, at least by the people, to be a most outrageous, atrocious thing. I want to express myself as being opposed to any tax that will affect religion.

Mr. RICHARDS. I may say I served five terms in the Senate of the State of New Jersey, and Acting Governor, and any time a proposal got anywhere near that type they came down on our

necks so fast it wasn't funny, and if this gets started, your correspondennce will probably increase. I think it was purely a slip; I don't think anybody intended it, and I think there should be some relief, both as to the tax and the retroactive feature, and some clarification as to what constitutes a sale, because lots of times we take an old organ—I know a case in Chicago where they spent $5,000 on an old organ and never put a pipe in; all they did was revamp it. Now, whether that comes within the provisions of the bill may be uncertain but you can bet that, if asked, the Revenue Bureau would try to collect it.

That is, in general, most of everything I wanted to tell you about this matter. It is, of course, a question of policy. I might suggest also that if you decide that you must tax musical instruments, what is the matter with taxing sheet music as well? You are taxing phonograph records. Now, the Society of Composers has an income of over $5,000,000 a year from copyrights alone on sheet music, and the sheet-music business is far bigger than the musical-instrument business. I might call your attention to the fact also that most of the so-called professional musicians are also members of a labor union; I am, myself, a member of the American Federation of Labor Musicians Union, and I don't think they have gotten wise to the fact that their tools are being taxed. If it is logical to tax the tools we use in our trade, why not all the trades? In other words, I think a good deal of the pain in these things comes about because they only hit certain things.

Where they do not meet everybody alike we have this trouble of this fellow trying to push it onto the other.

In this case it doesn't mean a cent to me one way or the other, except that I don't want to see this rather small but very beautiful industry harmed because it is a craft and art, and the building of organs and inspiration of organ music in church is something which I think we all treasure, and don't want to see dissipated.

I believe this tax would not only probably put some of these people out of business, because most of them have been running in the red during all of this depression; it would otherwise fail of its purpose.

The largest company in the business which had quite a large surplus lined up lost $250,000 last year. It is about to a point where it has to quit or cease losing money so that I hope the committee will be able to work out a proposition in which they can eliminate the tax, so far as the churches and educational institutions are concerned, if it can go no further.

I think that, as far as all instruments are concerned, what has been said here is largely true. I know that, if you gentlemen had been able to come to Atlantic City to the public auditorium when there were those contests between bands from all over the country, kids were brought from all over—I saw 8,000 youngsters in one massed band—those kids or their parents bought those instruments and if they are to be taxed for having them, there probably will be fewer of them.

The CHAIRMAN. Can you give us any idea of the manufacturers' selling prices of the instruments used in bands?

Mr. RICHARDS. No; I know everything about the prices of organs, from an engineering standpoint; I don't know anything about other

musical instruments. There is undoubtedly quite a large spread between the manufacturers' and the retailers' prices; how much that would be pyramided I don't know. I suggest that in that case, if it is going to be taxed, it be done as in the automobile industry so there cannot be any pyramiding.

It is the same with a piano. The situation which exists with respect to a piano is a development of the last 10 years. Before that there weren't many musical instruments in schools; now every institution has a band, even if it is only a few pieces and the instruments are paid for by contributions and collections.

May I submit a memorandum to the members of the committee? I prefer to mail it to them.

The CHAIRMAN. You may do so or give it to the clerk.

Mr. RICHARDS. I could give him a copy.

(Mr. Richard's statement is as follows:)

MEMORANDA REGARDING TAX ON PIPE ORGANS, BY EMERSON RICHARDS, ORGAN ARCHITECT

The revenue bill now pending before the committee as approved by the House of Representatives provides for a 10 percent tax on musical instruments. The framers of this bill had in mind the former bill which taxed radios and probably intended to extend this tax to the manufacture of such musical instruments as pianos, orchestral instruments like trumpets, saxophones, and other band instruments which are manufactured and sold over the counter for cash or on installments. Such instruments are manufactured in quantity and the tax, if applied, could be passed on to the consumer as is evidently intended to be the policy of the bill. This could not apply to pipe organs, which are installed these days in only churches or schools, because such organs are built to order for these institutions, and to those now under construction the tax would be retroactive.

The present bill would work a hardship because, so far as future organs are concerned, it would be a direct tax upon the religious and educational institutions of the United States. Insofar as it relates to organs now under construction, the tax would fall upon the builders and would more than wipe out any prospective profit that they might have anticipated. Moreover, the act is uncertain with relation to alterations, repairs, and additions to present organs.

The organ industry is a small one. Its gross business in 1940 was approximately $1,800,000 distributed among about a dozen builders who are in active competition with each other. This gross business includes repair work, tuning, alterations, rebuildings, and additions to existing organs. There has always been intense rivalry among builders and in attempts to get business, prices are habitually cut to a point where the profit is very small, never reaching anything like 10 percent. So that a 10 percent tax on organs now under construction, or upon which payments are still being made, would completely wipe out any anticipated profit of the builder and would result in actual losses upon the contract.

It should be understood that organs are designed and built for the particular church or other auditorium in which they are to be used. Consequently, no two organs are alike and their actual construction is largely a labor and material matter, similar to the building of a house or even the church in which the organ is placed.

The general procedure is for the church authorities to contract with an organ builder, after competition, for the building of the organ. The various parts of the organ are then made in the builder's shop or factory and later set up in the church by the builder's workmen. A down payment is made when the contract is signed and payments are usually made during the progress of the work, with the final payment after the organ is completely erected and accepted by the church authorities. Occasionally credit is extended by the builder for a longer period of time, and payment completed in installments after the actual installation of the organ. All such installment payments would be subject to the tax, even in the case of organs already installed.

It consequently follows that all contracts made before July 1, 1941, where delivery has not been made by that date or upon which installments are still due, would be subject to the tax under section 549, pages 64 and 65, of the House

bill. The usual time between the making of a contract and the completion of the organ in the church average between 6 months and a year, depending on the size of the instrument. It follows that this tax is therefore retroactive and would require the builders to pay the tax on organs that may have been contracted for more than a year ago, but not yet completely delivered and paid for. Since, as before stated, profits do not range as high as 10 percent, this would mean that the builder's profit upon these instruments would be wiped out and an actual loss sustained.

The organ industry has never been a lucrative one. Its best years were around 1925 when organs were demanded by moving-picture theaters. With the advent of sound pictures this demand ceased and a large percentage of organ builders were forced out of business. During the period of depression most of the builders operated at a loss, since there was not enough demand to cover the overhead of their business. Because of this lessened demand very few, if any, young men have been attracted to the organ-building craft and the workmen are now mostly elderly men who would not be adaptable for absorption in other manufacturing processes.

Organs are more than 85 percent hand labor, requiring special skill and ability from the workmen. The materials employed are principally wood with some metal, such as zinc, lead, and tin, used in the metal pipes. Neither men nor the material could be suitably absorbed into defense work. The shops and factories of the organ builders are not adapted for such work, and as the 10 percent tax will in all probability result in a still lessened demand for organs, it is inevitable that most of the builders will be compelled to cease operations, thereby throwing their workmen out of their jobs.

It should also be realized that so far as the sale of future organs is concerned, the 10 percent tax would have to be paid directly by the churches and schools of the United States. About 98 percent of all organs built today are installed in the religious and educational institutions of the United States. About 80 percent go to the churches and the remaining 18 percent to the schools and colleges, the remaining 2 percent to residences and other occasional uses. Only tax-supported schools controlled by a political subdivision of the State would be exempt under the bill, and there are many instances where even this exemption would not apply to these institutions because the organ is not bought directly out of tax moneys, and in any event there would be a discrimination between the schools and colleges not supported by direct taxation and those in the exempt class. It has not heretofore been the policy of the Federal Government to tax religious and educational institutions directly, and it is doubtful if this result was understood when the present language was incorporated in the bill.

Another complication results from the fact that very few organs built today are completely new instruments. Quite a few are simply rebuilds of older instruments, while others employ either in part or in whole the pipes from older instruments. It would be very difficult to determine the extent of the tax in such instances. In other cases the work consists in alterations or additions to present instruments, and again the language is not clear as to the method of determining the tax.

Conclusion.—It is respectfully submitted that the total revenue collected would be very small. Against this a considerable body of workmen would lose their present employment without prospect of reengagement elsewhere. A precedent in the taxing of religious and educational institutions of the United States would be made which would inevitably lead to much future controversy. The language of the present bill would be retroactive and tax the builders for work already done but not yet paid for.

It is, therefore, suggested that after the words "musical instruments", there be inserted the words "except pipe organs purchased by religious or educational institutions" and that in the administrative section a proviso be inserted providing that this act shall not apply to pipe organs purchased by religious or educational institutions now contracted for but not yet completed and installed or upon which installments of the contract price remain unpaid.

Respectfully submitted.

EMERSON RICHARDS, *Organ Architect.*

The CHAIRMAN. I am advised that Mr. C. M. Christensen, auditor of the Triumph Mining Co., whose name appears on the calendar, has

filed a brief in lieu of making an oral statement. Mr. Christensen's brief will be incorporated in the record at this point.

(The statement of Mr. Christensen is as follows:)

STATEMENT OF C. M. CHRISTENSEN, AUDITOR, TRIUMPH MINING CO., TRIUMPH, IDAHO

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: This presentation is a protest against a tax situation created by the Excess Profits Tax Act of 1940 and its amendments. This protest is made by the Triumph Mining Co. of Triumph, Idaho, a producer of zinc and lead, and is directed against the limitations set forth in supplement A, section 740, and against the retroactive provisions of supplement B, section 752 of such Revenue Act. The inequity and injustice to this corporation and to any and all other corporations in a similar position as a result of the limitation and inclusion in the above mentioned sections has been fully discussed with the Treasury Department and Bureau of Internal Revenue and it is our understanding that these two agencies are in complete sympathy with the request for relief as hereinafter set forth and are agreeable to the purposes of the amendments herein requested.

Section 741 grants to corporations known as "acquiring corporations" the election to use either section 713 (the income method) or section 714 (the invested capital method) in computing their excess profits tax credit. But section 740 which defines "acquiring corporations" eliminates all corporations which came into existence as a result of having acquired only a portion or portions of the assets of predecessor transferor corporations. The Triumph Mining Co. is such a corporation and is thus deprived of its rightful privilege of using its own base period income in computing its excess profits tax credit.

For several years prior to 1940 the "A" corporation (owning and operating other mines in other mining districts) owned certain mining claims in the Wood River mining district of Idaho and had a long-term lease on all of the mining claims owned by two other corporations in that same district. These various mining lands, which were all adjacent and continuous to each other, had been operated by the "A" corporation for many years as one single mining operation with a separate and exclusive set of books and records just as completely kept as if it had in fact been an independent corporation.

In order to avoid disagreement over extralateral rights, to effect a permanency of operations and to simplify their respective interests in this one natural mining operation, the three corporations decided to and did in February 1940, organize the Triumph Mining Co. and on March 15, 1940, transferred their respective assets above set forth to such corporation for all of its voting capital stock in the following proportions:

	Percent
Corporation A	38.00
Corporation B	50.84
Corporation C	11.16
Total	100.00

Corporation A, B, and C continued to exist and function as separate corporations after this transfer of only a portion of their respective assets.

Thus the Triumph Mining Co., having acquired only a portion of the assets of other corporations, fails to meet the definition of an acquiring corporation and is deprived of the benefit of its base period income in computing its excess profits tax credit, an income record which it rightfully earned and to which it should be entitled by virtue of its merely continuing the identical enterprise. It so happens that the various mining claims involved in this reorganization were acquired by the respective transferor corporations many years ago by location and assessment work and have no cost basis and the depreciable assets have been largely written off through depreciation. As a result the entire assets of the Triumph Mining Company, although highly valuable at the time of reorganization, represent an insignificant amount of invested capital on which

to compute an excess profits credit. But a second and perhaps even greater injustice results from the effects of Section 752 as it strikes this particular corporation. This section is discussed later in this presentation.

So long as the still remaining transferor corporations involved in such reorganizations are willing to forego that portion of their own respective base period incomes which pertains to the assets transferred, it appears indefensible not to allow the resulting transferee corporation the benefit of such rightfully earned income. This amounts only to a division of a predecessor corporation's income to its own component parts.

In permitting what is defined as "acquiring corporations" the benefit of base-period net income in computing their excess-profits credit, it was clearly the intention of the Treasury Department and Congress to grant this privilege to all domestic corporations which could clearly establish such a record during their base period and it is assumed that the same privilege was withheld from reorganizations under section 112–B–5 on the theory that if only a portion of the assets of a corporation or corporations was transferred, the income produced by such assets during the base period could not be definitely or equitably established. It appears to be pure oversight that the income attributable to the assets transferred was not allowed to follow the assets so transferred and the transferee corporation allowed the same choice as other corporations in electing its excess profits credit to be determined upon the base-period income allocable to the assets transferred or the invested capital represented by those same transferred assets, whichever is the greater. Such a provision would have more completely given effect to the equity contemplated in the act.

Correction of this inequity could be accomplished by a simple amendment to section 740 (a) broadening the definition of "acquiring corporation" expressed in the following language or in language which gives effect to the thought herein expressed:

"Section 740 (a) is amended by adding at the end thereof the following new subsection:

"(5) At the option of the transferee corporation and with the written consent of the transferor corporations, a corporation which has acquired property from one or more corporations in a transaction with respect to which gain or loss was not recognized under section 112 (b) (5) of chapter 1 or a corresponding provision of a prior revenue law, provided that accounting records have been maintained which shall have clearly defined the net income attributable to such transferred assets; and provided further, that only the net income allocable to such transferred assets be considered in arriving at such acquiring corporation's base-period net income. Base-period net income so allocated to such acquiring corporation shall be deducted from the base-period net income of the transferor corporations. The matter of whether or not net income is allocable to such transferred assets shall be on the basis of fact to be determined by the Commissioner of Internal Revenue."

SEC. 752. "*Highest bracket amount.*"—No objection is raised to the general theory of establishing a "highest bracket amount" available to corporations which undergo reorganizations and thus avail themselves of a device for defeating the rates of excess-profits tax to which they would otherwise be subject without the provisions of section 752. Our objection is that this section includes corporations which were not intended to be included under the basic theory of this section. Section 752 was, by its very nature, intended purely as a safeguard to prevent corporations from breaking up into smaller units and thus distribute their income in such a way as to evade the rates of tax contemplated and set forth in the act.

It was clearly the intention of Congress to allow all domestic corporations, existing at the time this act was introduced in Congress, a highest bracket amount of $500,000 and added supplement B only as a measure for retaining such a basis of excess-profits taxation thereafter. The Triumph Mining Co. was organized in February 1940, which was some months prior to the time this tax measure was even introduced in Congress, and yet it is limited in its highest bracket amount to about one-fourth the intended $500,000 and each corresponding bracket proportionately reduced.

It must be admitted that section 750 (e), section 752, and all other sections of Supplement B dealing with "highest bracket amount" pertains to a condition brought about by the passage of the act itself and were not intended to penalize or limit the actions of corporations prior to such new law. It could not, or at least, should not have been intended to penalize actions entered into innocently prior to the time the contents of the act became public information.

Correction of this discrimination and injustice can be accomplished by the following amendment:

"Section 752 is amended to read as follows:

"'SEC. 752. Computation of highest bracket amount in connection with certain exchanges effective on all exchanges occurring after (date of introduction of the bill.)'"

Also article 30.750-4 of regulations 109 should be rewritten to give effect to such new date.

Like the amendment to section 740-(a) herein suggested, this amendment would not open the door to any unworthy corporation since it would yet specifically bar transactions entered into for the purpose of evading the tax imposed by the law or transactions entered into in full knowledge of the existence of such limitations or contemplated limitations.

Respectfully presented.

TRIUMPH MINING CO.,
By C. M. CHRISTENSEN, *Auditor.*

The CHAIRMAN. Mr. Birch?

Mr. Birch, you are representing whom?

Mr. BIRCH. The Criterion Advertising Co., Inc., of New York City.

The CHAIRMAN. What subject do you wish to talk to the committee about?

Mr. BIRCH. On the matter of billboards.

The CHAIRMAN. Billboards, outside billboards?

Mr. BIRCH. Yes.

STATEMENT OF FRANK H. BIRCH, NEW YORK, N. Y., REPRESENTING THE CRITERION ADVERTISING CO., INC.

Mr. BIRCH. I don't want to take up your time and the time of the committee in covering the general matter which has been well covered. I do feel, however, I have a business, I and some associates have a business which, while it is included under this act, is totally different from billboards; billboards are the large structures along the boulevards.

We have a small poster display about the size of that door [indicating] which we attach to retail stores generally, advertising products sold in the stores. We also contact the dealer and see that the products are sold in the store. There are thousands of the other small displays maintained by manufacturers and advertisers and also by retail dealers themselves, with whom we are really in competition.

Now, I am not going to take up your time or that of the members of the committee in telling you that we think that, because of the discriminatory nature of advertising in the class that this should be thrown out, and also for other reasons which have been covered, not only those but from the fact that here is a small business which is doing something which comes under the act but which is totally different. A business which has not had a profit for 9 years, which this year, may have a small profit, and if taxed at a dollar per display, would not permit us to continue business. The contracts are made over a long period of time, not a short period like the big billboards. The contracts do not provide for any such taxes so it could not be passed along. Now, our display has 24½ square feet.

The act contains a clause providing for a dollar excise tax for 100 square feet which would be at the rate of 4 cents a square foot on

our 24½ square feet, and 1 cent a square foot on the larger. Now, as I say, we are totally opposed to retaining this in the tax law at all for the reasons that have been given to you by the speakers but, in addition to that, I would like to offer an amendment which I have here and which I will give to the secretary.

The CHAIRMAN. Yes; give it to the secretary.

Mr. BIRCH. On the basis simply that the act should be amended, it is proposed by us that the excise up to 25 square feet be 25 cents; from 25 to 50 feet, 50 cents; and from 50 to 100 feet, a dollar, leaving that exactly on the same basis as 1 cent a square foot.

The CHAIRMAN. Well, thank you very much. Your prepared statement will be included in the record.

(Statement submitted by Mr. Birch is as follows:)

Hon. Walter F. George, chairman, and members of the Finance Committee of the United States Senate:

Mr. name is Frank H. Birch, president of the Criterion Advertising Co., Inc., of New York City, a company engaged in erecting and maintaining the smaller type of advertising signs, know as three-sheet displays each containing 24½ square feet of advertising space.

These displays are placed on the side walls of retail stores and generally advertise some article on sale in the store. A yearly rental is paid to the store merchant in each instance. There are thousands of other small signs on retail stores and filling stations, placed and maintained by the manufacturers or advertisers themselves, in addition to thousands of small signs placed and maintained by the little retail dealers themselves, which signs we understand will not be taxed under this act. These signs and not the big billboards, are our main competition and to tax our signs and not the others would be discriminatory and unfair in this field.

Our company makes contracts with advertisers to erect and maintain these three-sheet displays for a period ranging from 1 to 3 years for a rental of $36 per year each. Most of our present business is contracted ahead for from 1 to 3 years.

We realize the necessity to raise funds so vitally needed to finance our defense activity and do not want to dodge our share of the burden. We stand ready to pay any tax on our profits which Congress may see fit to levy, but feel that the proposed tax imposed by section 3269, part XI, of H. R. 5417, is economically unsound, discriminatory, and unwise. We urge its complete elimination and that the necessary funds be raised by some general tax which applies equally to all business and which does not discriminate against one industry.

Outside of paying ourselves reasonable salaries our company has not made an operating profit for a number of years, but this year it appears now that we will make a small profit on our operations. However, should we have to pay a dollar tax per display, which could not be absorbed by ourselves or passed on to the advertiser whose contract does not require him to pay it, we could not continue the business as a profitable operation, meaning the loss of our investment in signs and the throwing out of work our several hundred employees, many of whom have spent the best part of their lives in this business—in some cases up to 25 years.

The proposed exise tax on outdoor signs is levied without regard to profits and in our case would be a tax on losses as the small estimated profits we anticipate this year would not be sufficient to cover the $1 tax per display.

I respectfully call to your attention that the proposed excise tax if applicable to three-sheet displays of 24½ square feet each, the rate would be over 4 cents a square foot while on a billboard of 100 square feet the proposed rate would be 1 cent a square foot. This is wholly unjust and unfair. If the Congress concludes that outdoor signs must pay an excise tax, certainly then all in the industry should be treated alike and the tax be made uniform at a rate of 1 cent a square foot for the advertising space contained in each sign.

Furthermore, all signs not being utilized and producing any revenue should be exempt from taxation and this should be true even if the advertising space thereon was donated by us in furtherance of the defense program or for some other governmental or public purpose. A tax on outdoor advertising would be

unfair while exempting that of newspapers, magazines, window displays, and direct mail. There would be no justice in singling out one medium for taxation thereby leading to an unfair competitive advantage in favor of other advertising mediums not taxed.

In conclusion, I believe for the reasons above given that the Senate Finance Committee should amend the revenue bill of 1941 by striking from it section 3269 which contains the excise tax on outdoor advertising or an amendment should be adopted whereunder signs having an advertising space area of not more than 25 square feet should be taxed not over 25 cents each, or at the rate of 1 cent a square foot.

Amend act as follows: For each billboard having an advertising space area of:	*Per annum*
(1) Not more than 25 square feet	$0.25
(2) More than 25 and not more than 50 square feet	.50
(3) More than 50 and not more than 100 square feet	1.00
(4) More than 100 and not more than 200 square feet	2.00
(5) More than 200 and not more than 300 square feet	3.00
(6) More than 300 and not more than 400 square feet	4.00
(7) More than 400 and not more than 600 square feet	8.00
(8) More than 600 square feet	11.00

The CHAIRMAN. If there are any other witnesses here scheduled to testify tomorrow who desire to testify this afternoon, we will be glad to hear them. If not, the committee will recess until tomorrow at 10 o'clock.

(Whereupon, at 3:55 p. m., the hearing recessed until 10 a. m., Thursday, August 21, 1941.)

REVENUE ACT OF 1941

AUGUST 21, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Mr. Bachmann.

STATEMENT OF HON. CARL G. BACHMANN, CHARLESTON, W. VA., WEST VIRGINIA LIQUOR CONTROL COMMISSION

The CHAIRMAN. Mr. Bachmann, before you commence, let me inquire. I see there are five or six witnesses here having to do with the tax on liquor. Are you gentlemen all speaking to the same general purpose?

Mr. BACHMANN. I do not know what the other gentlemen are speaking about, Senator.

The CHAIRMAN. You had no conferences at all?

Mr. BACHMANN. Yes. I am appearing for the West Virginia Commission.

The CHAIRMAN. All right. Well, go ahead with your statement. You may proceed. There is very little point, however, in having half a dozen witnesses to the same general question, and, therefore, I will ask you to stay strictly within the rule of 10 minutes because there are a number of people here who want to be heard. We would be glad to hear the whole case, but a multiplicity of witnesses always means delay in getting through with the subject.

Mr. BACHMANN. Mr. Chairman, my name is Carl G. Bachmann. I am a member of the West Virginia Liquor Control Commission, appointed by Governor Neely as a minority member of that commission. I am also a former Member of Congress.

I appear on behalf of the State of West Virginia and the National Alcoholic Beverage Control Associaton, which is an association composed of the States of Maine, New Hampshire, Virginia, West Virginia, Alabama, Ohio, Michigan, Iowa, Wyoming, Utah, Idaho, Montana, and Oregon. There are 17 States that handle distilled spirits through a monopoly system. The 4 States that are in that group that do not belong to the association are Washington, Vermont, Pennsylvania, and North Carolina.

We are interested in presenting to your committee two questions with which we are vitally concerned back in the States. The first is that an increase in tax tends to increase bootlegging and illicit distilling, and the second is a decrease in Federal revenue if the tax becomes so high.

Now, I have some interesting information taken from our records, and I would like to call your attention to just what has happened since the other tax increase has gone into effect, insofar as our State is concerned. I am speaking now of the number of stills seized in West Virginia by the Federal authorities and by the State authorities. For the period, the fiscal year ending June 30, 1940—that was before the last increase in tax went on—as compared to the period ending June 30 this year, this remarkable result appears from our records: Before the tax increase of 75 cents went on the 1st of July 1940, the Federal and State agencies captured in West Virginia 246 stills. After the tax went on we captured for the same period 658 stills, or an increase in stills captured after the tax went on of 167.5 percent.

Gallons of whisky seized before the tax went on, 1,691; after the tax went on, 2,784 gallons, or an increase of 64.6 percent.

Senator VANDENBERG. There ought to be a tax on stills.

Mr. BACHMANN. I do not know how much more they are making down there, Senator, but I know we captured this many stills.

Senator TAFT. Or there ought to be a tax on copper coils.

Mr. BACHMANN. I do not know how we can get the coils in the mountains. They hide them.

We captured, in that period before the tax went on, 27,106 gallons of mash, and after the tax went on 86,569 gallons of mash, or an increase in the amount of mash captured of 219.4 percent.

I would like to ask unanimous consent of the committee to introduce this analysis as part of my remarks.

The CHAIRMAN. You may do so.

Mr. BACHMANN. And also a short statement showing what the West Virginia enforcement agency did, and also the Federal agency in the State of West Virginia.

The CHAIRMAN. Yes, sir; you may put that in the record.

Mr. BACHMANN. You know they make moonshine in West Virginia for about 25 cents a gallon. There are 3 gallons of liquor in a case, so they make a case of liquor for 75 cents. We start out now, under the present law, with a tax of $9 on a case, or $3 a gallon, and if the other dollar goes on, you have got $12 on a case of liquor in taxes.

The more tax you put on the more you enlarge the opportunity of people to get into the illicit distilling business, because the greater the margin of profit for the illicit distiller, the more we encourage the big distilleries, just as we did in prohibition days, to get back into the business.

Here is some startling information from our records. For the fiscal year ending June 30, 1940, the value of the whisky seized in West Virginia was $5,073, and after the tax went on the value of whisky seized was $8,352, an increase of 64.6 percent.

Senator LA FOLLETTE. How did you arrive at the value of seized whisky?

Mr. BACHMANN. Well, they value it by the gallon.

Senator LA FOLLETTE. I know, but how did you arrive at the value of that whisky? Do they compare it with anything?

Mr. BACHMANN. They compare it with legal liquor.

Senator LA FOLLETTE. They compare it with legal liquor?

Mr. BACHMANN. Yes. Now, the value of mash seized during that period before the tax was put on was $16,263, and after the tax went on the value of the mash seized was $25,600, or an increase of mash and liquor seized from $21,336 to $33,952, or 59.1 percent.

I would like the consent of the committee, if I may, to introduce that little table.

The CHAIRMAN. Yes, sir; you may do that.

Senator LA FOLLETTE. What was the total consumption of legal liquor in this period?

Mr. BACHMANN. I am just coming to that, Senator La Follette.

For the fiscal year 1940 we consumed in West Virginia 2,009,483 gallons of distilled spirits. For the period ending June 30, 1941, we consumed 1,809,003 gallons. In other words, we have decreased our consumption in West Virginia about 10 percent, and we lead the monopoly States.

Senator TAFT. What was the second figure?

Mr. BACHMANN. The first figure was 2,009,483, and the second figure was 1,809,003, or a decrease of about 10 percent, in gallons, 200,480.

Here is the point: The Federal tax loss at $3 per 100-proof gallon in West Virginia alone was $511,224. That is figured from the average of liquor at 85 proof.

I would like the permission of the committee, Mr. Chairman, to introduce this little table, if I may.

The CHAIRMAN. Yes, sir.

Senator VANDENBERG. Do you relate the decrease entirely to the tax?

Mr. BACHMANN. Senator, there is no way of telling, but I think the major part of our decrease is due to the increased illicit distilling. In our mountain sections, we have 13 men on our enforcement unit continually.

Senator TAFT. That is not due to a decrease in drinking in West Virginia?

Mr. BACHMANN. No; I think it is on the increase.

The CHAIRMAN. You have had no decrease in population?

Mr. BACHMANN. No, sir.

Senator VANDENBERG. You ought to have, after that large amount of sale of moonshine.

Mr. BACHMANN. That is not true of West Virginia alone. If I may just take a minute to give you some startling information from the State of Virginia, I asked Colonel Bullington of the Virginia Alcoholic Beverage Control Board, who I think is one of the most outstanding men on the liquor control commissions in the country, the best advised man that I know of in that business, to give me the facts pertaining to the State of Virginia, and I was amazed when I saw what was happening down in the State of Virginia. For that period, before the 75-cent increase went on, the Federal and State agencies in the State of Virginia captured 1,325 stills, and after that tax went on, for the same period, they captured 1,771, or an

increase of 446 stills. Now, here are some startling figures. The value of stills, equipment, mash, and so forth, captured in the State of Virginia for the period before the tax went on was $426,686, and after the tax went on the value of stills, equipment, mash, and so forth, was $754,715, or a total increase in value of equipment, illicit distilling equipment captured by the Federal and State agencies in the State of Virginia of $328,028.

That shows this, that before these tax increases came on bootlegging in Virginia and West Virginia was on the decrease. We were not having any trouble with these illicit distillers. These figures in Virginia are significant of this. They show that the big moonshiner is getting back into the business again, because when they capture equipment amounting to that figure, in the hundreds of thousands of dollars, you have got the big distiller going back into the business, the illicit distiller.

Now, the Virginia State stores sold—coming back to Senator La Follette's question, the question that you asked Senator La Follette about West Virginia—for the period ending June 30, 1941, the Virginia State stores sold 2,850,786 gallons of distilled spirits. In the previous year the Virginia State stores sold 3,136,646 gallons, or a decrease after the last tax increase went on of 285,860 gallons. If you figure that at $3 per proof gallon, the tax that the Government was receiving on that amount of decrease, the Federal Government alone lost from the State of Virginia alone in revenue $728,943.

Now, I think in West Virginia and Virginia we could have anticipated, because of the defense program, an increase in business, an increase in the sale of liquor, of distilled spirits, but this worked just the opposite down there. Had that increase gone along in liquor of about 10 percent, which we have a right to assume from other businesses that have improved in those two States, figuring the 10-percent increase in business, the Federal Government would have lost by reason of that $3 tax $1,528,788 in the State of Virginia alone.

I would like to ask unanimous consent, Mr. Chairman, to introduce Colonel Bullington's letter. There is some valuable information on that question.

The CHAIRMAN. Yes, sir.

(The letter referred to is as follows:)

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL,
ALCOHOLIC BEVERAGE CONTROL BOARD,
Richmond, Va., August 19, 1941.

Hon. CARL C. BACHMAN,
Washington, D. C.

DEAR MR. BACHMAN: Referring to our telephone conversation this morning, and your reference to my letter to you of May 14, wherein I gave you certain information relative to still seizures and other data:

As I understand it, you would like for this information to be brought up to date, or to the end of our fiscal year, which was June 30, and you will probably use this in the hearing on the proposed increase of Federal taxes on liquor, which takes place tomorrow before the Senate Finance Committee in Washington.

Here in Virginia we realize it is necessary for the Government to increase the tax burden in order to raise the revenue necessary for the defense program. But it is our honest opinion that any increase in the tax on alcoholic beverage will not bring about any increase in revenue but will actually result in a decrease in the revenue the Federal Government is now receiving from that source.

Assuming that the Senate committee does not agree with this view and does put on an additional tax, the addition of as much as $1 a gallon will actually result in a great loss of revenue. Any amount over $1 per gallon would be ruinous insofar as the revenue from this source is concerned.

As you know, on July 1, 1941, the Federal Government placed an additional tax of 75 cents per gallon on all distilled spirits, and the Virginia Legislature, at its session in February 1940, added a 10-percent tax on distilled spirits to the retail price, to be effective July 1 of that year. For your information, I am listing below certain comparative figures for the 12-month period ending June 30, 1940, and for the 12-month period ending June 30, 1941:

	Number of stills seized	Value of stills equipment, mash	Number of raids
Fiscal year ended June 30, 1940	1,325	$426,686.60	9,879
Fiscal year ended June 30, 1941	1,771	754,715.05	14,339
Increase	446	328,028.45	4,460

These figures represent the joint operations of the Virginia A. B. C. Board and the Federal Alcohol Tax Unit. I understand that the Alcohol Tax Unit did some additional work, which is not included in these figures, and which will probably increase the totals by about 10 percent. I have omitted from this tabulation the number of investigations, since these activities are not a fair measure of increased enforcement.

For your further information, in the 12-month period ended June 30, 1941, Virginia State stores sold 2,850,786 gallons of spirits. In the previous fiscal year the Virginia stores sold 3,136,646 gallons of spirits. This is a decrease of 285,860 gallons. Assuming these spirits to be only 85 proof, the loss in gallonage at $3 per proof-gallon would be a loss in Federal taxes alone of $728,943. Assuming that without increased Federal and State taxes Virginia stores would have had an increase of approximately 10 percent in quantities sold—due chiefly to improved economic conditions and defense expenditures—the Virginia A. B. C. Board could reasonably have expected to sell 3,450,322 gallons of spirits, or an increase of 599,525 gallons. Assuming these spirits also to be an 85 proof at $3 a proof-gallon, the loss in Federal taxes may be estimated at $1,528,788.

From the above, you can get a pretty good picture of what the last increase in Federal taxes is doing to us in Virginia.

Aside from the question of revenue, as you know, a great many other law violations accompany bootlegging and moonshining, and I feel that we should not entirely lose sight of the social problem involved in this matter. Prior to July 1, 1940, we had eliminated most of the larger illicit operators of stills and were gradually going after the smaller ones. You can see from the above figures that after July 1940, when the additional tax was levied, not only was there an increase of 446 stills but the value of the equipment was about doubled, showing that the larger operators who had gone out of business were getting back into it, and we fear that these conditions will be still worse with the increased tax.

I feel that the monopoly association is very fortunate that you are in Washington to represent that particular group before the committee and wish to thank you for your willingness to accept such service.

With kind personal regards,

Very truly yours,

VIRGINIA ALCOHOLIC BEVERAGE CONTROL BOARD,
By R. McC. BULLINGTON.

Mr. BACHMANN. I have just one other matter and I am finished.

The CHAIRMAN. All right.

Mr. BACHMANN. I notice in the bill as it is now introduced there is no exemption for gallonage to the stores. When you put on the 25-percent increased tax there was an exemption in the bill of 250 gallons for each store. When you put on the 75 cents tax there was an exemption in the law of 100 gallons for each store. Now that is very important to all of us down there in our respective States, because the 13

members of this control association, in those 13 States combined, we have 2,841 stores and agencies, and if we would have the benefit of the same exemption in these stores that we had in the last law it would mean an exemption of 284,100 gallons of distilled spirits.

The reason for that is this: When this tax goes on we have to get out a new price list, and in some States to get out a price list, changing prices of liquor, it costs about $5,000, and in other States less. I think in Senator Taft's State it is about, if I am not mistaken, $1,500 to $2,000 to change the price list. I am not so certain about that amount, however, but it is near that figure. So if we had the benefit of the same exemption that we had in the previous acts, when you put on the tax increase, you would help the States to take care of the additional cost that this increase in tax will cause us.

Thank you, gentlemen.

Senator TAFT. Mr. Bachmann, have you any figures from Ohio?

Mr. BACHMANN. Senator, I do not.

Senator TAFT. Is bootlegging greater in the Mountain States than it is in the Plains States, do you think?

Mr. BACHMANN. I can give you the Federal figures on that for Ohio, if you would like to have it.

In Ohio, as shown by these figures that were obtained from the Treasury Department, still and mash seizures in Ohio for the year 1941 were 264, and for the fiscal year ending 1940 it was 322. You had a decrease in Ohio.

Senator TAFT. A decrease?

Mr. BACHMANN. Yes.

If I may be permitted, in the chairman's State of Georgia, for the fiscal year ending 1940, they captured 1,501 stills, and in the year ending 1941 they captured 1,939, or an increase of 29 percent in the illicit stills captured in the State of Georgia.

Senator BARKLEY. They have probably got better law enforcement in Georgia.

Mr. BACHMANN. Senator, I do not know. As I said, we have 13 enforcement officers down in West Virginia now, and we will have to put some more on, because as the tax goes on we encourage the illicit distillers to go back into the business and therefore we will have to increase our enforcement agencies.

Senator TAFT. Is there a State tax in West Virginia?

Mr. BACHMANN. No; there is no State tax in West Virginia.

Virginia levies a 10-percent tax, but the State of West Virginia levies no tax.

Senator TAFT. What does that come to in gallons?

Mr. BACHMANN. That comes to about 10 cents on a proof gallon in tax.

Senator TAFT. That is after the Federal Government puts on a tax?

Mr. BACHMANN. That is right. We put nothing on in West Virginia by way of a tax.

Senator TAFT. Mr. Chairman, I think it would be interesting if the Treasury or our committee would give use the actual results of this last increase as compared to what their estimates were at that time, whether the actual results have been less than the estimated increase.

The CHAIRMAN. We will take that up, Senator, in executive session. Can you answer it now, what Senator Taft would like to have?

Senator TAFT. I do not mean right now.

Mr. BACHMANN. Senator, I do not know anything about the liquor business. I cannot answer these general questions. All I know is what I learned down there as a member of our commission, in the State of West Virginia.

The CHAIRMAN. Perhaps the Treasury might answer now, if you have it.

Mr. RAY. No, we do not, Senator; but I will look into that immediately.

The CHAIRMAN. All right. Thank you, Mr. Bachmann.

(The tables submitted by Mr. Buchmann are as follows:)

Comparative analysis of activities, combined Federal and State enforcement divisions, for fiscal years ended June 30, 1940, and June 30, 1941

	Fiscal year ended June 30, 1940	Fiscal year ended June 30, 1941	Total increase	Percent of increase
Cases and investigations:				
Federal	378	509	131	34.7
State	383	847	464	121.1
Total	761	1,356	595	78.2
Arrests:				
Federal	585	759	174	29.7
State	266	354	88	33.1
Total	851	1,113	262	30.8
Stills seized:				
Federal	210	293	83	39.5
State	36	365	329	913.9
Total	246	658	412	167.5
Gallons whisky seized:[1]				
Federal	1,141	1,644	503	44.1
State	550	1,140	590	107.3
Total	1,691	2,784	1,093	64.6
Gallons mash seized:[1]				
Federal	24,201	37,806	13,605	56.2
State	2,905	48,763	45,858	1,578.6
Total	27,106	86,569	59,463	219.4

[1] Illegal manufacture of whisky upon which no tax has been paid.

EXHIBIT 1-A.—*Comparative analysis of activities, enforcement division, West Virginia Liquor Control Commission, for fiscal years ended June 30, 1940 and 1941*

Month	Investigations			Arrests			Stills seized			Gallons whisky seized [1]			Gallons mash seized [1]		
	1939	1940	Percent increase or decrease	1939	1940	Percent increase or decrease	1939	1940	Percent increase or decrease	1939	1940	Percent increase or decrease	1939	1940	Percent increase or decrease
July	21	58	176.2	16	37	131.2	-------	17	----------	137	76	—44.5	-------	2,055	----------
August	10	34	240	2	14	600	-------	16	----------	-------	57	----------	-------	2,078	----------
September	5	68	1,260	1	10	900	-------	30	----------	88	223	153.4	-------	3,450	----------
October	39	65	66.7	14	8	—42.8	-------	34	----------	25	74	196	-------	4,055	----------
November	56	47	—16.1	51	5	—90.2	-------	19	----------	2	95	4,650	-------	3,020	----------
December	49	74	51	43	45	4.6	3	23	666.7	9	119	1,222.2	450	4,553	911.8
	1940	1941		1940	1941		1940	1941		1940	1941		1940	1941	
January	51	84	64.7	34	42	23.5	1	45	4,400	-------	-------	----------	-------	722	----------
February	34	62	82.3	27	26	—3.7	-------	32	----------	-------	81	----------	-------	6,125	----------
March	50	120	140	42	68	61.9	3	39	1,200	35	146	317.1	-------	5,450	----------
April	9	99	1,000	1	47	4,600	13	49	276.9	213	136	—36.2	760	7,535	891.4
May	19	57	200	6	19	216.7	10	29	190	26	60	130.8	1,025	4,510	340
June	40	79	97.5	29	33	13.8	6	32	433.3	15	73	386.7	670	5,210	677.6
Total	383	847	121.1	266	354	33.1	36	365	913.9	550	1,140	107.3	2,905	48,763	1,578.6

[1] Whisky illegally manufactured upon which no tax has been paid.

EXHIBIT 1–B.—*Comparative analysis of activities, Federal Enforcement Division in State of West Virginia, for fiscal years ended June 30, 1940 and June 30, 1941*

Month	Cases			Arrests			Stills seized			Gallons whisky seized [1]			Gallons mash seized [1]		
	1939	1940	Percent of increase or decrease	1939	1940	Percent of increase or decrease	1939	1940	Percent of increase or decrease	1939	1940	Percent of increase or decrease	1939	1940	Percent of increase or decrease
July	25	50	100	42	84	100	9	37	311.1	68	121	77.9	960	4,020	318.7
August	42	57	35.7	65	70	7.7	15	23	53.3	204	223	9.3	2,036	2,340	14.9
September	23	44	91.3	33	68	106.1	16	19	18.8	33	210	536.4	1,940	2,676	37.9
October	32	35	9.4	52	88	69.2	23	22	−4.3	59	125	111.9	3,260	2,915	−10.6
November	30	34	13.3	47	50	6.4	16	21	31.3	113	125	10.6	1,855	2,395	29.1
December	34	48	41.2	50	73	46.0	25	24	−4.0	89	190	113.5	3,005	4,535	50.9
	1940	1941		1940	1941		1940	1941		1940	1941		1940	1941	
January	17	53	211.8	31	60	93.5	9	36	300	47	104	121.3	725	3,335	360
February	36	32	−11.1	49	52	6.1	16	20	25	99	139	40.4	3,330	2,940	−11.7
March	42	55	31	53	70	32.1	21	24	14.3	183	142	−22.4	1,295	3,375	160.6
April	27	35	29.6	61	64	4.9	19	22	15.8	101	69	−31.7	2,735	3,390	23.9
May	26	40	53.8	32	37	15.6	17	28	64.7	93	76	−18.3	1,310	4,270	225.9
June	44	26	−40.9	70	43	−38.6	24	17	−29.2	52	120	130.7	1,750	1,615	−7.7
Total	378	509	34.7	585	759	29.7	210	293	39.5	1,141	1,644	44.1	24,201	37,806	56.2

[1] Whisky illegally manufactured upon which no tax has been paid.

EXHIBIT II.—*Comparative analysis whisky and mash seizures by Federal and State enforcement divisions, fiscal years ended June 30, 1940, and June 30, 1941*

	Fiscal year ended June 30, 1940	Fiscal year ended June 30, 1941	Total increase	Percent of increase
Total whisky seized: [1]				
Gallons	1,691	2,784	1,093	64.6
Value	$5,073.00	$8,352.00	$3,279.00	64.6
Total mash seized: [1]				
Gallons	27,106	42,668	15,562	57.4
Value	$16,263.60	$25,600.80	$9,377.20	57.4
Total value of seizures	$21,336.60	$33,952.80	$12,616.20	59.1

[1] Illegal manufacture of whisky upon which no tax has been paid.

EXHIBIT III.—*West Virginia distilled spirits sales (gallons) before and after 1940 Federal-tax increase, July 1, 1940*

Month	1939	1940
July	141,179	122,982
August	140,898	148,663
September	136,329	132,503
October	164,525	154,733
November	176,322	174,400
December	245,018	207,417
	1940	1941
January	157,680	145,681
February	160,116	143,284
March	178,516	157,124
April	158,185	139,829
May	168,317	146,972
June	162,398	135,415
Total	2,009,483	1,809,003

Decrease 200,480 gallons; 9.97 percent.
Federal-tax loss at $3 per 100 proof gallon, $511,224 (figured from the average of 85 proof).

Number of stores and agencies in monopoly States and total floor stock exemption at 100 gallons per store or agency

State [1]	Number of stores and agencies	Total floor stock exemption at 100 gallons per store or agency	State [1]	Number of stores and agencies	Total floor stock exemption at 100 gallons per store or agency
Alabama	56	5,600	Oregon	145	14,500
Idaho	124	12,400	Utah	105	10,500
Iowa	175	17,500	Virginia	99	9,900
Maine	40	4,000	West Virginia	134	13,400
Michigan	1,517	151,700	Wyoming	1	100
Montana	157	15,700			
New Hampshire	37	3,700	Total	2,841	284,100
Ohio	251	25,100			

[1] Members of National Alcoholic Beverage Control Association.

The CHAIRMAN. Mr. Fontenot.

STATEMENT OF RUFUS W. FONTENOT, BATON ROUGE, LA., COLLECTOR, DEPARTMENT OF REVENUE OF THE STATE OF LOUISIANA

Mr. FONTENOT. My name is Rufus W. Fontenot, Baton Rouge, La., collector, Department of Revenue.

The CHAIRMAN. You may proceed, Mr. Fontenot, with your statement.

Mr. FONTENOT. Thank you, sir.

As the chief revenue collecting officer of the State of Louisiana, I have asked permission to appear before your committee to tell you briefly of my State's attitude toward any further change in the Federal taxes on liquor.

I do not feel that I come before you as an amateur in such matters, since in the last 25 years I have had considerable experience in the regulation and taxation of the liquor business. I have served twice as United States collector of internal revenue and once as Federal prohibition administrator for my State, in addition to my present service as Louisiana State collector of revenue. I feel that my many years in these fields of activity give me a knowledge and experience which make my comments worthy of consideration.

In connection with the imposition of excise and license taxes, it has been the experience of many States that on certain luxury commodities, a saturation point may be reached beyond which an increase in the tax levied will almost certainly produce a loss of revenue. It is elementary to say that this is due to the unfailing effect of the law of diminishing returns. The economic ability of the liquor industry to merchandise its products under the burden of a tax load that makes consumption economically undesirable to the purchasing public is now being tested to a far greater degree than ever before.

More and more States are relying on the revenues derived from liquor taxes for a large portion of their operating revenues. As a result, the liquor business is compelled to carry the constantly increasing tax burden. It is obvious that at some point in the schedule of tax rates, gallonage consumption will begin to drop to such an extent that the revenue realized will be less than that formerly obtained through a smaller tax rate.

While it is not the desire of any State to be guilty of anything which might be considered failure to cooperate with the national-defense program of the Federal Government, we feel that the revenue problems of the States must be given every possible consideration. As our national emergency grows graver by the hour so do the responsibilities and duties of the States grow heavier and more expensive. The Federal Government alone cannot assume and carry the full load of the national-defense program in all of its component parts. The States must increase their police services, their fire prevention and control services, their health services, their hospitals, their employment facilities, and all of the other numerous activities which are considered essentially local activities of the States but which are unquestionably a vital part of the operation of this Nation in the present emergency.

We who represent State governments are well aware of the difficult financial problems which now face the National Government. We desire to do everything we can to cooperate in solving those problems. But we feel that extreme caution must be exercised in order to avoid imposing a levy which will have the effect not only of reducing the Federal income from the source against which it is levied, but will also have a devastating effect on one of the few remaining reservoirs from which the States may derive the income necessary for their essential governmental functions. We feel that this is assuredly true in the case of liquor taxes. In my State alone a small increase in tax has already resulted in a decrease in gallonage. While the decrease is as yet negligible, it is to me a clear indication of the dangerous quicksand which lies in the direction of additional liquor taxes. I feel confident that any further increase in liquor levies will bring about a decrease in consumption which will be sufficient to reduce the revenue collected.

An interesting fact to remember in connection with this experience in Louisiana, is that my State, according to authoritative reports, until recently consumed more liquor per capita than any other State in the Union. In spite of this fact, a small change in the tax rate has already produced a decrease in consumption.

I should like to call your attention to another potential effect on an increase in the liquor tax. Taxation can bring prohibition or partial prohibition just as surely as the passage of a statute. The people of this country have clearly indicated that the majority of them are opposed to prohibition. Thereby, by increasing taxes you may bring about partial prohibition even though this result is contrary to the wishes of the people.

I might add here that one-third of the parishes in the State of Louisiana have gone dry in the last year.

It seems obvious to me that an increase in the tax rates on liquor must of necessity bring about an increase in retail prices. Naturally, an increase in cost means that the average purchaser will, in all probability, reduce the quality of the merchandise he buys. He will do this not because he wants to, but because the amount which he can spend on liquor will require it. This is particularly true when we stop to consider that many Federal taxes are being levied now with the purpose of reducing the amount the average citizen may spend for luxuries. If we carry the taxation feature to an extreme, we will certainly cause such a lowering in the quality of the average merchandise as to encourage the return of the illicit liquor traffic. Such ventures are not profitable enough now to justify their existence on a large scale. But, if the tax rate and the retail prices are increased sufficiently, then the illegal liquor business will be profitable enough to justify its risks.

This result carries with it, in addition to its partial prohibition aspect, another very dangerous feature. If the illegal traffic returns, both the Federal and State Governments will be faced with an enforcement problem of increasing seriousness and, consequently, an increasingly heavy expense in connection with enforcement. It can very easily be true that the cost of enforcement alone will exceed the revenue collected as a result of an increased tax. This, I am sure, neither the Federal nor the State Governments desire.

In conclusion, let me urge as strongly as I may that you give consideration to these facts: An increase in the liquor tax which is too

large will, in my opinion, inevitably lead to a reduced revenue from this source; a form of partial prohibition which is foreign to the wishes of the majority of our people; and a fiscal problem for the State governments which may be insurmountable without considerable Federal assistance, which would, of course, nullify completely and irrevocably any increase in revenues the Federal Government might gain.

Let me remind you that I speak to you as a revenue official of one of our States and not as a representative of any liquor interest or interests. These opinions are my own and are given you with the sole idea of presenting the case for the States in general, and my State in particular.

Thank you, sir.

The CHAIRMAN. Are there any questions?

Senator VANDENBERG. Do you supervise the gas-tax collection also?

Mr. FONTENOT. Yes, sir.

Senator VANDENBERG. How does the total gas tax compare with the total liquor tax?

Mr. FONTENOT. The gas tax total and liquor tax are about the same.

Senator VANDENBERG. If there is a general Nation-wide curtailment in gasoline consumption does not that involve a very serious hazard to State revenues everywhere?

Mr. FONTENOT. Yes; I am sure it does, in my State particularly, because from the severance tax, which is the tax on every commodity severed from its natural habitat, like gravel, oil, sulfur, all of the things produced in Louisiana, the amount we collect from the severance tax and gasoline tax amounts to over one-third of our revenue in the State of Louisiana. We get about $24,000,000 out of the severance tax and out of the gasoline tax.

Senator VANDENBERG. And a reduction of one-third, an arbitrary reduction of one-third in gasoline consumption, would automatically reduce your revenue by one-third?

Mr. FONTENOT. That is right; yes.

Senator VANDENBERG. That is all.

The CHAIRMAN. Thank you very much.

Mr. Childs.

STATEMENT OF RANDOLPH W. CHILDS, PHILADELPHIA, PA., REPRESENTING PENNSYLVANIA ALCOHOL BEVERAGE STUDY, INC.

The CHAIRMAN. All right, Mr. Childs, you may proceed.

Mr. CHILDS. Mr. Chairman and gentlemen, I am the executive director and counsel of a nonprofit organization known as the Pennsylvania Alcoholic Beverage Study, Inc., which was formed in the spring of 1940.

Its purpose is to study conditions in the alcoholic beverage field in Pennsylvania, to cooperate with Federal, State, and municipal authorities in the enforcement of laws and regulations relating to alcoholic beverages and to recommend improvements in existing laws and practices in order to maintain in the State of Pennsylvania a sound and effective system of alcoholic beverage control.

The president of this organization is Laurence H. Eldredge, of Philadelphia, who is professor of law in the law school of the University of Pennsylvania, a legal writer and associated with various civic movements including the Better Business Bureau of Philadelphia of which he is president.

Among our directors are the Right Reverend Alexander Mann, of the Protestant Episcopal Church, bishop of Pittsburgh; W. W. Montgomery, Jr., of Philadelphia, a lawyer and a former law partner of Mr. Justice Owen J. Roberts; Leon J. Obermayer, of Philadelphia, lawyer and member of the Board of Education of the city of Philadelphia; Thomas W. Phillips, of Butler, president of the T. W. Phillips Gas & Oil Co. and a former Member of Congress; Raymond Pitcairn, of Philadelphia, president of the Pitcairn Co., a publicist and the builder of the Bryn Athyn Cathedral; and W. Chattin Wetherill, of Philadelphia, a director of student welfare of the University of Pennsylvania and vice president of Franklin Institute.

From time to time this organization has published its findings and recommendations on various subjects, such as central licensing; support of the Pennsylvania Quota Act of 1939, limiting the number of retail licenses to 1 to each 1,000 of population; disposition by the courts of appeals from orders of the liquor control board; limitations on transfers of retail liquor licenses; suppression of bootlegging, and the need for cooperation of local police authorities in law enforcement.

We wish now, for the first time, to record our apprehension of the dangers which we think are inherent in the plan of taxing liquor to the point where social evils, crime, and racketeering will return to create an important national problem which up to now we thought was solved by the repeal of the eighteenth amendment.

In fixing the tax on distilled spirits it is important to consider the taxes already placed on this commodity. These taxes, which ultimately are borne by consumers, include the Federal liquor tax of $3 per gallon (an increase of 50 percent over the post-repeal tax of $2 per gallon), a State tax averaging about $1 a gallon, and miscellaneous license taxes. In Pennsylvania the monopoly system obtains and while no State tax is imposed upon liquor purchased by the monopoly, the liquor-control board imposes a mark-up (now 55 percent) on the cost price of liquor, and subjects the sale price to a 10 percent emergency tax. Small wonder that it has been said that a person drinking legal liquor drinks more taxes than liquor.

There is a grave danger that increased Federal excise taxes on liquor will result in liquor prices which are prohibitive. When such a price level is reached, consumers of liquor will turn to the bootlegger.

I do not wish to be understood as condoning the conduct of any citizen in purchasing illegal liquor. However, we are confronted not with a theory but with a condition. Illegal liquor can be produced and sold at about one-fourth the present price of legal liquor. If prices of legal liquor become prohibitive, a large group of citizens will resort to bootleggers with attending loss of revenue to Federal and State Governments and the revival of the widespread racketeering and corruption of public officials which darkened the prohibition era.

The probability of an enormous illegal liquor trade following prohibitive liquor prices is enhanced by the fact that there is already a nucleus of illicit liquor traffic which will expand as opportunity for profit increases.

It is estimated that about 1,095,000 gallons of 60-percent proof illegal spirits are brought into Philadelphia each year. It is also estimated that about 400 to 500 gallons of "moonshine" are produced daily in the Philadelphia area alone. This amount of "moonshine" can be produced every 24 hours by about 35 house-pot stills. At 500 gallons per day this "moonshine" would amount to about 182,500 gallons per year. "Alky" and "moonshine" would thus aggregate 1,2 7,500 gallons, which would be about 10 percent of all legal liquor sold in Pennsylvania (about 12,500 000 gallons). The above estimate covers only the Philadelphia district. If anyone claims that our figures for this district are too high, the apparent amount of illegal liquor sold in the remainder of the State, especially in the counties of Allegheny, Schuylkill, Luzerne, and Lackawanna, will show the conservatism of my estimate that from 5 to 10 percent of all liquor sold in the State of Pennsylvania is illegal.

The existence of a substantial percentage of bootleg liquor in Pennsylvania does not reflect upon the agents of the Federal Alcohol Tax Unit or upon the agents of the Pennsylvania Liquor Control Board. Necessarily the Federal agents are primarily concerned with large-scale distilling and transportation. The Federal agents in conjunction with the State agents have substantially driven the large illegal distiller out of business in Pennsylvania. The State agents are limited in number. Thus some 40 agents are available in the first enforcement district comprising five populous counties. There is one such agent for about each 70,000 of population. The difficulties of apprehending and convicting small violators are tremendous. In many districts throughout the State the local police are inactive in apprehending and prosecuting offenders engaged in the manufacture, transportation, sale, and possession of illegal liquor.

The average citizen in Pennsylvania would prefer to purchase liquor from the State stores. Many citizens have a natural aversion to dealing with bootleggers and the seal of the State stores insures the purity and genuineness of liquor purchased at the State stores. On the other hand, if legal prices mount to a point which the average liquor consumer cannot afford to pay, many citizens will be induced to patronize bootleggers. In the last analysis, observance of any law depends upon the feeling of the average citizen that the law is just and not upon the fear of legal sanctions. It is so with the liquor law. The drinking of liquor can no more be stopped by excessive taxes than it could be wiped out by national prohibition. Indeed, if Federal liquor taxes are excessively increased, such taxes can in effect restore national prohibition. It is important that increases of taxes do not drive liquor prices to a peak which creates resentment on the part of the consuming public. The need is for a tax which the consuming public will accept as fair in view of the defense needs of the United States.

The new revenue act, which is now being formulated by your committee, will impose such additional heavy burdens upon the average citizen that he will be obliged to completely readjust his method of

living. Many citizens will feel that after making enormous sacrifices in their standard of living in order to pay high taxes to the Government, they cannot be blamed for patronizing bootleggers who sell liquor for less than one-third the cost of taxed liquor.

I have no hesitation in expressing the opinion that fair liquor prices, which in turn depend upon fair liquor taxes, constitute the supremely important factor both in good enforcement and sound revenue policy.

It has already been noted that the illicit operator in Pennsylvania is a small operator. While his operating profit is high he must "fix" the outlets for the sale of his products. However, as his margin of net operating profit increases, as would be the case if alcoholic-beverage taxes are substantially increased, the illegal operator can afford to pay greater protection. The prospect of tremendous profit will attract the large-scale operator and gangster, who of recent years have practically withdrawn from the scene. An example of extensive illegal enterprises is today found in the so-called "numbers racket" which flourishes in certain populous communities. The profits from such rackets are sufficiently large to attract the well-financed criminal into the field. Such large-scale criminals will enter the illegal alcoholic-beverage field if and when liquor prices become prohibitive as a result of excessive taxes. It is unnecessary to enlarge upon the evils which accompany the conduct of the illicit liquor traffic when conducted on a vast scale.

The members of your committee will realize that taxes on liquor, unlike taxes on other commodities, can be evaded by the substitution of illegal products. This is shown by the experience of 13 years of national prohibition. Alcoholic-beverage taxes are peculiarly subject to an inexorable law of diminishing returns which is that as the margin of profit to the illicit operator increases, sales of the legal purveyor will decrease with a consequent loss of revenue to the taxing authorities.

Senator VANDENBERG. I call your attention to the sentence on page 4 of your statement, which says:

> The need is for a tax which the consuming public will accept as fair in view of the defense needs of the United States.

What tax on liquor do you think the consuming public would accept as fair in view of the defense needs of the United States?

Mr. CHILDS. Senator, of course, we all realize the tremendous need of our Government for revenue in order to carry on the vital project of national defense. I would say this, that if possible the present tax on alcoholic beverages, on spirits, which has been increased from $2.25 to $3, should not be increased, because we have reached what I consider the danger zone. So if you ask me my opinion, I would say it should not be increased. but I haven't the responsibility of a Senator of the United States. I do not know but what, when you gentlemen weigh the various factors that are here involved, you may find it necessary to make some increase. All I am trying to do is to point out, as the result of actual observation and experience, that if you raise the tax at all, you are getting into the danger zone. I hope if you raise it at all you will raise it as little as you, with your vast responsibility, find it possible.

Senator VANDENBERG. I think your observations are very important. I am not quarreling with your conclusions, but I was struck with your suggestion that there might be some tax on liquor which the consuming public would accept as fair, as you said in view of the defense needs of the United States. I wondered how far you would go and still be fair as far as the public opinion is concerned.

Mr. CHILDS. I would say this, Senator: My own feeling about it is that the tax we have now of $3 a gallon must be considered fair. I see a good side to the proper, the moderate, use of alcoholic beverages. I know it will go on. It is better to have a regulated liquor traffic than an unregulated liquor traffic. I feel at the present time the people ought to be willing to sacrifice, to pay the present tax, if they can do anything to save our country in this hour of peril.

Senator BARKLEY. Let me ask you this: An increase of the tax from $3 to $4 a gallon represents an increase of 25 cents a quart, does it not?

Mr. CHILDS. Yes.

Senator BARKLEY. And 12½ cents per pint.

Mr. CHILDS. Yes.

Senator BARKLEY. Do you know whether, and if so to what extent, those who are engaged in the distribution of the liquor to the public, that is the retailer, whether they add anything to that tax in the price that they get for their commodities? When the individual purchases it, for instance, if this dollar tax were added it would add, theoretically and actually if only the tax is added, 12½ cents a pint. You cannot split a penny, you either get 12 cents or 13 cents or maybe 15 cents. To what extent, if you know, does any retailer selling liquor by retail add more than the tax which is represented, we will say, by an increase of a dollar a gallon?

Mr. CHILDS. I think, Senator, he does add more in most cases, because of the fact that he has been trained, as every businessman is trained, to add a mark-up on his cost. I think the answer is "Yes," Senator.

Senator BARKLEY. You do not know how much?

Mr. CHILDS. No. Take in the State of Pennsylvania, for example, in the case of our monopoly there, the Pennsylvania State Liquor Store, the board adds about 55 percent to the cost of the liquor, which cost would include taxes. Now, I might say frankly, we propose in the next 2 weeks to make a strong plea to the State liquor board to lower the mark-up, so that in effect it will not be imposing a mark-up on emergency taxes imposed by the Federal Government. I would say as a matter of accounting practice, leaving aside people who want to profiteer, I do not think the State of Pennsylvania wants to profiteer or make too much money, even though they start out with the form of imposing their mark-up on the cost, which includes taxes.

Senator BARKLEY. That is all.

Mr. CHILDS. Thank you, very much.

The CHAIRMAN. Thank you, sir.

Mr. O'Rear.

STATEMENT OF JAMES B. O'REAR, REPRESENTING BUFFALO SPRINGS DISTILLING CO., STAMPING GROUND, KY.

Mr. O'REAR. My name is Jim O'Rear. I am president of the Buffalo Springs Distilling Co., a small, independent Kentucky distillery. I have been requested by the Kentucky Distillers Association and by the Distilled Spirits Institute, producers and owners of more than four-fifths of the distilled spirits of the United States, to outline to you the attitude of the industry as represented by these associations toward the proposed increase in the excise tax on distilled spirits.

The distilled-spirits industry is not only ready but is desirous of doing everything it possibly can for national defense. The industry, which after all is only a tax collection agency so far as excise taxes are concerned, can collect for the Government only such taxes as consumers are willing to pay.

In fixing the rate of excise tax on distilled spirits, certain facts and factors must be kept in mind which are peculiar to this industry.

In most other industries the imposition of excise taxes involves the sole problem of determining the maximum revenue producing point. It is just a question of whether the rate of tax results in a price which the consumer will pay for the product or whether because of the tax the consumer will elect to do without the product.

In the distilled-spirits industry, however, there is an entirely different and much more difficult problem. In considering the rate of excise tax on distilled spirits, there must be kept in mind the fact that so long as the laws of nature exists and so long as there are sugars and starches in existence the demand for distilled spirits will be supplied.

This was made abundantly clear to the American people during the ill-fated prohibition era. The problem in considering a rate for excise taxes on distilled spirits, therefore, is not whether the consumer will buy the product or do without it but is whether the consumer will buy the tax-paid product or the illicit product.

An excessively high rate of tax on distilled spirits is just as sure to re-create the illicit industry as the reenactment of statutory prohibition.

If the excise tax rate on distilled spirits is raised to the point where sufficient subsidy is given to the now disorganized racketeering mobs which flourished during the prohibition era, those disorganized mobs will most certainly be brought back to life and the country will be again faced with the scandals and mob law enforcement problems with which it was faced during the era of the eighteenth amendment .

I need not elaborate on the law-enforcement problems or on the attendant evil effects on the young people of the country which resulted from prohibition and it is our sincere hope that this condition will not be revived in the form of prohibition by taxes on distilled spirits.

We do not believe that it is our function or our right to tell the committee at what point the excise taxes bring about the prohibition evils.

We do feel, however, that it is our duty to advise the committee of facts from which it may draw a sound conclusion in this regard. I have with me Mr. Howard Jones, of the Distilled Spirits Institute, who will present to the committee various facts, figures, and charts which show the effect of the various increases in the distilled-spirits excise taxes which have occurred since repeal of the eighteenth amendment.

Mr. Jones' figures deal with both State and Federal taxes. I am sure these will be enlightening to the committee. I only want to call attention to two things—(1) that not only is the Federal Government dependent on the excise tax on distilled spirits for a substantial portion of its revenue but that the State governments are also dependent on the excise tax on distilled spirits for a substantial portion of their revenue.

Prior to prohibition this situation did not exist. During all of the years prior to prohibition the Federal Government was the only governmental entity that levied an excise tax on distilled spirits.

It must be kept in mind that whenever the Federal tax depresses the volume of business, even though the total Federal tax collections increase, the State revenue is proportionately decreased.

Thus, any Federal tax which depresses consumption is incentive to the States to maintain their gross income by increasing the State tax rate; and unless we are very careful we are liable to create a vicious circle of taxation which, taken as a whole, will create prohibition by taxation even though the Federal rate standing by itself may not be sufficient to result in a real subsidy to the bootlegger; (2) after the last increase in tax, there was virtually no increase in total consumption of distilled spirits despite the fact that national income rose materially.

Mr. Jones will give you the figures but it is my recollection that with national income increasing 10 percent the consumption of distilled spirits increased only 1.6 percent. This leveling off of consumption would indicate that possibly the saturation point has been reached in the excise tax on distilled spirits.

The $1 increase now proposed may be a dangerous dollar. That is something for this committee to determine. I trust that you will analyze the figures which Mr. Jones will give you carefully and that they will be helpful to you.

In conclusion I want to call the attention of the committee to the fact that America is now faced with a hidden danger in its defense program. Any real subsidy to the racketeering mobs through a tax on distilled spirits would, I am afraid, create a real danger to national defense.

In this connection, if in your wisdom you should find it proper to impose the $1 tax or any portion thereof, it is respectfully suggested that the matter be called to the attention of the Appropriations Committee so that they may give some additional appropriation to the law enforcement authorities, particularly to the Alcohol Tax Unit which is charged with the duty of policing illicit production and distribution of distilled spirits.

In this connection, your attention is directed to a circular, copy of which is filed for the record, issued by the Alcohol Tax Unit and covered by Treasury Department news release of August 12, 1941.

seeking cooperation of sugar refiners, brokers, and wholesalers, in keeping sugar out of bootleggers' hands.

Mr. Chairman, I would like to have your permission to introduce this circular as part of the evidence.

The CHAIRMAN. Yes; you may.

Mr. O'REAR. It was issued by the district supervisor, Alcohol Tax Unit, New York City.

The CHAIRMAN. You may do so; yes, sir.

Any questions, gentlemen?

Senator BARKLEY. May I ask Mr. O'Rear the question I asked Mr. Childs a while ago, if he can answer? To what extent, if at all, any retailer is calculated to add more than the tax to the bottle of whisky which he sells to the ordinary consumer who buys it over the counter.

Mr. O'REAR. Senator Barkley, in the commerce of the liquor industry it is the fairly universal custom that the average mark-up, through the channel which liquor is distributed—and that is very carefully regulated by the Treasury Department—the distiller sells to the wholesaler and in most instances the wholesaler takes the average mark-up of about 15 percent, and the wholesaler sells to the retailer and the retailer takes an average mark-up of about 33⅓ percent, or, roughly, a 50-percent mark-up upon your taxes. In the State stores of monopoly States—some 17 of them—I think the average mark-up is approximately 50 percent.

Senator BARKLEY. In other words, we will take liquor that has been in bond 4 years and is bottled—the tax is paid at the time the liquor is removed from the bonded warehouse and bottled; let us suppose it bears a $4 tax, that tax is added to the other costs of the production, and the wholesaler pays the distillery sales price plus the $4 tax; is that correct?

Mr. O'REAR. That is correct.

Senator BARKLEY. Now, the wholesaler then adds his profit based upon a percentage of what he has paid, and that percentage is added to the tax.

Mr. O'REAR. That is correct.

Senator BARKLEY. No; that is to the original cost of the liquor. So there is a pyramiding process there by which everybody who handles it—whether his mark-up is 10 percent or 50 percent, or 20 or 25 percent—everybody who handles it bases his mark-up on the cost to him, and that cost includes the tax, and the greater the tax the greater the mark-up. That is true, is it not?

Mr. O'REAR. That is right.

Senator BARKLEY. So the average mark-up by the time the ordinary consumer gets it, based upon the price that the wholesaler paid for it, is about 50 percent?

Mr. O'REAR. The retailer's mark-up is 33⅓ percent. The total mark-up on the tax is about 50 percent.

Senator BARKLEY. That is what I mean—from the time it leaves the distiller until it gets to Dick, Tom, and Harry.

Mr. O'REAR. Yes, sir.

Senator VANDENBERG. Would it be possible to control that mark-up pyramiding of the tax by requiring that the tax be carried as a separate item on the bill from start to finish?

Mr. O'REAR. That presents a great many difficulties, Senator. I would not be prepared to state that. In the American system of commerce, where any excise tax is imposed, it is customary in all lines that the mark-up shall be on the entire cost of the product, including the tax, whether it is an excise tax or hidden tax.

Senator VANDENBERG. I do not see any theory by which State sales taxes are protected against mark-up by being carried as a specified item, why that same theory could not be applied to this tax from start to finish on liquor.

Mr. O'REAR. In the handling of our distilled spirits, in the channels of commerce, we are very strictly regulated, including the line of questions that you are proposing. The State stores do not have that regulation applied to them, and they are able to make their own laws and regulations to suit themselves for their own business, which is different from that which we use, and they impose a sales tax which is different from an excise tax.

Senator TAFT. On the cheap whisky what, roughly speaking, proportion of the price is taxed when it goes to the wholesaler?

Mr. O'REAR. Based upon today's tax rate, the withdrawal tax is $9 per case or $3 per gallon on cheap whisky that would sell at $15 per case to the wholesaler.

Senator TAFT. That is $6 for whisky and $9 for the tax?

Mr. O'REAR. $6 does not represent the whisky. It represents hidden taxes, costs, and various and sundry other things, but $9 of that price is the tax.

Senator TAFT. For $15 a case, $9 is Federal tax, or 60 percent, roughly?

Mr. O'REAR. Yes.

Senator TAFT. And if this is made $12, of course, that would be two-thirds, or 66 percent?

Mr. O'REAR. Yes.

Senator GUFFEY. How old is that cheap whisky that we are talking about? Is it blended by the time the consumer gets it?

Mr. O'REAR. Senator, at that price some of it may be 4 years old and some of it may be blended.

Senator GUFFEY. All right.

The CHAIRMAN. Thank you, Mr. O'Rear.

(The circular referred to by Mr. O'Rear is as follows:)

SUGAR—THE LIFEBLOOD OF ILLICIT DISTILLING

Since all alcohol is produced through the processes of fermentation and distillation from sugar, sugar is the one absolute essential which an illicit distiller is dependent upon for his existence when operating in any thickly populated areas. Deprived of it, his theft of taxes so sorely needed to support the national-defense program would cease.

Sugar is used by bootleggers in the preparation of mash in the general proportion of one 100-pound bag to each 50 gallons of mash. On distillation, such mash may be expected to produce about 6½ gallons of 95-percent alcohol, or 190° proof. Since the Federal tax is $6 on each gallon of pure 200° proof alcohol, each bag of sugar so used represents a loss to the Federal Government of $37.05. Any State taxes evaded represent so much additional public loss.

The average sugar dealer at the present time (July 1, 1941) enjoys a profit of approximately 10 cents on the sale of a bag of sugar. Consider the figures:

1 bag of sugar:		
Dealer's profit	$0.10	
Tax loss to United States		$37.05
		37.05
		.10
Our net loss		36.95

Any comment here on such a balance sheet would be a gross insult to native American business intelligence. Then help us to keep sugar out of bootleggers' hands; cooperate by refusing to sell sugar in quantity to suspicious or unknown persons; obtain automobile license numbers and notify district supervisor, Alcohol Tax Unit, Federal Building, 90 Church Street, New York N. Y. Telephone, Rector 2-9100.

The CHAIRMAN. Mr. Jones.

STATEMENT OF HOWARD T. JONES, WASHINGTON, D. C., GENERAL COUNSEL, DISTILLED SPIRITS INSTITUTE, INC.

Mr. JONES. My name is Howard T. Jones, of Washington, D. C. I am general counsel of the Distilled Spirits Institute, a trade association of distillers of the United States.

The distilled-spirits industry, like every other American industry, is ready and willing to do everything it possibly can for national defense. The industry—which is, after all, only a tax-collecting agency so far as excise taxes are concerned—can collect for Government only such taxes as consumers are willing to pay.

As has been stated by Mr. O'Rear, we are not here to complain about the present burden of the industry nor are we going to protest any increase which this committee determines is appropriate after considering all factors involved. However, we would be derelict in our duty as a tax-collecting agency if we did not place before the committee pertinent information which we possess bearing on our tax problem.

We fully appreciate that one of the moving influences in bringing about repeal of the prohibition amendment was the expectation of revenue from taxation of alcoholic beverages, and it is our desire that Government, State and Federal, receive their measure of benefit from their local sale.

We respectfully submit for the consideration of the committee the known fact that the product of the distilled-spirits industry is peculiarly subject to the competition of the illicitly produced non-tax-paid product—a condition not a factor in any other substantial tax-producing industry.

With the total tax rate on distilled spirits as high as it already is, the point of diminishing returns appears to be dangerously close. It is, of course, impossible to predict accurately what would happen if the tax were increased again, but there is abundant evidence that the present tax rate is extremely close to the danger point.

We believe that the information presented here indicates a consumer turn from tax-paid to bootleg liquor, and we are of the view, therefore, that the proposed increase may likely be a "dangerous dollar" to the Federal and State Governments, as well as to the legal taxpaying trade.

In this connection, your attention is directed to a circular, copy of which is filed for the record, issued by the Alcohol Tax Unit and covered by Treasury Department news release of August 12, 1941, seeking cooperation of sugar refiners, brokers, and wholesalers, in keeping sugar out of bootleggers' hands.

Background.—The prohibition amendment was repealed in 1933 for two principal reasons: (1) To put an end to rampant bootlegging, racketeering, and gangsterism, and (2) to provide Government—both State and Federal—with a much-needed new source of revenue.

After a great deal of careful study by the House Ways and Means Committee and the Senate Finance Committee of just how high the tax could go without giving bootleggers sufficient incentive to stay in business, it was calculated that a tax rate of $2 per gallon on distilled spirits would insure the maximum possible revenue with a minimum of bootlegging. Congress accordingly increased the rate of $1.10 per gallon in effect at the time of repeal to $2 per gallon. In addition, the open States levied State taxes initially averaging about 66 cents per gallon. As calculated, this rate of taxation discouraged large-scale bootlegging. There was not enough tax margin to finance highly organized bootlegging rings such as had flourished under prohibition. The vast network of criminal syndicates of prohibition days largely disappeared.

However, taxes on distilled spirits did not long remain at the rates then best calculated to discourage bootlegging and insure adequate revenues. The total of Federal and State taxes was steadily increased year by year, thus progressively enhancing the profit possibilities of illicit operations. Finally, in 1940, the Federal tax was increased 75 cents on top of an existing Federal tax of $2.25 and average State taxes of $1, making the total State and Federal tax $4 per gallon; and bootlegging became a more tempting venture. Since the 75 cents Federal tax increase of 1940, bootlegging has increased significantly. If the tax is now increased another $1—making the total State and Federal tax more than $5 per gallon—the tax margin may be sufficient to bring back the big-time bootlegger and his vicious entourage of crime and corruption.

Another tax increase well might endanger the two major purposes of repeal—one of the most significant actions ever taken by the American people—by reviving the highly organized bootlegging operations of prohibition days, and by jeopardizing anticipated public revenues from distiller spirits.

Inequities.—Distilled spirits are already bearing a very heavy share of the national tax burden, including a special 75-cent defense tax levied last year, an increase of 33⅓ percent, whereas most other taxes were increased only 10 percent. The increase of $1 now proposed would increase the present tax by another 33⅓ percent. The total Federal tax on distilled spirits would then be more than 3½ times the rate effective on the date of repeal, and 100 percent greater than the first post-repeal rate. It would be 78 percent more than the tax in force on June 30, 1940, a little more than a year ago.

No other commodity is bearing as heavy a load of taxation, nor have the taxes on any other commodities been increased so much in the last several years. In addition to the Federal tax, 28 States and the District of Columbia levy excise taxes on distilled spirits and 17

States sell distilled spirits and take their revenues in the form of profits, gallonage taxes, and sales taxes. Moreover, the Federal Government, the States, cities, towns, and counties are levying a bewildering assortment of license taxes. Total governmental revenues on distilled spirits now represent some 60 percent of the retail selling price. The national average tax on cigarettes—Federal, State, and local included—runs about 50 percent. Taxes on gasoline run about 40 percent of retail selling price. Taxes on beer run about 25 percent of retail selling price.

The tax burden on distilled spirits has been growing steadily more inequitable. While other major Federal commodity taxes, those producing more than $100,000,000 annually, have decreased relative to the total of Federal excise taxes or increased only slightly, distilled spirits taxes have increased sharply from 13.8 percent of total Federal excise taxes in the fiscal year 1935 to 20.2 percent of the total in 1941. The Federal tax on distilled spirits has been increased 273 percent since repeal—from $1.10 to $3 per gallon. The tax on cigarettes was $3 per thousand at the time of repeal and has been increased only once in the meantime to $3.25, an increase of only 8 percent. The tax on gasoline has been increased only once from 1 cent per gallon to 1½ cents, a 50 percent increase. The tax on beer was reduced shortly after repeal from $6 to $5 per barrel and then increased last year back to $6, for no net change.

Bootlegging.—It is a well-known fact that the product of the distilled-spirits industry is peculiarly subject to the competition of the illicity produced, nontaxpaid product—a condition not a factor in any other substantial tax-producing industry.

When taxes are increased on other products, the consumer must pay more or do without. When taxes are increased on distilled spirits, bootleggers and racketeers take advantage of both the Government and the consumer by substituting illicit concoctions for the taxpaying product.

Last year's defense tax increase sharply reversed the long-term downward trend of bootlegging. Prior to the tax increase, bootlegging had been reduced until in the fiscal year 1940 it stood at the lowest levels since repeal. In the first full year of the defense-tax increase, fiscal year 1941, bootlegging turned sharply upward. The Federal Alcohol Tax Unit seized nearly 1,200 more stills and nearly 400,000 gallons more mash, increases of 11 percent and 6 percent respectively, over the year before the tax increase. State-enforcement agencies report similar or greater increases.

It is estimated that the illicit stills seized by Federal agents alone last year turned out nearly 21,000,000 proof gallons of bootleg liquor, defrauding the Federal Government of $63,000,000 in taxes and the States of a minimum of $21,000,00 additional.

The 75-cent tax increase of 1940 raised the total tax margin to the point where bootlegging is again a highly lucrative business proposition. With another tax increase, the tax margin would probably be high enough to permit big-time, highly organized bootlegging operations on the prohibition scale, with all their ramifications of crime and corruption.

The bootlegger would then have what would be in effect a Government subsidy of $5 per gallon, the total of Federal and State taxes, which amounts to $15 a case, or $1.25 per quart bottle.

Revenues.—The average consumer has only so much money to spend for distilled spirits, a quota pretty rigidly fixed by other pressing demands for his income. Increases in the tax-paid gallonage of distilled spirits can be expected only when public purchasing power expands. In the past, the total tax-paid gallonage of distilled spirits has shown a strikingly close relationship to total purchasing power, hovering around 1.90 gallons per $1,000 of national income year in and year out. When national income increased, tax-paid gallonage increased proportionately, and when national income decreased, so did tax-paid gallonage.

However, when the Federal tax was increased 75 cents per gallon last year, the average consumer got less legal distilled spirits with a given amount of money. Public purchasing power increased more than 10 percent in fiscal year 1941—and unit sales in most other lines increased accordingly or to a greater percentage—but Federal tax-paid gallonage of distilled spirits increased only 1.6 percent. This slight increase was more than accounted for by increases in wholesale and retail inventories. Sales to consumers are estimated to have fallen off by some 3 percent for that period.

Sales actually were more than 3 percent lower than they might have been. The 75-cent tax increase reduced the volume of purchases from the previously normal 1.90 gallons to 1.79 gallons per $1,000 of national income. If there had been no 75-cent tax increase last year and the rate of 1.90 gallons per $1,000 had been maintained, tax-paid gallonage would have risen to 153,500,000 gallons against which the realized figure of 144,500,000 gallons represents a 9,000,000-gallon decrease, or 6 percent.

If there is no further tax increase, tax-paid consumption can be expected to increase during the next year in line with the expected increase in public purchasing power, with a consequent sizable increase in tax collections. If there is a tax increase, the Government may not realize much more of a relative increase in revenues than it would if there were no tax increase, and much of the increased revenues might be dissipated in increased enforcement expenditures.

Experience.—What might be expected nationally if the Federal tax is increased again is suggested by the experience of Louisiana and Virginia, the only two States which increased their taxes in 1940 on top of the Federal tax increase of 1940.

The total tax in these two States is now approximately what it would be nationally if the Federal tax were increased another $1.

In the first full year under such a rate in Virginia, legal sales fell off 9 percent, and bootlegging as measured by mash seizures increased 65 percent.

In the first 10 months under such a rate in Louisiana, legal sales dropped 23 percent, and bootlegging went up 211 percent.

Similarly, in the State of Kentucky, which increased its State tax a few months before the Federal tax increase of 1940, sales in the fiscal year of 1941 were off 6 percent, and bootlegging increased 26 percent.

States.—When the Federal Government increases its tax rate and thereby depresses national tax-paid gallonage, most States lose State tax revenues on distilled spirits.

In the fiscal year following the Federal tax increase of 75 cents every State in the Union realized an increase in consumer purchasing

power. In 19 of these States, tax-paid consumption actually declined over the preceding fiscal year. In 39 States sales of legal distilled spirits—upon which the States collect taxes or realize profits—lagged behind the increase in consumer purchasing power. In 20 States, tax-paid consumption failed to increase in line with consumer purchasing power. In all 39 States, State revenues were less than they should have been as a result of the 75-cent Federal tax increase.

Such losses are extremely serious to the States and their citizens because of the essential social services for which distilled spirits revenues are frequently earmarked—old-age pensions, mothers' aid, aid to the blind and crippled children, teachers' funds, and so forth.

If there is another Federal tax increase now, more severe and more widespread losses may be expected, with resulting unbalanced budgets in many States. The States would then be faced with a choice between giving up essential social service and finding new tax sources.

Miscellaneous.—In the light of the foregoing, there are a number of other important factors that should be taken into account in considering another tax increase on distilled spirits.

The farmers who supply the grain would find the legal market for distilling grains reduced. The legitimate distilling industry's grain purchases are highly important to farmers, representing as they do a very significant factor in establishing prices on the cash grain market.

Thousands of small retailers and wholesalers throughout the country would be faced with the necessity of securing additional capital to finance their businesses.

Distillers and rectifiers would have to secure many millions of dollars of additional capital to finance the tax increase on the huge volume of "floating stocks" necessary to keep their business going.

In addition, the floor-tax requirement alone would entail an estimated $38,000,000 of financing, principally by the hard-pressed small businessmen in the wholesaling and retailing end of the trade.

Summary.—Since the repeal of the prohibition amendment in 1933 taxes on distilled spirits—Federal, State, and local—have been increased steadily year by year. By every criterion, distilled spirits are already bearing far more than their fair share of taxes compared to other commodities. In simple equity, should distilled spirits be called upon to bear yet another sharp increase so soon after the 33⅓ percent defense-tax increase of last year?

Should not the invitation to bootlegging—the peculiar and difficult problem of distilled spirits taxation which sets it apart from all other tax commodities—implicit in a too-high tax rate be sufficient to deter the imposition of such a rate? There is obviously a point beyond which distilled spirits taxes cannot be increased without retarding legal consumption and stimulating bootlegging.

There is strong evidence that that point was reached last year when the Federal tax on distilled spirits was boosted sharply for defense purposes. Since that tax increase, consumers have been forced to the consumption of bootleg whisky in considerable volume as evidenced not only by the pronounced rise in bootlegging, but also by the otherwise inexplicable failure of tax-paid gallonage to keep up with rising public purchasing power.

With a 75-cent tax increase retarding sales, despite the greatest increase in national income in recent years, would not another tax increase on top of the 75-cent tax increase reasonably be expected to

retard tax-paid gallonage still more? Without a tax increase, it is reasonable to expect an increase in tax-paid consumption during the next year in line with the expected increase in public purchasing power.

A tax increase of $1 would make the profit margin of bootlegging sufficiently high to again finance big-time operations on the prohibition scale. Is it not conceivable that big-time bootleggers would be invited to enjoy the enormously high profits of illicit operations?

Even if consumers do have considerably more money to spend next year, can they be expected to buy heavily taxed legal spirits in preference to readily available bootleg liquor? Can consumers—particularly in the low-income groups which because of their number are responsible for the bulk of tax-paid consumption—be blamed for shifting to the bootleg product if the legal product is taxed out of their reach?

Regardless of what may happen to Federal revenues, if there is a tax increase, the States—which depend on distilled spirits revenues for many essential social services to their citizens—would likely suffer severe revenue losses. A great many States suffered losses in distilled spirits revenues following the 75-cent Federal tax increase of 1940. If the tax is now increased another $1, the States would suffer still greater losses.

The need for increased revenues must be carefully weighed against the serious consequences that may flow from too high a tax rate on distilled spirits.

Having in mind all the factors involved—some of which have been touched upon here—we feel that we are justified in asking that serious consideration be given to the advisability of a tax increase at this time.

There is a very real risk of serious consequences—not only to the industry but to governmental revenues and public welfare.

Senator VANDENBERG. I would like to ask the witness one question. When you figure the total Federal and State taxes at $5 per gallon, I assume that includes the proposed $1 increase, so your present figure would be $4; is that correct?

Mr. JONES. You mean our present tax, Senator?

Senator VANDENBERG. Your statement is that both the Federal and State taxes now would average $5 per gallon.

Mr. JONES. That is correct.

Senator VANDENBERG. So it is now $4 per gallon, without this $1 added.

Mr. JONES. Yes.

Senator VANDENBERG. I understand the Canadian rate is $7 per imperial gallon, and the rate in Great Britain is $16.50 per imperial gallon. How much bigger is an imperial gallon than our gallon?

Mr. JONES. Roughly, I would say, one-fifth bigger. It is quite a little larger.

Senator VANDENBERG. Then the Canadian and British rates are very substantially higher than ours, are they not?

Mr. JONES. Yes.

Senator VANDENBERG. Have they been confronted with dire consequences, do you find?

Mr. JONES. No, sir; I should say they have not. We have a little different situation in this country. We have gone through 13 years

breeding a situation that has not existed either in Canada or in England.

Senator VANDENBERG. I think that is so, I would have to agree with you there.

Senator CONNALLY. You mean we have developed a taste for bootleg and it is hard to get them off of it?

Mr. JONES. I do not know whether that is the entire reason, Senator. I think we have developed a disrespect for law in this country. We have a lawless situation in this country that we have not entirely eliminated. We had in prohibition days, and we think this would bring about a recrudescence of that.

Senator VANDENBERG. There is a great difference between $4 in this country and $7 in Canada and $16.50 in Great Britain.

Mr. JONES. Yes. I think the taxes in Great Britain are very definitely punitive taxes at the moment.

The CHAIRMAN. They prohibited the distilling of grain during the last war, and they are now imposing a tax as a revenue measure.

Mr. JONES. Yes.

The CHAIRMAN. Beyond any doubt they were totally prohibited during the last war, but now they are imposing a tax.

I want to call your attention to the fact that Senator Taft asked about the Treasury reports, and they show a net gain after the imposition of the last raise of 75 cents to the Treasury of $393,000,000 from July 1, 1940, to June 30, 1941, against $289,000,000 from July 1, 1939, to June 30, 1940, and that, according to the Treasury statistics the consumption on the whole is still going up.

Mr. JONES. Consumption is going up, Senator, and in the last fiscal year went up about 1 percent. Our graph up here will show you that the national income went up roughly 8 or 9 percent in that period. I think the estimate which the Treasury has made on this particular tax to the committee indicates a decrease in consumption, I mean just taking the figures. I did not get it from the Treasury but their figures indicate the decrease in consumption in the next year.

The CHAIRMAN. They show a constant upward increase in revenue since the last raise.

Mr. JONES. That is right.

The CHAIRMAN. On practically all liquors except on imported distilled liquors, because the imports fell off.

Mr. JONES. Yes.

The CHAIRMAN. The imports on certain types of imported liquors fell off.

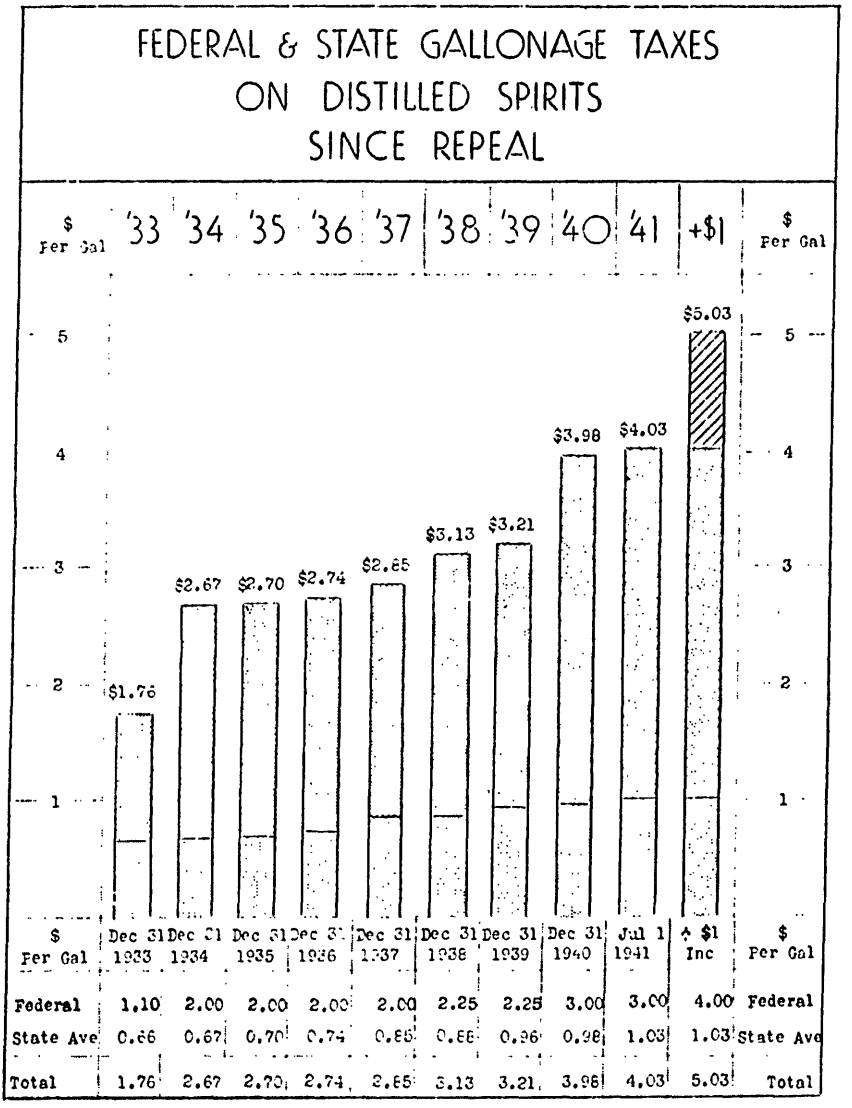
Mr. JONES. We went up nearly 2 percent, something over 1 percent.

Senator BARKLEY. Is there a manufacturer of illicit liquor in Canada, where they consume largely rye and scotch, such as there is in the United States?

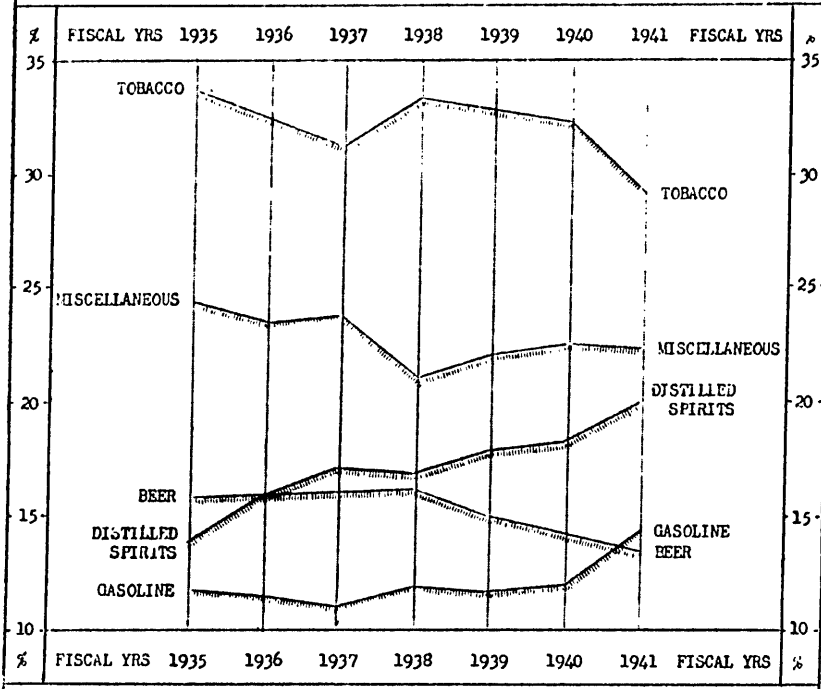
Mr. JONES. I do not think it is any different, Senator. I think the Canadians are now experiencing difficulty with bootlegging. It is growing up there. It had not existed before, but it is growing up there. We hear stories of alcohol being shipped from this country into Canada now in opposition to their laws, as we used to get their whisky in the prohibition days.

The CHAIRMAN. All right, Mr. Jones, thank you very much.

(The charts and tables submitted by Mr. Jones are as follows:)


FEDERAL & STATE GALLONAGE TAXES
ON DISTILLED SPIRITS
SINCE REPEAL
$ Per Gal
'33 '34 '35 '36 '37 '38 '39 '40 '41 +$1
$ Per Gal
5
4
3
2
1
$1.76
$2.67
$2.70
$2.74
$2.85
$3.13
$3.21
$3.98
$4.03
$5.03
$ Per Gal | Dec 31 1933 | Dec 31 1934 | Dec 31 1935 | Dec 31 1936 | Dec 31 1937 | Dec 31 1938 | Dec 31 1939 | Dec 31 1940 | Jul 1 1941 | + $1 Inc | $ Per Gal
Federal | 1.10 | 2.00 | 2.00 | 2.00 | 2.00 | 2.25 | 2.25 | 3.00 | 3.00 | 4.00 | Federal
State Ave | 0.66 | 0.67 | 0.70 | 0.74 | 0.85 | 0.88 | 0.96 | 0.98 | 1.03 | 1.03 | State Ave
Total | 1.76 | 2.67 | 2.70 | 2.74 | 2.85 | 3.13 | 3.21 | 3.98 | 4.03 | 5.03 | Total

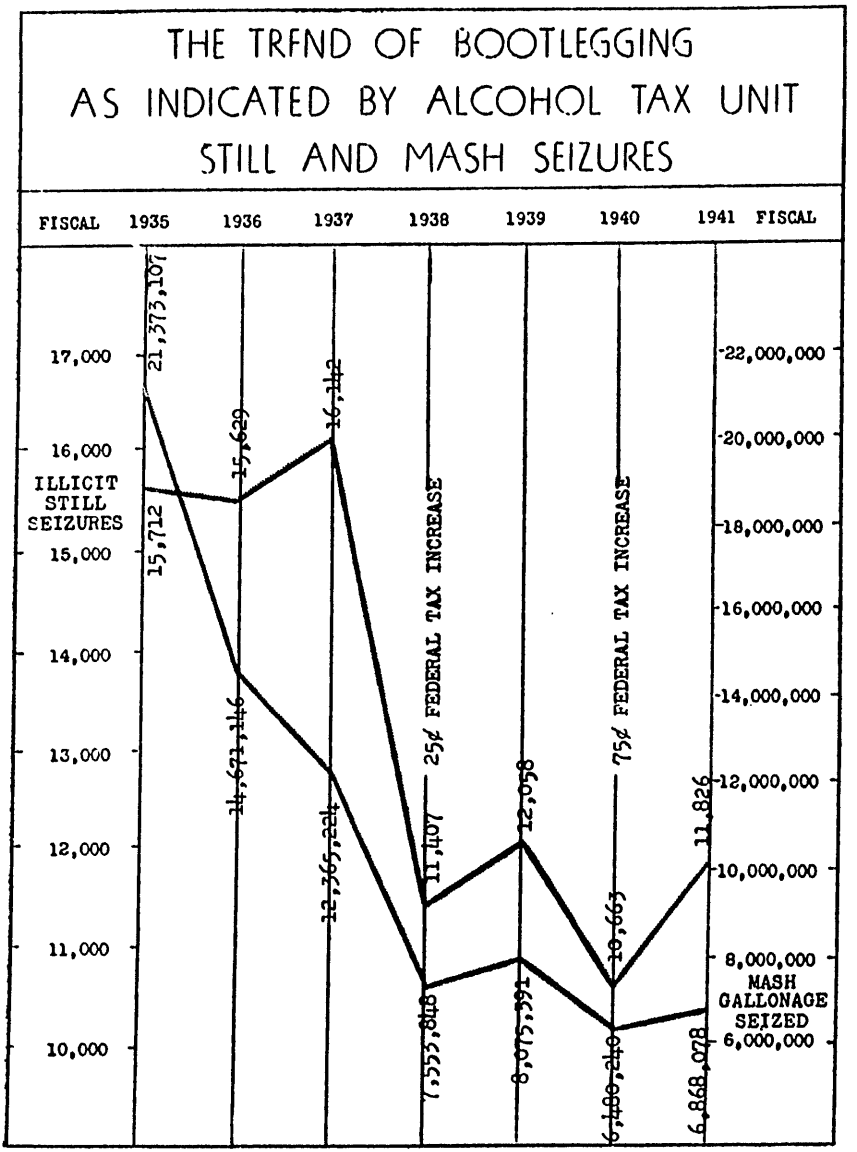
DISTILLED SPIRITS TAXES AND OTHER MAJOR[a] EXCISE TAXES AS PERCENTAGES OF TOTAL EXCISES[b]



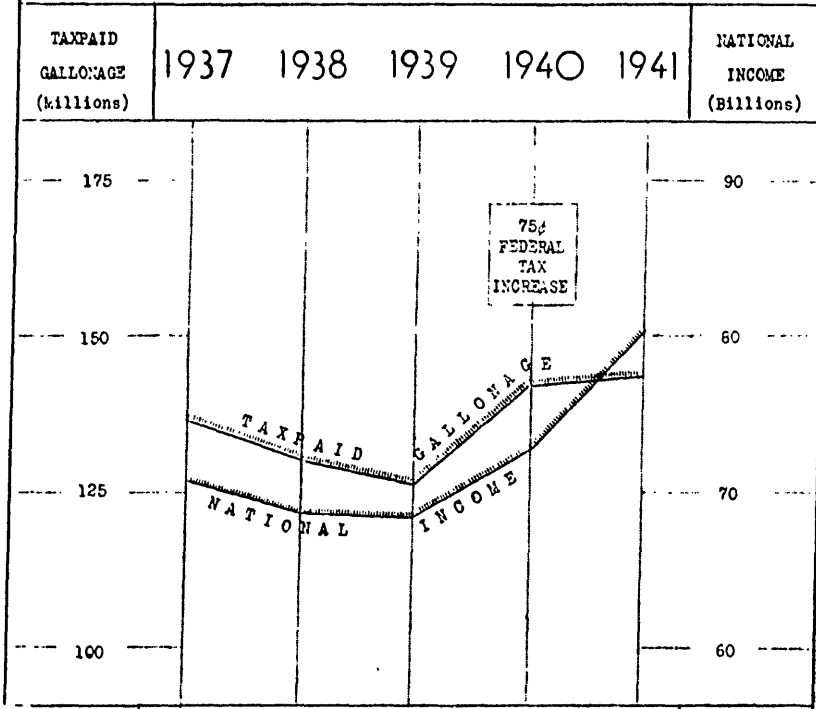
	1935	1936	1937	1938	1939	1940	1941	
TOBACCO	33.7%	32.4%	31.3%	33.4%	32.8%	32.3%	29.1%	TOBACCO
MISCELLANEOUS	24.3%	23.5%	23.9%	21.2%	22.2%	22.6%	22.4%	MISCELLANEOUS
BEER	15.8%	16.1%	16.0%	16.1%	14.9%	14.2%	13.4%	BEER
SPIRITS	13.8%	15.9%	17.2%	16.9%	17.0%	18.4%	20.2%	SPIRITS
GASOLINE	11.8%	11.5%	11.1%	12.0%	11.7%	12.0%	14.3%	GASOLINE
TOT. MILLIONS	$1362	$1547	$1765	$1700	$1768	$1885	$2399	TOT. MILLIONS

a/ Yielding more than $100,000,000 annually

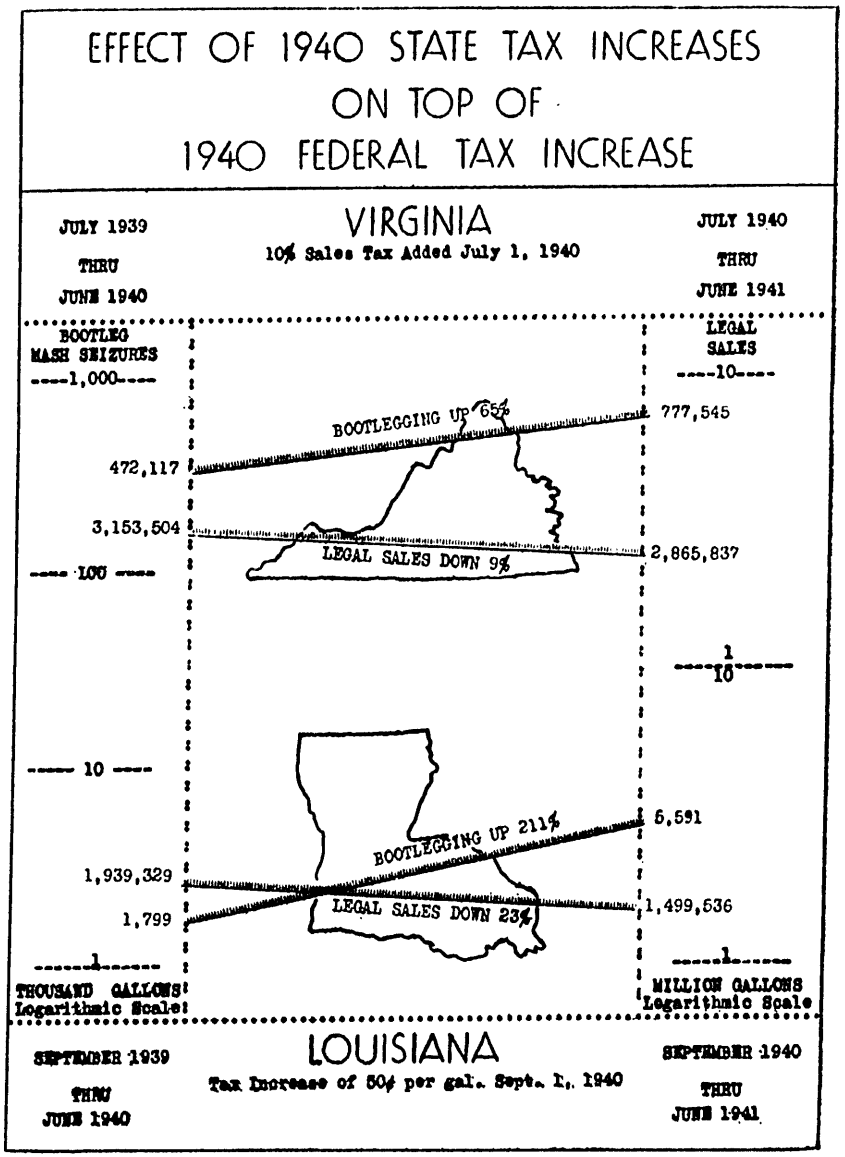
b/ Liquor, Tobacco, Stamp Taxes, Manufacturers' Excises, and Miscellaneous Revenues


THE TREND OF BOOTLEGGING
AS INDICATED BY ALCOHOL TAX UNIT
STILL AND MASH SEIZURES
FISCAL 1935 1936 1937 1938 1939 1940 1941 FISCAL
ILLICIT STILL SEIZURES
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
22,000,000
20,000,000
18,000,000
16,000,000
14,000,000
12,000,000
10,000,000
8,000,000
6,000,000
MASH GALLONAGE SEIZED
15,712
15,629
11,407
10,663
11,826
6,868,078
25¢ FEDERAL TAX INCREASE
75¢ FEDERAL TAX INCREASE

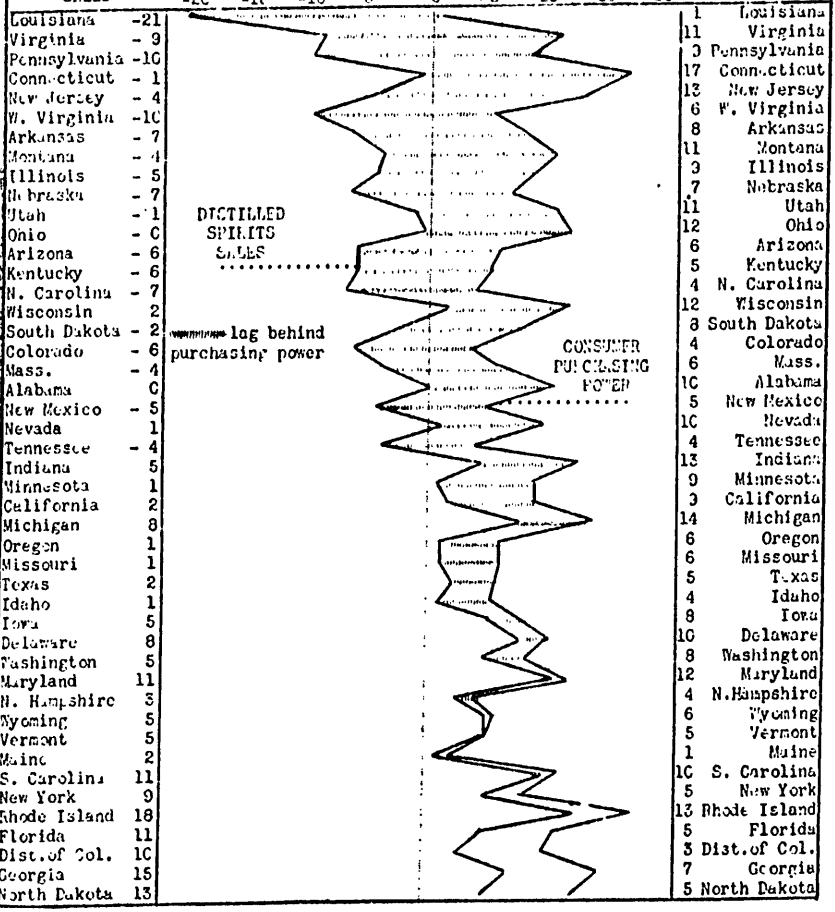
TAXPAID GALLONAGE OF DISTILLED SPIRITS RELATED TO NATIONAL INCOME



FISCAL YEARS	1937	1938	1939	1940	1941	FISCAL YEARS
TAXPAID GALS. (Millions)	136.9	130.2	126.7	142.2	144.5	TAXPAID GALS. (Millions)
NATL. INCOME (Billions)	71.3	69.2	68.4	73.2	80.9	NATL. INCOME (Billions)
TAXPAID GALS. PER $1000 INC.	1.92	1.88	1.85	1.94	1.79	TAXPAID GALS. PER $1000 INC.


EFFECT OF 1940 STATE TAX INCREASES
ON TOP OF
1940 FEDERAL TAX INCREASE
VIRGINIA
10% Sales Tax Added July 1, 1940
JULY 1939 THRU JUNE 1940
JULY 1940 THRU JUNE 1941
BOOTLEG MASH SEIZURES
----1,000----
LEGAL SALES
----10----
BOOTLEGGING UP 65%
777,545
472,117
3,153,504
LEGAL SALES DOWN 9%
2,865,837
---- 100 ----
1
10
---- 10 ----
BOOTLEGGING UP 211%
6,591
1,939,329
1,799
LEGAL SALES DOWN 23%
1,499,636
1
1
THOUSAND GALLONS Logarithmic Scale
MILLION GALLONS Logarithmic Scale
LOUISIANA
Tax Increase of 50¢ per gal. Sept. 1, 1940
SEPTEMBER 1939 THRU JUNE 1940
SEPTEMBER 1940 THRU JUNE 1941

LEGAL DISTILLED SPIRITS CONSUMPTION AND CONSUMER PURCHASING POWER BY STATES



Basic tax rates on distilled spirits, Federal and open State gallonage taxes as of Jan. 1, 1934, to July 1, 1941, inclusive, with effective dates of original rates and changes

	1933	Jan. 1, 1934	1934	Jan. 1, 1935	1935	Jan. 1, 1936	1936	Jan. 1, 1937	1937	Jan. 1, 1938	1938	Jan. 1, 1939	1939	Jan. 1, 1940	1940	Jan. 1, 1941	1941	July 1, 1941
1. Arizona	Dec. 5	$0.80		$0.80		$0.80												
2. Arkansas								$0.80		$0.80		$0.80		$0.80		$0.80		$0.80
3. California	Dec. 5				Mar. 16	.40		.40	Mar. 11	.65	Apr. 1	.80	Mar. 18	1.12		1.12		1.12
4. Colorado	do	.80			July 1	.80		.80		.80		.80				.80		.80
5. Connecticut	do			.80	Apr. 12	1.60		1.60		1.60		1.60		1.60		1.60		1.60
6. Delaware	do	1.00							July 1	.60		.60	July 1	1.00		1.00		1.00
7. District of Columbia			Jan. 24	1.00		1.00		1.00		1.00		1.00		1.00		1.00		1.00
8. Florida			Nov. 9	.50		.50		.50		1.20		.50		.50		.50		.50
9. Georgia					May 27	.80		.80	June 5	1.50		1.20		1.20		1.20		1.20
10. Illinois			Jan. 31	.50						1.10	Feb. 3	1.00		1.00		1.00		1.00
11. Indiana	Dec. 5	2.00		2.00	Mar. 11	.50		.50		.50		.50		.50		.50	July 1	1.00
12. Kentucky			Mar. 17			1.00	Apr. 30	1.00		1.00		1.00		1.00		1.00	May 1	1.08
13. Louisiana			Aug. 1	.50	Oct. 1	.60		1.40		1.04		1.04		1.04	Mar. 3	1.20		1.20
14. Maryland	Dec. 5	1.10		1.10		1.10		.60		.60	June 30	1.00		1.00	Sept. 1	1.50		1.50
15. Massachusetts	do	.40		.40		.40		1.10		1.10		1.10	Oct. 1	1.25		1.25		1.25
16. Minnesota			Jan. 8	.60		.60		.40		.40		.40	Sept. 1	.95		.95		.95
17. Missouri			Jan. 13	.80		.80		.60	July 30	1.00		1.00		1.00		1.00		1.00
18. Nebraska					May 24	.50		.80		.80		.80		.80		.80		.80
19. Nevada					Apr. 1	.40		.50	Apr. 2	.80		.80		.80		.80		.80
20. New Jersey	Dec. 5	1.00		1.00		1.00		.40		.40		.40		.40		.40		.40
21. New Mexico	do		June 1	.80		.80		1.00		1.00		1.00		1.00		1.00		1.00
22. New York	do	1.00		1.00		1.00		.80	Mar. 17	1.20		1.20		1.20		1.20		1.20
23. North Dakota								1.00		1.00		1.00	May 10	1.50		1.50		1.50
24. Rhode Island	Dec. 5	.50		.50		.50	Dec. 3	.60		.60		.60		.60		.60		.60
25. South Carolina					May 14	.80		.50	July 1	.75		.75	Mar. 15	1.00		1.00		1.00
26. South Dakota					Mar. 14	.50		.80	May 18	.96		.96	July 1	1.28		1.28	July 1	1.92
27. Tennessee								.50	July 1	.75		.75		.75		.75		.75
28. Texas					Nov. 15	.80	Oct. 31	.96					Apr. 1	.70		.70		.70
29. Wisconsin	Dec. 5		Jan. 12	1.00		1.00		1.00		.96		.96		.96		.96	May 1	1.28
										1.00		1.00		1.00		1.00		1.00
Number of States		13		26		26		27		27		28		29		29		29
Tax increases			2		4		2		9		2		7		2		4	
Average State tax		.66		.67		.70		.74		.85		.88		.96		.98		1.03
Federal tax	Dec. 5	1.10	Jan. 11	2.00		2.00		2.00		2.00	July 1	2.25		2.25	July 1	3.00		3.00
Combined tax		1.76		2.67		2.70		2.74		2.85		3.13		3.21		3.98		4.03

Federal distilled spirits taxes compared to other excise and miscellaneous Internal Revenue taxes, fiscal years 1935–41

	Distilled spirits	Wine	Beer	Tobacco	Gasoline	Miscellaneous	Total
Fiscal years—	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	
1935	13.8	0.5	15.8	33.7	11.8	24.3	$1,362,840,785
1936	15.9	.7	16.1	32.4	11.5	23.5	1,546,912,519
1937	17.2	.5	16.0	31.3	11.1	23.9	1,764,561,158
1938	16.9	.4	16.1	33.4	12.0	21.2	1,700,283,592
1939	17.9	.4	14.9	32.8	11.7	22.2	1,768,112,560
1940	18.4	.5	14.2	32.3	12.0	22.6	1,884,512,357
1941	20.2	.5	13.4	29.1	14.3	22.4	2,399,417,597

Source of data: Bureau of Internal Revenue.

Bootlegging indexes, illicit still and mash seizures, fiscal years 1935–41

	Stills	Mash gallonage		Stills	Mash gallonage
Fiscal years—			Fiscal years—		
1935	15,712	21,373,107	1940	10,663	6,480,240
1936	15,629	14,671,146	1941	11,826	6,868,078
1937	16,142	12,365,224	Increase, 1941 over 1940 (percent)	10.9	6.0
1938	11,407	7,553,848			
1939	12,058	8,075,391			

Source of data: Alcohol Tax Unit.

Tax-paid gallonage related to national income

	National income	Tax-paid gallonage	Gallons per $1,000
Fiscal years—			
1937	$71,262,000,000	136,889,824	1.92
1938	69,245,000,000	130,203,694	1.88
1939	68,360,000,000	126,663,446	1.85
1940	73,152,000,000	142,246,840	1.94
Total, 4 years	282,025,000,000	536,003,804	1.90
1941	80,885,000,000	144,455,854	1.79
Calendar years—			
1936	68,116,000,000	130,083,683	1.91
1937	72,213,000,000	134,567,347	1.86
1938	66,584,000,000	125,261,745	1.88
1939	71,016,000,000	132,324,956	1.86
1940	75,754,000,000	141,863,058	1.87
Total, 5 years	353,683,000,000	664,100,789	1.88
First 4 months—			
1936	20,731,000,000	36,701,587	1.77
1937	23,329,000,000	41,124,668	1.76
1938	21,628,000,000	35,443,358	1.64
1939	22,633,000,000	38,805,526	1.71
1940	24,088,000,000	41,233,433	1.71
Total, 5 years	112,409,000,000	193,398,572	1.72
1941	27,021,000,000	41,866,285	1.55

Source of data: Gallonage statistics, Bureau of Internal Revenue; income statistics, Department of Commerce.

Distilled spirits sales and bootlegging in Kentucky, Louisiana, and Virginia, fiscal year 1941 versus 1940

GALLON SALES

	Kentucky	Louisiana	Virginia
Fiscal year—			
1940	2,401,980	[1] 1,939,529	3,153,504
1941	2,251,850	[1] 1,499,536	2,865,837
Decrease	150,130	439,993	287,667
Percent decrease	−6.2	−22.7	−9.1

BOOTLEG MASH SEIZURES (GALLONS)

Fiscal year—			
1940	145,709	1,799	472,117
1941	182,975	5,591	777,545
Increase	37,266	3,792	305,428
Percent increase	25.6	210.8	64.7

[1] September-June.

Source of data: Gallonage statistics: State authorities; bootlegging statistics: Alcohol Tax Unit

Relative percentage changes in State distilled spirits, gallon sales, and State purchasing power, fiscal year 1941 compared to fiscal year 1940

State	Gallon sales	Purchasing power	State	Gallon sales	Purchasing power
	Percent	*Percent*		*Percent*	*Percent*
Louisiana	−21.2	1.0	Nevada	1.0	9.8
West Virginia	−10.0	5.6	Oregon	1.0	5.9
Pennsylvania	−9.5	9.3	Missouri	1.1	5.7
Virginia	−9.1	10.7	California	1.5	8.8
North Carolina	[1] −7.2	3.5	Texas	1.8	4.6
Arkansas	−6.5	8.3	Maine	2.3	1.3
Nebraska	−6.5	6.7	Wisconsin	2.3	12.3
Colorado	−6.3	3.5	New Hampshire	2.6	3.8
Kentucky	−6.2	4.8	Indiana	[1] 4.6	12.7
Arizona	−6.0	5.7	Washington	5.2	7.6
New Mexico	−4.6	4.8	Iowa	5.4	7.8
Illinois	−4.5	9.2	Vermont	5.4	5.4
New Jersey	[1] −4.4	12.5	Wyoming	[1] 5.4	5.6
Montana	−4.1	10.6	Delaware	7.9	10.4
Massachusetts	−4.0	5.8	Michigan	8.2	14.4
Tennessee	−3.9	4.3	New York	8.6	5.0
South Dakota	[1] −2.4	7.6	District of Columbia	10.3	2.7
Utah	−1.2	10.9	Maryland	10.5	11.7
Connecticut	−.5	10.7	Florida	[1] 11.1	5.4
Ohio	−.2	11.8	South Carolina	11.4	10.0
Alabama	.4	10.1	North Dakota	13.2	5.2
Idaho	[1] .7	3.8	Georgia	15.3	7.3
Minnesota	1.0	8.8	Rhode Island	18.2	12.7

[1] 11 months.

Source of data: Gallonage statistics, State authorities; purchasing power statistics, "Sales Management" Magazine.

The CHAIRMAN. Will you give your full name?
Mr. JAFFE. Theodore Jaffe.
The CHAIRMAN. For whom are you appearing?
Mr. JAFFE. National Retail Liquor Package Stores, Inc.
The CHAIRMAN. All right, proceed.

STATEMENT OF THEODORE JAFFE, PROVIDENCE, R. I., REPRESENTING THE NATIONAL RETAIL LIQUOR PACKAGE STORES, INC.

Mr. JAFFE. I will make the statement as short as I can and ask leave to file a written statement later in the day.

The CHAIRMAN. Yes; you may do that.

Mr. JAFFE. I represent the small retailers that operate the privately owned stores where liquor is sold that is consumed off the premises in the 28 open States as distinguished from the so-called monopoly States in the country. My point is different from that which was argued this morning by other speakers. I am not here asking any reduction in the tax increase, although my personal opinion and that of my associates is that this proposed increase is apt to work against the purpose for which it is designed in that we will be confronted with the condition of diminishing returns. The point I am to make is more limited in scope, and that is that the bill as presently drawn does not provide for any exemption on the floor stocks of the retailers. Twice before the Congress has passed increased tax legislation and did provide for exemptions on floor stocks. That becomes very important as far as we, the small retailers, are concerned.

Senator LA FOLLETTE. You were given up to 10 months to take care of that.

Mr. JAFFE. No; we were given up to 10 months to pay the tax on our inventories, but not given any time to dispose of any of that upon which you have to pay a tax increase. In other words, the industry is so constituted that it would take a minimum from 15 to 30 days to adjust the price structure of the industry. We would have to pay that tax increase on every gallon of inventory which we have in the store as of the effective date of the act. The price changes could not possibly be arranged until this 15 or 30 days later, in which case all that inventory which we are selling during that interval we would have to pay a tax on and could not get it back.

Now, we are perfectly willing to pay our share of the tax increases.

Senator CONNALLY. Why would it take that long to get your prices adjusted?

Mr. JAFFE. Because we deal almost exclusively in the nationally advertised brands.

Senator CONNALLY. But you would know when the price will be effective. Why couldn't you change rates then?

Mr. JAFFE. Those prices are arranged for the various States by the principals that control those brands.

Senator CONNALLY. Your floor stock is not controlled; you could put any price you wished on that?

Mr. JAFFE. That may be true in this respect: They wouldn't get around to changing their prices for, say, 30 days, and while I could say, "I will raise my prices," if my competitor didn't, I would lose the business.

Senator CONNALLY. How about your competitors? You don't complain, you say, about the fact and he is going to have to pay it. You will ruin your competitors.

Mr. JAFFE. Well, speaking for the people I represent, there isn't anyone that operates in one of these establishments that I know of

that carries less of an inventory than the inventory provided for in the last legislation of 1940, but I would say this, what I am asking is not that the floor stocks be exempt from taxation; that was the provision in 1937 and we came here and asked to have the tax imposed on the floor stocks because if it wasn't that would put the small retailer at a tremendous disadvantage. The large dealer could go out and purchase large stocks where the little fellow couldn't; the big fellow would be protected and could make capital out of that, so that, therefore, it is protection for the little fellow to have this floor tax and makes it impossible for the big fellow to take advantage of him under the provision existing in the 1940 act, and that is the very thing we are asking to have repeated. This is the first time that was not repeated and it is certainly justifiable because there is no way the smaller fellows can get it back if they have to pay that amount of money themselves. It would certainly make it very difficult for them. That is why we are asking for 10 months here. These retailers are only small operators and any time they have to dig down for this kind of money it is very difficult for them.

The CHAIRMAN. What was the exemption in the previous bill?

Mr. JAFFE. One hundred gallons.

The CHAIRMAN. What was the exemption for the producers?

Mr. JAFFE. This provision is just for the retailers; there was no exemption for the producers or wholesalers and there was no exemption for the retailers above this amount.

The CHAIRMAN. I understand you simply want an exemption of 100 gallons.

Mr. JAFFE. Yes.

Senator CONNALLY. How many retailers are there in the United States?

Mr. JAFFE. I haven't the Treasury figures, but there are quite a number of thousands, because this would cover and include the small restaurants.

Senator CONNALLY. Well, 100 gallons—that would be $300 tax?

Mr. JAFFE. No; it would be just the increase, $1 a gallon.

Senator CONNALLY. Well, $100; so the Government would be losing $100 on every retailer in the United States?

Mr. JAFFE. Well, it isn't $100 the retailer is getting; he is passing that and much more on to the consuming public without getting it back. And take your argument: The Government says to the small retailer: "You might not be able to get this back, but if you dispose of it we still ask you for a—and it amounts to a contribution—of $100."

Senator CONNALLY. Well, you said you passed it on to the retailer.

Mr. JAFFE. No, I said we would have to pass on part of our inventories to the consumers without including it.

Senator CONNALLY. Why would you; nobody is going to take the whisky away from you unless you want to sell it?

Mr. JAFFE. Competitive conditions in the industry would force that and experience in the past has definitely proven that to be a fact.

The CHAIRMAN. Thank you very much for your appearance.

(The following letter was ordered printed in the record:)

NATIONAL ASSOCIATION OF ALCOHOLIC BEVERAGE IMPORTERS, INC.,

Washington, D. C., August 21, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR MR. CHAIRMAN: The National Association of Alcoholic Beverage Importers, Inc., appeared at the public hearings held by the Committee on Ways and Means on the revenue revision of 1941 and presented oral testimony, which appears on pages 1459 to 1461, inclusive, of that hearing. The association, in order to conserve the time of the committee, respectfully requests that this communication be made part of the record of the hearing now being held by your committee.

The importers of alcoholic beverages made it clear to the Committee on Ways and Means that they were anxious to aid the Federal Government in the obtaining of revenue necessary during the present emergency. I am instructed by the officers of this association to inform your committee that there has been no change in the position we have taken heretofore.

We most respectfully renew the suggestion I made in behalf of the association to the Committee on Ways and Means. We recommend that in the pending bill the committee consider the adoption of two excise taxes on alcoholic beverages. It is our view that the excise taxes which were in effect prior to the adoption of the defense tax bill of July 1, 1940, should be restored as the permanent excise tax rates for wines, spirits, and beers. We feel that there should be designated as special defense tax rates any additional excise taxes which may be carried in the pending measure. We further recommend that the additional taxes should take the form of a percentage sales tax payable at the time of purchase by consumers or buyers of alcoholic beverages. A tax of this nature could be collected easily and is equitable. Furthermore, it has the distinct advantage of being a direct tax paid by the consumer which would eliminate financial carrying charges which are true when excise taxes are increased and must be paid at the time when the alcoholic beverage is withdrawn from bonded warehouse.

Excise taxes are included in the price charged wholesale distributors by the firms who pay the Government the tax. Wholesale distributors base their prices to retailers on the prices paid to the primary producer or importer. Finally, retailers base their consumer prices on the price they pay wholesalers. It is commonly believed in the alcoholic beverage trade that for each $1 tax imposed by the Government, consumers pay $2 at the retail point of purchase.

The proposed bill now carries a number of consumer taxes on luxury items. We feel that alcoholic beverages could easily be treated in the same class. The details of our argument on this proposal were stated clearly in the testimony given before the Committee on Ways and Means.

The members of this association have been the victims of the present war. We are unable to trade with Continental Europe excepting for Portugal and Spain. As a result the main portion of our business has been the importing of Scotch whiskies and other spirits and wines from the British Isles. We have been able to establish for the British Government important dollar credits which include not only the price paid producers and shippers in the British Isles but also the cost of freight and other charges. It is our estimate that in the calendar year of 1940 such dollar credits made available to the British Government amounted to $45,291,000.

In addition to this huge sum which has been of great value to the British Government for the purchase of items not covered by the Lease-Lend Act, we paid the Federal Government in the form of tariffs and internal revenue taxes for the same period the amount of $62,883,000. There should not be forgotten, however, that the States collected a considerable revenue in addition to the amounts collected by the Federal Government.

Federal taxes on alcoholic beverages may be likened to a two-edged sword. High taxes may result in an increase of revenue for the Federal Government, but accompanied by a drop in the revenue obtained by the individual States. Obviously, the sound way of solving the problem is the collection of a single tax b the Federal Government and the returning of a portion of that tax to the various States. Another method might be the obtaining of a compact from the individual States with respect to the amount of the gallonage tax to be imposed by such States.

The foregoing possibilities are theoretical. Congress is faced with a definite concrete problem. How far can it go in increasing Federal taxes without reducing the present revenue obtained by individual States and without causing an increase in illicit operations?

If increases in Federal taxes result in a decline in consumption and a resulting decline in the revenue of the individual States, there may be expected an increase in the tax rates imposed by the States. This has already happened in certain States.

The Treasury Department is not unmindful of the dangers of high taxes, especially when two taxes are collected by two different Government authorities. Although Deputy Commissioner Stewart Berkshire, of the Alcohol Tax Unit, has done a magnificent job in controlling operators of illicit stills, it is particularly significant that recently the Alcohol Tax Unit issued a circular pointing out that from a bag of sugar of 100 pounds, which gives a legitimate sugar dealer a profit of approximately 10 cents, there may result a tax loss to our Government of $36.95 because a bootlegger can produce approximately 6½ gallons of 190 proof alcohol from 100 pounds of sugar. This calculation is made on the basis of the existing $3 per proof gallon tax on spirits. At the proposed $4 rate the estimated tax loss to the Government would be $51.30 for every 100 pounds of sugar used by illicit operators. There was not included in the figures cited above the tax losses to the individual States which, on the average, collect $1 for every wine gallon of spirits sold in their territories.

The foregoing is mentioned so that the committee will realize that the proposed taxes carried in the present bill, taken in conjunction with the existing State taxes, offer a fertile field to illicit operators. It, therefore, appears reasonable to assume that, if the taxes carried in the present bill are going to be adopted, Congress should strengthen the hands of Commissioner Berkshire of the Alcohol Tax Unit.

I have been instructed to request the committee to consider adoption of such language as is necessary to wipe out an existing inequality in the application of internal revenue taxes on imported distilled spirits. The present Internal Revenue Act and the Tariff Act of 1930 require the payment of the internal Revenue tax on a wine-gallon basis where the imported spirit is below proof. As a result, imported spirits pay a higher internal revenue tax than is true for American distilled spirits. We have no quarrel with the imposition of the Federal Internal Revenue taxes on imported articles. We believe that to be entirely appropriate, but we do feel that the language in the present Internal Revenue law should be changed to provide that imported distilled spirits should pay the Internal Revenue tax on a proof-gallon basis. This would place imported alcoholic beverages on the same basis as domestic spirits, which would still enjoy the protective benefits of the existing tariff rates.

Very truly yours,

HARRY L. LOURIE, *Executive Vice President.*

The CHAIRMAN. Mr. Burnett.

STATEMENT OF GEORGE H. BURNETT, BOSTON, MASS., REPRESENTING THE FLAVORING EXTRACT MANUFACTURERS ASSOCIATION OF THE UNITED STATES ET AL.

Mr. BURNETT. My name is George H. Burnett; address, 437 D Street, Boston, Mass. I am treasurer and general manager of Joseph Burnett Co., a firm engaged in the manufacturing of flavoring extracts for 94 years. I also represent the Flavoring Extract Manufacturers Association of the United States, which all the large and many of the small manufacturers belong to; also the National Association of Soda Water Flavorers, an association of fruit and sirup flavorers.

I have been asked since I came to this meeting to represent them; I also represent the Interstate Manufacturers Co.

These four associations cover the entire flavoring field, and probably use 90 percent of the amount of distilled spirits used in the manufacture of flavoring extracts in the United States.

Gentlemen, I am going to refer to some notes I have here.

Senator CONNALLY. Are you a manufacturer of alcohol?

Mr. BURNETT. No, sir. I am appearing before you to ask the establishment of a differential in the tax on alcohol used for nonbeverage purposes; that is, for use in strictly manufacturing purposes. I mean by that in flavoring extracts and medicinal preparations. Those articles today bear the same tax, pay the same tax, that the liquor people pay. My reason for asking this is as follows: There is no sound reason for the imposition of a tax on alcohol used in the preparation of flavoring extracts and medicines any more than in the preparation of perfumes, tooth pastes, hair tonics, or such things, except from the point of view of administrative costs. The use of substitutes, which contain no alcohol and from which the Government derives no benefit, is rapidly drying up this source of revenue.

Every country in the world recognizes the difference between beverage and nonbeverage alcohol. In most countries there is no tax levied on alcohol consumed in nonbeverage products. In Canada, which was referred to a little while ago, there is a tax of $1.50 a proof gallon used for nonbeverage purposes, with a tax of $7 per gallon on alcohol u for liquor. The difference is, of course, in the imperial gallon, which brings the base down to $1.27½ a proof gallon.

There is no satisfactory substitute for alcohol and the use of synthetic chemicals used in nonalcoholic imitation extracts will also affect to a certain extent, as far as the fruit extracts are concerned, the growers of fruit, particularly in the Pacific Northwest, where the dried-berry industry is a large one. Those cannot be used in the preparation of any extracts except pure extracts. The most important thing is that the revenue to the Government is drying up. You have heard and will hear what the effect of this increased taxation will be in the liquor industry. We can show you how the tax has already affected our industry since it has been increased, and that I will take up a little later. I have asked the clerk to distribute among you gentlemen a number of exhibits and I am going to refer to those, if it is satisfactory to you.

The first is a copy of an amendment to section 2800, Internal Revenue Code, the title being title V, section 533, "Domestic nonbeverage ethyl alcohol,' and intending to establish a new classification. It provides for the imposition on all ethyl alcohol produced in the United States and used exclusively in the manufacture of food products, flavors, flavoring extracts, medicinal preparations, and other nonbeverage products a tax at the rate of $2.25 on each proof gallon or wine gallon to be paid by the distiller when withdrawn from bond. Manufacturers using nonbeverage ethyl alcohol must file application for permits, execute bonds, and keep such books and records as the Commissioner, under proper rules and regulations, prescribes to insure that such nonbeverage ethyl alcohol purchased by them shall not be used for beverage purposes, which records, of course, shall be open and available to the Internal Revenue Bureau. It provides for nonbeverage alcohol diverted to beverage purposes being taxed, makes unlawful the procuring of nonbeverage alcohol for diversion to beverage purposes and prescribes penalties for violation of the act; it is further provided that there shall be no refunds on floor stocks of tax-paid ethyl alcohol held and intended for nonbeverage uses if this provision is accepted.

Senator VANDENBERG. What differential do you propose?

Mr. BURNETT. We are not asking for complete exemption. We realize that the Government wants to collect as much as possible and we are proposing $2.25 a proof gallon be used, which is the rate at which the greatest amount of revenue has been collected by the Government.

Senator BAILEY. What can you do to prevent nonbeverage alcohol from being substituted for beverage alcohol?

Mr. BURNETT. It is a question of administration.

Senator BAILEY. Can you make a suggestion here as to how we can do that? I am in sympathy with your view that beverage alcohol should bear a greater, larger tax than alcohol used in nonbeverage products. The question is one of administration.

Mr. BURNETT. The best answer to that is what happened during the prohibition era. At that time there was a differential.

Senator BAILEY. During prohibition the problem of diversion was a considerable one. Much nonbeverage alcohol was used for beverage purposes.

Mr. BURNETT. The use of the words "nonbeverage alcohol" may be deceptive. It is exactly the same alcohol whether used for beverage or nonbeverage purposes. Denatured alcohol is alcohol with something added to it.

Senator BAILEY. That is what I was thinking of. How was that administered?

Mr. BURNETT. By the same system I suggest. The manufacturer would apply to the Treasury Department; he would be looked up as to whether or not his firm was reliable and if his application was granted he was required to post a very large penalty bond and was finally issued a permit. He kept records and was under the supervision of the Treasury Department during the entire period.

Senator CONNALLY. As a matter of fact, the diversion of nonbeverage alcohol to beverage purposes is what we have to guard against.

Mr. BURNETT. I agree with you.

Senator CONNALLY. During prohibition there were abuses, widespread abuses. In Baltimore, for instance, there was a patent medicine concern found to be buying a great amount of nonbeverage alcohol and it was discovered that the firm was simply bootlegging; it was not using the alcohol for patent medicines, but diverting it to beverage purposes. That is the danger.

Mr. BURNETT. Yes; that is the danger.

Senator CONNALLY. But your answer is that the Treasury investigates the firm and will not license it unless it is reputable?

Mr. BURNETT. Yes; and furthermore, we must not forget that it is possible now to buy legal liquor.

Senator CONNALLY. But 75 cents a gallon is a pretty good inducement; if alcohol can be bought for $2.25 instead of $3, a pretty good inducement is supplied.

Mr. BURNETT. Well, as I understand it, at the present time the market for bootleg alcohol is around $3.50 a wine gallon.

Senator CONNALLY. I am not talking about that; I am saying if you can get this alcohol for $2.25 instead of $3 there is a substantial inducement there to do so.

Mr. BURNETT. That is true, and I think it is a problem of administration which the Treasury Department can work out.

Senator BAILEY. Would you be willing to impose an extremely heavy penalty for those who abuse the privilege?

Mr. BURNETT. Oh, yes.

Senator BAILEY. You would go along with us to the limit on that?

Mr. BURNETT. Absolutely. We will be agreeable to any restrictions that will insure against diversion from nonbeverage to beverage purposes of any alcohol.

Senator BAILEY. I think you need something more than the imposition of a forfeiture of the bond; it would have to be very severe. You might have to provide for the dissolution of the business itself.

The CHAIRMAN. If this tax is increased to $4 a gallon now, and you get a tax of $2.25, there would be considerable opportunity for licensees to do pretty much what they did under the Prohibition Act; there is an opportunity for quite a margin of profit there.

Mr. BURNETT. Yes; that is true; but there is an opportunity for the purchase of legal liquor now which did not exist then. Furthermore, I believe the way in which bootlegging is established today—not that I am an expert on the subject—but I understand that a great deal more of it is done by distilling corn or sugar, whatever they use, and it is much simpler to do that and safer because the penalties are not nearly as severe when they are apprehended in that way as they would be on a man who was posing as a legitimate manufacturer.

The CHAIRMAN. That has been the real problem; the difficulty of administration.

Mr. BURNETT. Yes; I think that is correct. However, we feel that the Treasury Department has been a little bit overanxious on that subject. May I refer to this a little later?

Senator CONNALLY. May I ask a question? Do you use any kind of spirits in your business except alcohol; do you use any whisky?

Mr. BURNETT. No; no whisky or brandy; only ethyl alcohol.

Senator CONNALLY. Pure alcohol?

Mr. BURNETT. Well, I will take that back; we use a small amount of rum to make a sirup.

Senator CONNALLY. That would probably be a fairly good argument for you; you couldn't sell this alchol; you would have to process it, which would add something to the cost; there wouldn't be quite so much temptation.

Mr. BURNETT. It would be very difficult to do that; you couldn't do that.

Senator CONNALLY. Oh, yes; you could.

The CHAIRMAN. Well, proceed.

Mr. BURNETT. If you will refer to this exhibit again, you will see a photostatic copy of invoices, which show what the tax amounts to, but I won't touch on that. The next page shows how the tax has gone up, so that we are paying today 19½ times the value of the commodity; a tax absolutely unknown in any country of the world. I think opium, the tax on opium is only 2½ times its value, and cigarettes three or four times their value. Now, from the point of view of revenue, I think the figures on the next page will be interesting to you. You have heard before from the previous speakers what will happen if the tax goes up. We can show you what has happened since it was raised. There has been a net decrease in revenue under the $3 rate of $321,828. The interesting part of that is that during

the last 3 months of the period the loss was $150,000 or $50,000 a month, as compared with $171,000 for the first 9 months, or $19,000 per month.

We are quite certain from the studies of the industry that if the tax is further increased this revenue will be further decreased, because we know of any number of manufacturers who have recently and others who are now preparing to abandon the use of fewer extracts and use the substitutes. In the bakery, confectionery, and candy trade there are comparatively few left who use pure flavors containing alcohol.

Now, I want to call your attention to one other thing, the question of administration, which I know will interest you very much. The figures given here are from the Treasury Department to the House Ways and Means Committee at a time when a somewhat different bill was before them. The bill we are presenting today would change that number of permits very materially. You notice here we say that this ethyl alcohol can only be used for manufacturing purposes, so that does away entirely with classification J. Classification T—that is, permits to dentists, veterinarians, and so forth—to use alcohol, and to dentists to administer liquor, is omitted, which reduces the administration problem. In addition classification Q should be left out; there are at the present time allowed to purchase tax-free alcohol. A permits to manufacturers, bonded warehouses, and free warehouses are not an additional amount, as they are already supervised by the Alcohol Tax Unit. This would reduce the cost of administration somewhere to around, well, depending on which you take, $300,000 to $500,000, and with a fee of $5 or $10 on each permit, would reduce it so at the very highest the cost of administration would not be over $250,000; that is, the net cost.

I will be very glad to answer any questions.

In closing, I want to assure the committee that it is our intention to cooperate with the Government in every way and intend to accept and abide by the regulations.

Senator BAILEY. You have here the comparison of the tax with the amount of cost, which indicates that the tax under this bill will be approximately 25 times the commodity cost.

Mr. BURNETT. That is right.

Senator BAILEY. How would that be with respect to ordinary brands of whisky; how would that compare?

Mr. BURNETT. I can't tell you about whisky; I am not an expert on that; I know my own business, but I do not know anything about the whisky business.

Senator BAILEY. What I have in mind is this: You can put the tax on whisky so high that you will turn all the distillers and bootleggers loose, break down your whole conception of the repeal of the eighteenth amendment.

Mr. BURNETT. Well, I am sorry I can't answer that question.

Before I leave, there is just one point I would like to mention. I want to show you these two bottles of flavoring extracts, both sold for the same price. That [demonstrating] is imitation; this is pure. This pays a tax to the Government of 1¼ cents; you get 1¼ cents out of that; this you don't get anything from. The use of this is increasing by leaps and bounds and the reason is largely this 1¼ cents.

Senator VANDENBERG. I would like to complete the record in regard to those comparative figures on the tax in Great Britain, Canada, and

the United States. The figures I used were on imperial gallons, which are a fifth larger than our gallons.

Mr. BURNETT. Excuse me, sir; 25 percent larger.

Senator VANDENBERG. Well, that is all right; it depends on which way you figure it. The adjusted price, compared to ours, would be $13.20 in Great Britain, compared to our present rate of $3; and $5.60 in Canada compared to our rate of $3; that is the adjusted fair relationship.

Senator BAILEY. I raised that question to point out that the proposed tax is approximately twice the commodity cost on whisky.

The CHAIRMAN. Approximately twice the cost?

Senator BAILEY. Yes. A man buys a bottle of whisky, two-thirds of what he pays goes for tax, one-third for the whisky.

The CHAIRMAN. Thank you very much.

(Mr. Burnett submitted the following material:)

AMENDMENT TO H. R. 5417

Amend title V, section 533, by inserting on page 41, after line 9, the following new subsection:

"(e) DOMESTIC NONBEVERAGE ETHYL ALCOHOL.—Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsection:

"'(*j*) DOMESTIC NONBEVERAGE ETHYL ALCOHOL.—

"'(1) There shall be levied and collected on all ethyl alcohol produced in the United States and used exclusively in the manufacture of food products, flavors, flavoring extracts, medicinal preparations, and other nonbeverage products, an internal-revenue tax at the rate of $2.25 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller when withdrawn from bond.

"'(2) Manufacturers using nonbeverage ethyl alcohol as herein provided for shall file application for permit, execute such bond, and keep such books and records as the Commissioner, with the approval of the Secretary, may by rules and regulations prescribe to insure that such nonbeverage ethyl alcohol purchased by them shall not be used for beverage purposes. Such books and records shall be preserved for a period of four years and during such period shall be open at all times during business hours for inspection by any internal-revenue officer or agent.

"'(3) Nonbeverage ethyl alcohol withdrawn and tax paid under the provisions this subsection subsequently diverted to beverage purposes or used in the manufacture or production of any article intended for use as a beverage, shall be taxed as provided by Section 2800 (a) (1) of the Internal Revenue Code, such tax to be paid by the person responsible for such diversion or prohibited use. It is hereby declared unlawful for any person procuring nonbeverage ethyl alcohol as herein provided for to divert or cause the same to be diverted to beverage purposes, and on conviction thereof such person shall be fined for each offense not more than $5,000 or be imprisoned for a period of not more than five years, or both.

"'(4) No refund shall be made on floor stocks of tax-paid ethyl alcohol held and intended for nonbeverage uses on the effective date of this Act.'"

U. S. INDUSTRIAL CHEMICALS, INC.

BALTIMORE, MD.

Sold to McCormick & Co., Inc., Light and Barre Streets, Baltimore, Md., April 24, 1941. Shipped via truck; customer's permit No. MD-ST-11. Shipped to same, 414-432 Light Street, Baltimore, Md. Our order No. 8607; shipped from Curtis Bay; contract No. 25-2591; transfer No. 55029. Terms: Cash in advance on tax; net 10th approximately on alcohol. Date shipped, April 24, 1941. Salesman, Whitescarver.

748491-562

Tax paid, alcohol, 190 proof, 72 fifty-four-gallon drums (3888 gallons, at $0.305, gallon)	$1,185.84
Internal-revenue tax (added) (7,387.20 proof gallons, at $3, proof gallon)	22,161.60
Total	23,347.44

Part of carload order. Proof gallons, 7,387.20. Stamp Nos. 254614-685. Invoice, customer's copy 25, No. 24247.

Comparison of commodity cost and internal revenue tax

Fiscal year 1940:	
1 carload tax-paid alcohol, 190 proof, 72 54-gallon drums, 3,888 gallons at $0.305	$1,185.84
Internal revenue tax (added), 7,387.20 proof gallons, at $2.25 per proof-gallon	16,621.20
Total	17,807.04

In 1940 the tax was approximately 14 times the commodity cost.

Fiscal year 1941:	
1 carload tax-paid alcohol, 190 proof, 72 54-gallon drums, 3,888 gallons at $0.305	$1,185.84
Internal revenue tax (added), 7,387.20 proof-gallons, at $3 per proof-gallon	22,161.60
Total	23,347.44

In 1941 the tax was approximately 19½ times the commodity cost.

Fiscal year 1942:	
1 carload, tax-paid alcohol, 190 proof, 72 54-gallon drums, 3,888 gallons, at $0.305	$1,185.84
Internal revenue tax (added), 7,387.20 proof-gallons, at $4 per proof-gallon	29,548.80
Total	30,734.64

In 1942 the tax will be approximately 25 times the commodity cost.

Nonbeverage ethyl alcohol consumption and taxes paid (comparative statement, fiscal years 1940-41)

[Ethyl alcohol taxpaid during 1940 compared with 1941, and proof gallons of alcohol dumped for rectification (beverage) in like period. Difference is nonbeverage use. Figures from ATU releases]

	Fiscal year 1940	Fiscal year 1941
	Proof gallons	*Proof gallons*
Total tax paid	24,344,306	27,866,524
Total dumped (beverage)	17,475,958	22,822,539
Net nonbeverage	6,868,348	5,013,985
Internal revenue tax per proof gallon	$2.25	$3.00
Total revenue	$15,453,783	$15,131,955

Net decrease in consumption under $3 rate (proof gallons)	1,824,363
Percent decrease in consumption under $3 rate	26.55
Net decrease in revenue under $3 rate	$321,828

Nonbeverage ethyl alcohol consumption and taxes paid (comparative statement, fiscal years 1940–42)

[Based on the experience gained during the fiscal year 1941, ethyl alcohol tax paid during 1940 is compared with the estimate for the fiscal year 1942, being confined however, only to nonbeverage uses]

	Fiscal year 1940	Fiscal year 1942
Net taxpaid nonbeverage alcohol (proof gallons)	6,868,318	3,707,329
Internal-revenue tax per proof gallon at	$2.25	$4.00
Total revenue	$15,453,783	$14,829,316

Net decrease in consumption under $4 rate (proof gallons)	3,161,010
Percent decrease in consumption under $4 rate	52.9
Net decrease in revenue under $4 rate	$624,467

ADMINISTRATION

Treasury Department opposition to establishment of a tax differential is premised on the magnitude and high cost of administration.

PERMITTEES

Magnitude of the task is proportionate to the number of possible applicants for permits to use nonbeverage alcohol. Based on experience during prohibition, the Department has made an estimate of potential permittees, analyzed below. In an adjoining column is an estimate of potential permittees based on common sense in the light of existing conditions. The false base on which the Department's estimate rests is immediately evident.

Classes of permits	Number	
	Treasury estimate	Practical estimate
A. Permits to manufacturers, bonded warehouses, and free warehouses	427	427
B. Permits, wholesale druggists	266	266
H. Permits to use intoxicating liquors in the manufacture of preparations unfit for beverage use and for experimental purposes	20,113	10,056
I. Permits to use and sell	24,222	12,111
J. Permits to physicians	86,810	.....
Q. Permits to hospitals	2,877	.....
T. Permits to dentists, veterinarians, etc., to use alcohol, and to dentists to administer liquor	49,828	.....
Total	184,649	22,860
Add 5 percent on account increase in population	9,232	1,143
Total, potential permittees	193,881	24,003

With intoxicating liquors legally available in 45 States, it is evident the practical estimate of potential permittees represents a greater degree of accuracy than the estimate of the Treasury Department.

Further the Department neglects to inform Congress of the fact that today it supervises the activities of more than 400,000 alcohol beverage taxpayers.

HIGH COST

Based on an estimated 194,000 permittees, the Treasury Department calculates cost of administration to be $2,370,138. Assuming the accuracy of this calculation, it is equivalent to approximately $12.20 per permittee.

Applying this unit cost to a liberal estimate of 25,000 permittees, administrative costs will be approximately $305,000, compared with an estimate of $2,370,138.

Subtract also from this estimated cost of administration the amount which will be derived from annual licenses, which if fixed at $5 per annum would produce a revenue of $125,000, or more than 40 percent of the cost of administration.

Thus, it is contended the high cost of administration as calculated by the Treasury is but camouflage, conceived and determined on a false premise.

BRIEFS

A tax differential on ethyl alcohol consumed in nonbeverage industrial products is effective in every nation in the world except the United States.

Today, under extreme war pressure, Canada taxes nonbeverage ethyl alcohol at $1.50 per gallon. Beverage alcohol is taxed at $7 per gallon.

During prohibition, the United States taxed nonbeverage ethyl alcohol at $1.10 per gallon. Beverage alcohol was taxed at $6.40 per gallon.

Administration of the law in Canada is satisfactorily accomplished under a permit and bond system. A similar system was employed in the United States from 1917 to 1933.

Ethyl alcohol consumed in food products, flavors, and medicines is a necessary use. Ethyl alcohol consumed in beverages is a luxury use.

In 1791 Congress first taxed all domestic distilled spirits. On June 5, 1794, Congress first distinguished between luxury and necessary use of distilled spirits. In that act it was provided the tax should not apply to physicians, apothecaries, surgeons, or chemists, as to any wines or spirituous liquors which they may use in the preparation or making up of medicines for sick, lame, or diseased persons only.

Congress distinguished between luxury use and necessary use of ethyl alcohol during practically all the years between 1794 and 1933.

With the repeal of prohibition all distilled spirits (beverage and nonbeverage ethyl alcohol) were taxed at $2 per gallon. This liquor-taxing act followed the principle of the law of 1791.

Later distilled spirits were taxed at $2.25 per proof gallon, then $3, and now there is proposed a tax of $4 per proof gallon.

The distinction between beverage and nonbeverage use of ethyl alcohol has been lost. Use of ethyl alcohol in the production of necessities should be fostered by reestablishment of a tax differential.

Producers of food products, medicines, flavors, and flavoring extracts, and druggists' compounding prescriptions ask no tax exemption. Each and every one of them pays every other tax, license or fee levied by Federal, State, county, and municipal government. In addition they are willing to pay an equitable tax on pure alcohol used by them.

These producers ask only that there be reestablished a classification of ethyl alcohol used for nonbeverage purposes and that a just tax of not more than $2.25 per proof gallon be placed thereon. Increased consumption and increased revenues will result.

The CHAIRMAN. Mr. Embry. Are you appearing for your own industry, American Bakeries Co.?

Mr. EMBRY. Yes; my company.

The CHAIRMAN. You may proceed.

STATEMENT OF B. S. EMBRY, ATLANTA, GA., REPRESENTING AMERICAN BAKERIES CO.

Mr. EMBRY. My name is B. S. Embry. I am secretary-treasurer of the American Bakeries Co., which has its principal office in Atlanta, Ga.

I have prepared a brief statement, Mr. Chairman, which sets forth our case and which I would like to read to you and the other members of the committee.

The CHAIRMAN. You may proceed.

Mr. EMBRY. First, I will state that the purpose of my appearance is not to enter an objection to the imposition of the excess-profits tax. The purpose of my appearance is to call to your attention what appears to be an inadvertent omission in the present law, which imposes a peculiar hardship on our company and compels us to bear a burden out of proportion to that which is borne by other companies with similar earnings. I refer particularly to the failure of sections 742

and 713 (f) of the Excess Profits Act of 1940, as amended March 1941, to provide the same treatment of acquiring corporations as of other corporations.

Until December 31, 1938, our operations were conducted by two companies, a parent corporation and one subsidiary corporation. The parent corporation was organized in 1927 and acquired all of the common stock of the subsidiary corporation. It conducted no business other than the receiving of dividends from the subsidiary corporation and the payment of dividends to its stockholders. The subsidiary corporation, since its organization in 1920, was continuously engaged in the manufacture and distribution of bakery products. At December 31, 1938, the subsidiary corporation was merged into the parent corporation, which action was in conformity with the general desire of the administration to simplify corporate structures and eliminate holding companies. As a consequence of the merger and liquidation of the subsidiary corporation, the former parent corporation became the operating and surviving company.

In 1940 we had a taxable net income of appoximately $1,460,000 and a taxable net income in 1939 of approximately $1,130,000. In 1936, 1937, and 1938 the annual net loss exclusive of dividends received from the subsidiary corporation each year amounted to approximately $24,000. These losses are explained by the fact that the real income for those 3 years was from the operations of the subsidiary corporation.

Obviously, we are at a substantial disadvantage if in determining the base-period credit under the average-earnings method, our earnings are limited to those of the present company as a separate entity as distinguished from the combined earnings of the two companies over the base period. As the result, our base-period credit for 1940 was but $805,488, whereas it would have been $1,073,586.

In other words, our company paid excess-profits tax for the year 1940 amounting to $134,664, whereas other corporations with exactly the same amount of earnings during 1940 and the base-period years would have paid $23,744.

Senator BAILEY. Did you make your consolidation prior to the passage of the act?

Mr. EMBRY. We effected our consolidation December 31, 1938.

Senator BAILEY. Prior to the act?

Mr. EMBRY. Yes; that was prior to the passage of the act.

It is our belief that all taxpayers having comparable earnings should be similarly treated under the provisions of the statute.

If the subsidiary company had been merged and liquidated prior to January 1, 1936 (the beginning of the base period), our company would have paid excess-profits tax in 1940 of $23,744, which is $110,890 less than what was paid as heretofore stated.

The mere fact that the subsidiary was not merged and liquidated until December 31, 1938, resulted in this excessive amount of excess-profits tax for the year 1940 alone.

If the underlying theory of the excess-profits tax is to reach profits in excess of the average earnings over the base period, it would seem that we should be entitled to the benefits of section 713 (f) as well as the use of the combined earnings of the present company and its former subsidiary, since the operations then conducted by both companies are now conducted solely by the present company.

In a subject as complex as the excess-profits tax, we can appreciate the difficulty of initially drafting, with 100-percent thoroughness, provisions which fully consummate the congressional intent. In the amendments passed in 1941 it was intended, we believe, to give a certain measure of relief to those companies whose earnings increased in the last half of the 4 years of the base period. That relief was given in section 713 (f). As the statute is worded, it fails to give relief uniformly to a parent corporation which has acquired its subsidiary during the base period.

Counsel for the company have prepared a memorandum which points out, in somewhat greater detail, the omissions in the statute which deny us the benefits which we believe Congress intended us to have, and which makes a suggestion as to the changes we think should be made in the statute. We ask permission to file a copy of this memorandum for your consideration.

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

Mr. EMBRY. Any questions?

The CHAIRMAN. It may be that in the subsequent bill the committee will be called on to consider during the coming winter that your situation can be pretty carefully canvassed.

You can file your memorandum for this record so we will have it.

Mr. EMBRY. Thank you.

(Mr. Embry submitted the following memorandum:)

MEMORANDUM AS TO APPLICATION OF GROWTH COMPANIES RELIEF PROVISION TO PARENT CORPORATION AND CONTROLLED SUBSIDIARY

EXCESS-PROFITS TAX

The excess-profits-tax provisions of the Internal Revenue Code fail to make adequate provision for acquiring corporations. As the statute now reads, it is certain that an acquiring corporation electing to be taxed under section 742 would lose the benefit of the growth provisions in section 713 (f). Denial of the benefit of such relief to acquiring corporations which have absorbed their subsidiaries during the base period is inconsistent with other provisions of the statute and with the general intention behind the 1941 amendments which inserted the growth provisions into the statute.

This memorandum is limited to a discussion of the problem as it affects a parent corporation which has absorbed, during the base period, a subsidiary which had been controlled by the parent corporation throughout the base period up to the time of absorption or acquisition. The fact that a company in such a situation is unequally treated under the 1941 excess-profits-tax amendments is readily illustrated by the use of comparative examples.

Situation I.—By way of illustration assume that corporation A has been in existence over the period from December 31, 1935, to date, and that during this period, until liquidation on December 31, 1938, it owned all of the voting stock of corporation B, which likewise has been in existence over such period; assume that the base-period net income of corporation A and corporation B (both up to December 31, 1938, when it was liquidated and merged with corporation A) was as follows:

Year	Corporation A	Corporation B	Combined
(1)	(2)	(3)	(4)
1936	$-32,409.18	$638,087.40	$605,678.22
1937	-21,966.58	768,538.39	746,571.81
1938	-17,687.22	881,013.01	863,325.79
1939	1,130,072.17		1,130,072.17
Total	1,058,000.19	2,287,638.80	3,345,647.99

(*a*) If the incomes of the companies A and B are combined under section 742, (see column 4) the combined income for the 4 years would be $3,345,647.99 and the average base period net income would be $836,421. The excess-profits credit, assuming no capital additions or deductions, would be $794,591.40.

(*b*) If corporation A computes its excess-profits credit under section 713 rather than section 742 (see column 2) its average base period income is $847,882.66 and its excess-profits credit is $805,488.53. This result is indicated in the following tabulation:

Corporation A

Calendar year 1936	—$32,409.18
Calendar year 1937	—21,966.58
Total first half	—54,375.76
Calendar year 1938	—17,687.22
Calendar year 1939	1,130,072.17
Total, last half	1,112,384.95
Difference	1,166,760.71
One-half of difference	583,380.36
Total, last half	1,112,384.95
Total	1,695,765.31
Average of above total (½)	847,882.66
Average base period net income	847,882.66
95 percent of average base period net income	805,488.53

Situation II.—If corporation B had continued in existence instead of being dissolved as of December 31, 1938, corporations A and B would have been entitled to file a consolidated return (I. R. C. sec. 730 added by sec. 201, Second Revenue Act of 1940 as amended by section 7, Excess-profits amendments of 1941; regulation 110, section 33.30 and 33.31 (a) (22)). On such consolidated basis the average base period net income after applying limitation would have been $1,130,072.17 and the excess profits credit would have been $1,073,568.56, as indicated in the following tabulation:

Corporation A and corporation B

Calendar year 1936	$605,678.22
Calendar year 1937	746,571.81
Total, first half	1,352,250.03
Calendar year 1938	863,325.79
Calendar year 1939	1,130,072.17
Total, last half	1,993,397.96
Difference	641,147.93
One-half of difference	320,573.97
Total, last half	1,993,397.96
Total	2,313,971.93
Average of above total (one-half)	1,156,985.97
Base period net income computed under section 713 would have been	$1,130,072.17
95 percent of average base period net income	1,073,568.56

Situation III. (*a*) If, on the other hand, instead of continuing in existence through 1939 and 1940 (situation II), or instead of liquidating on December 31, 1938 (situation I), which are the two suppositions made above, corporation B had liquidated into corporation A on December 31, 1937, corporation A's average base period net income computed under section 713 would have been 1,130,072.17 (after applying the limitation) and its excess-profits credit $1,073,568.56, as indicated in the following tabulation:

Corporation A

Calendar year 1936	—$32,409.18
Calendar year 1937	—21,966.58
Total, first half	—54,375.76
Calendar year 1938	863,325.79
Calendar year 1939	1,130,072.17
Total, last half	1,993,397.96
Difference	1,939,022.20
One-half of difference	969,511.10
Total, last half	1,993,397.96
Total	2,962,909.06
Average of above total (½)	1,481,454.53
Limitation under sec. 713 (f)	1,130,072.17
95 percent of average base period net income	1,073,568.56

(*b*) Assuming liquidation of corporation B into corporation A on December 31, 1937, if corporation A elected to compute its tax under section 742 rather than section 713, its excess-profits credit would be only $794,591.40, or the same as in situation I (a).

Summary of excess-profit credit allowable

Subsidiary liquidated Dec. 31, 1937 (1)		Subsidiary liquidated Dec. 31, 1938 (2)		Subsidiary not liquidated (3)
If taxpayer elects to compute credit under sec. 742	If taxpayer elects to compute credit under sec. 713	If taxpayer elects to compute credit under sec. 742	If taxpayer elects to compute credit under sec. 713	
$794,591.40	$1,073,568.56	$794,591.40	$805,488.53	$1,073,568.56

It seems reasonably clear that the mere fact of dissolution of the subsidiary on December 31, 1938, should not result in an excess-profits tax credit different from the credit allowed where the two companies remain in existence during the full base period and the taxable year or where the controlled subsidiary was liquidated December 31, 1937.

In the case which we have used as illustrating this problem (situation I—dissolution of corporation B on December 31, 1938), corporation A is strangely enough better off by electing to be taxed under section 713 on its own base-period earnings including 3 years of losses than by electing to be taxed under section 742 and using the combined earnings of itself and its subsidiary. The reason for this result is that by electing to be taxed under section 713 the company is assured of the relief provided in the growth provisions (sec. 713 (f)), whereas if it elects to be taxed under section 742 it must determine its average base period net income without reference to the growth provisions. In other words, while the combined income of A and B for the years 1936 to 1939, both inclusive, is $3,345,647.99; that is, approximately $2,288,000 more than the income of corporation A alone, the average base period net income of Corporation A determined on the combined income under section 742 is only $836,412 while the average base period net income of corporation A determined under section 713, and solely by reference to its own income, is $847,882.66.

If corporation B had liquidated 1 year earlier; that is, on December 31, 1937, corporation A would have increased its average base period net income from $847,882.66 to $1,130,072.17 if it had elected under section 713 to use only its own income; under section 742 it would have an average base period net income of $836,421, the same as though corporation B had liquidated December 31, 1938, rather than December 31, 1937.

If corporation B had not liquidated at all but continued as a subsidiary throughout the base period and the taxable year, the consolidated average base period net income of the enterprise would be $1,130,072.17.

The foregoing illustrations demonstrate the unevenness of the relief presently provided in section 742. It is inequitable not to recognize the singleness of identity and permit recognition of the growth factor in the unit where a parent and controlled subsidiary working together have through their efforts consistently increased the total earnings of the unit, as is done in the provision for consolidated returns. Clearly in a case of the character described in situation I it could not have been intended that the relief provided in section 742 should be less than the relief provided in section 713, nor could it have been intended that an acquiring corporation which has absorbed its subsidiary and thereby simplified its corporate structure should be given a lesser credit than is allowed to a parent and controlled subsidiary which continue in existence during the taxable year (see situation II); nor that a difference of 1 year in the time of absorption of a controlled subsidiary should result in an allowance for excess-profits credit which varies over 20 percent. (See situation III.)

The excess-profits tax was intended to reach only excess earnings or war profits. In the enactment of the original excess-profits tax provisions in the Second Revenue Act of 1940 and in the excess-profits-tax amendments of 1941, Congress has demonstrated its intention to adhere as closely as possible to this theory and to insert provisions in the statute to take care of cases which fall outside the simple types and in order to avoid unevenness in its application to varying situations which were basically alike.

In the case used by way of illustration in situation I, corporation A stands alone for the year 1940, having absorbed its subsidiary during the base period. The combined earnings of itself and subsidiary over the 4 base-period years average $836,412 a year. It should be entitled to use the average income of itself and subsidiary for the base-period years and the statute grants that privilege in section 742. However, in addition, it is strikingly a "growth enterprise," the earnings of the two companies having increased approximately 20 percent in each of the 4 years (see the figures above); its base-period net income for 1939 was $1,130,072.17. It would be unreasonable to impose an excess-profits tax on this corporation except on the theory that it was only the excess over $1,130,072.17, which represented excess profits, inasmuch as its profits before 1940 had reached that level and were still accelerating. This is undoubtedly a situation which Congress intended to provide for in subsection (f) of section 713, added by section 4 of the excess-profits tax amendments of 1941. The present language of the statute is, however, inadequate for that purpose.

The result suggested may be accomplished by adding to section 742 the following:

Add at the end of the first paragraph of section 742, after the phrase "section 713," eliminating the colon and substituting a comma, the following:

"subject to the exception that if the acquiring corporation has been in control of a qualified component corporation or corporations during its entire base period and at all times until the acquiring corporation became an acquiring corporation with respect thereto, and if the aggregate excess profits net income, as computed under subsection (h) for the last half of its base period and reduced by the aggregate of the deficit of such corporations in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (h) if greater than the amount otherwise determined hereunder."

Add as a new subsection at the end of section 742 the following:

"(h) *Average base period net income—increased earnings in last half of the base period.*—The average base period net income determined under this subsection shall be determined as follows:

"(1) by computing, for each of the taxable years of the taxpayer in its base period the excess profits net income for such year as determined in subsections (a) to (g) hereof or the deficit in excess profits net income so determined, but excluding the excess profits net income or deficit of all component corporations which are not qualified component corporations of which the taxpayer was in control during its entire base period and at all times until the acquiring corporation became an acquiring corporation with respect thereto;

"(2) by computing, for each half of the base period the aggregate of the excess profits net income, as computed in paragraph (1), for each of the taxable years in such half, reduced, if for one or more of such years there was a deficit in such excess-profits net income, by the sum of such deficits;

"(3) if the amount ascertained under paragraph (2) for the second half is greater than the amount ascertained for the first half, by dividing the difference by two;

"(4) by adding the amount ascertained under paragraph (3) to the amount ascertained under paragraph (2) for the second half of the base period;

"(5) by dividing the amount found under paragraph (4) by two;

"(6) The amount ascertained under paragraph (5) shall be the average base period net income determined under this subsection, except that the base period net income determined under this subsection shall in no case be greater than the highest excess-profits net income, as determined in subsections (a) to (g) hereof, but excluding the excess-profits net income or deficit of all component corporations which are not qualified component corporations of which the taxpayer was in control during its entire base period and at all times until the acquiring corporation became an acquiring corporation with respect thereto, for any taxable year in the base period;

"(7) As used in this subsection the term 'control' means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote."

The CHAIRMAN. There is a witness here who wants to get away and I understand his statement is very brief, Mr. Thomas Whitaker.

Mr. Whitaker, we are calling you out of order, because your statement is not long, as I understand it.

Mr. WHITAKER. I certainly appreciate it; I want to get away as I have to leave town.

STATEMENT OF THOMAS WHITAKER, TAMPA, FLA., REPRESENTING FLORIDA CABARETS AND RESTAURANTS

Mr. WHITAKER. My name is Thomas Whitaker, of Whitaker Bros., Tampa, Fla., and I am representing the Columbia Restaurant located in Tampa, Fla. I will say here, however, by way of interpolation, that while we only directly represent this one restaurant, there are undoubtedly thousands of restaurants in the United States in the same position we are in.

The Columbia Restaurant operates a strictly high-class Spanish restaurant, specializing in Spanish foods served in the atmosphere of the Latin countries. No performances nor entertainment of any kind is given with the exception that an orchestra is maintained by the restaurant and the patrons are permitted to dance if they so desire; however, no dance program is arranged by the restaurant. No admission or cover charge is made by the restaurant, and the music, along with the privilege to dance, is an incident to the restaurant business. In other words, the maintenance of the orchestra by this restaurant is for the purpose of carrying out the scheme of serving Spanish foods in a Latin country atmosphere, rather than for entertainment purposes. All we are asking is that this restaurant be protected by clarification of the section in question, so that the basis for a distinction between the interpretation as now made in the Treasury Department between restaurants such as the Columbia Restaurant and the ordinary restaurant will be removed.

Senator BAILEY. What is your contention?

Mr. WHITAKER. Our contention is that we are operating a restaurant business, purely and simply.

Senator BAILEY. But you have music and dancing.

Mr. WHITAKER. We have music and we permit dancing. We do not arrange dances; we don't put on cabaret shows or acts of entertainment or anything of that nature.

Senator BAILEY. Music is provided; dancing is optional, and if you call it Spanish atmosphere you will get free of the tax?

Mr. WHITAKER. No, sir; it just so happens, as I said awhile ago, there are thousands of restaurants throughout the United States who are in our position who are not following out the Spanish atmosphere. In other words, the music and dancing is purely an incident to the food with us, not a case of where the food is incidental to the entertainment and dancing.

Senator BAILEY. I don't know how you get the distinction as to that; whether the music is incidental or whether the food is incidental.

Mr. WHITAKER. One illustration: The restaurant business is one that operates on a very small margin of profit.. The profit shown by the Columbia Restaurant during the last year was less than 3 percent net of its gross revenue. Our average we had figured up before I left there. Our average bill as compared with our gross business, and it ranged between $1.65 and $1.75; that is the average bill of all people who come in here and trade with us; but under this proposal this will be a gross-receipts tax of 5 percent tacked on us, whereas we are competing with restaurants, not cabarets; in other words, we are in a position where we cannot, our economical position will not permit us to absorb that.

The CHAIRMAN. Have you an amendment?

Mr. WHITAKER. I have this suggestion only: We believe this can be done by the use of a few simple words clearly setting forth that this section covers an entertainment tax and is not intended to cover restaurants which only furnish music and permit dancing as an incident to the operation of the restaurant business. If, however—now we come to another point which we want clearly understood—if, however, it should be the desire to place a tax on restaurants, we feel it should cover all restaurants and should so state in the tax bill so that no question of interpretation can arise. In other words, we find ourselves in the anomalous situation that we are not operating a roof garden or a cabaret and yet we are being taxed for and on the theory that such is our operation.

Senator BAILEY. What is a cabaret?

Mr. WHITAKER. A cabaret is a place which sells entertainment.

Senator BAILEY. And food?

Mr. WHITAKER. And food. Food, however, is incidental to the entertainment; they have cover charges, admission prices of one kind or another, which we do not have. We have none of that at all. They put on performances; they have vaudeville acts and different types of entertainment that they give; we have none at all. Yet it has been ruled that the tax does not apply where they have what is known as canned music and the people get up and dance to that; we are in competition with those places in Tampa. Such places are not required to pay the tax because they do not furnish the music; that has been the interpretation placed on it. In other words, the restaurant itself is not furnishing the music to which they dance because the customer drops his nickel in the slot and dances. Yet music and dancing is available in these places in competition with us.

Senator BAILEY. I know of one hotel in Washington where they have this chain music, where the music comes in at meal times over the radio. Is that taxable?

Mr. WHITAKER. My understanding is that it is not under the provision we are complaining of.

Senator BAILEY. Cabarets are a new word in our vocabulary; I am not sure how it has been defined.

Mr. WHITAKER. My understanding is as I have indicated.

Senator BAILEY. In cabarets the entertainment is the main thing; in restaurants the food is supposed to be.

Mr. WHITAKER. That is it, and we have no objection, as I say, if it is the desire to place a tax on restaurants, we are perfectly willing to pay it, but we do feel that when we find ourselves in the restaurant business and taxed on the theory we are in the cabaret business, with a restaurant across the street from us serving food exactly as we are not being required to pay the tax, it is something which puts us at considerable disadvantage.

Senator BAILEY. If you had a tax on restaurants, you do have a tax on all dining rooms?

Mr. WHITAKER. Yes; and we are not complaining of that.

Senator BAILEY. Do you have a tax on food?

Mr. WHITAKER. No, sir.

The CHAIRMAN. The trouble seems to be the Treasury has construed a restaurant such as you operate as a cabaret, "or other similar place furnishing a public performance for profit," which for quite some years has been taxable. Perhaps, a distinction might be drawn if you only furnished the music, but when you furnish music coupled with an opportunity to dance, then the Treasury's interpretation doesn't seem to me to be so unreasonable in your case.

Mr. WHITAKER. The only complaint we have there is that the ruling and interpretation made by the Treasury Department only applies where the restaurant itself furnishes orchestra music. If it is carried on as I suggested a while ago by the use and employment of an organ where a coin is dropped in, they still permit it to go untaxed.

Senator BAILEY. You would be satisfied if we extended the tax to those places?

Mr. WHITAKER. Yes; that would eliminate the discrimination and that is our complaint.

The CHAIRMAN. We have your point: You would like to have the statute clarified so you wouldn't get under it, or if you did, that you would not be discriminated against?

Mr. WHITAKER. That is it exactly.

(The following prepared statement was submitted by Mr. Whitaker:)

AUGUST 20, 1941.

My name is Thomas Whitaker, of the law firm of Whitaker Bros., of Tampa, Fla., representing the Columbia Restaurant, located in Tampa, Fla. This brief is submitted on provisions of section 542 of H. R. 5417, being the revenue act now pending before the Finance Committee of the Senate.

The particular section above referred to, and which will be discussed herein, is entitled "Cabaret, roof garden, etc., tax," and is found on page 46 of the printed copy of said bill.

Our contention is that the tax imposed by said section above referred to does not apply to a restaurant such as is operated by the Columbia Restaurant. However, owing to the regulations and the interpretation placed upon the wording of said section, the Internal Revenue Division of the Treasury Department has ruled that the tax does apply. The Florida Senators agreed with us that it was not intended for section 542 to apply to restaurants operated in the manner which the

Columbia is operated. Senator Pepper called the legislative drafting committee and was informed that under their interpretation the section would not apply.

The Columbia Restaurant, with an investment of approximately $150,000 or more, operates a strictly high-class Spanish restaurant, specializing in Spanish foods served in the atmosphere of the Latin countries. No performances nor entertainment of any kind is given with the exception that an orchestra is maintained by the restaurant and the patrons are permitted to dance if they so desire; however, no dance program is arranged by the restaurant. No admission or cover charge is made by the restaurant, and the music, along with the privilege to dance, is an incident to the restaurant business. In other words, the maintenance of the orchestra by this restaurant is for the purpose of carrying out the scheme of serving Spanish foods in a Latin country atmosphere rather than for entertainment purposes.

All we are asking is that this section be clarified so that the basis for the difference between the interpretation as now made by the Internal Revenue Bureau of the Treasury Department and the opinion of legal authorities as well as the legislative drafting committee as to what this section covers will be removed. We believe that this can be done by the use of a few simple words clearly setting forth that this section is an entertainment tax and is not intended to cover restaurants which only furnish music and permit dancing as an incident to the operation of the restaurant business.

If, however, it should be the desire to place a tax on restaurants, we feel that it should cover all restaurants and should so state in the tax bill, so that no discrimination could result therefrom.

If a tax is levied, it should be mandatory that the tax be separately listed and shown on the bill rendered to the consumer.

The CHAIRMAN. Before taking a recess, I wish to have incorporated in the printed record a letter addressed to me by Senator Wiley, of Wisconsin.

(The letter referred to is as follows:)

UNITED STATES SENATE,
COMMITTEE ON THE JUDICIARY,
August 9, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR: Since August 4, 1941, when H. R. 5417 passed the House of Representatives, I have had occasion to make daily telephone calls to the Senate Finance Committee expressing my views with reference to certain portions of H. R. 5417.

Like all Members of Congress, I have received a great many letters concerned with certain specific portions of the pending measure. I have already discussed most of the views contained in these letters in conversation with the committee.

Because representatives of these various views will appear before your committee, and because the committee clerk advises me that the testimony in these hearings will be so voluminous that it will be impossible to encumber the written record of the hearings with such an extensive correspondence, I will not request that this material be incorporated in the hearings.

Supplementing my telephone conversations, however, I am presenting my correspondence files on H. R. 5417.

It is my understanding that the points raised in these letters will be given every consideration by the committee in their deliberations on this measure.

I want to express my appreciation for the courtesy and consideration which the members of your staff have extended to me. I have made numerous calls on their time, and they have always evidenced a genuine willingness to cooperate in the consideration of views presented by my constituents.

With kindest regards.

Sincerely yours,

ALEXANDER WILEY.

The CHAIRMAN. I have before me statements by Representative Curtis and Mr. A. W. Kohler and a memorandum by Mr. Ike Lanier, which will be incorporated in the record at this point.

(The statements and memorandum are as follows:)

STATEMENT OF HON. CARL T. CURTIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA, BEFORE THE COMMITTEE ON FINANCE IN REFERENCE TO A PROPOSED TAX ON BILLBOARDS

Mr. Chairman, I wish to impose upon the committee's time briefly to protest the tax upon outdoor advertising, or what is commonly referred to as billboards. No opportunity came to make this protest before the Ways and Means Committee of the House of Representatives. I believe it is fair to state that no notice was given that such a tax was being considered; consequently, no one had an opportunity to appear in protest thereof.

In support of my position, I wish to make the following points:

(1) A tax on billboards is a tax on advertising, without covering the whole field of advertising. I am not here to suggest that other mediums of advertising be taxed, but surely there is no justice in picking out one type of advertising and imposing a tax thereon. Advertising is essential to our system of free enterprise and open competition.

(2) The tax on billboards as it passed the House of Representatives would in many instances be confiscatory. I am referring particularly to billboards in rural areas and small towns where the revenue is very limited.

(3) Many billboards have been contracted for 2, 3, or 5 years in advance. The price has been agreed upon without any knowledge of any special Federal tax that might be placed against the billboard owner. In these cases it would either mean the breaking of the contract and the destruction of the billboard or an unjust and unfair tax imposed upon the owner of the billboard.

(4) The big concerns, or the wealthy advertiser, might be able to pay this tax and continue his billboards, especially if his advertising was carried on in order to cut down his income tax. That is not true of the smaller towns, or the small businessman. It merely takes his outdoor advertising away from him and destroys the property rights of the owner of the billboards.

(5) It must be borne in mind that the billboards of our Nation have given freely to safety campaigns, the Red Cross, community chests, national defense, and many, many other worth-while things. It is unjust to single out this particular type of advertising for a Federal tax.

Respectfully submitted.

CARL T. CURTIS, M. C.,
Fourth District of Nebraska.

NATIONAL ASSOCIATION OF MOTOR BUS OPERATORS,
Washington, D. C., August 21, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: As secretary-manager of the National Association of Motor Bus Operators, I am transmitting to you herewith a statement in opposition to the proposed increase in the Federal gasoline tax.

Our association does not oppose this tax for the reason that we are opposed to increased taxation in this period of emergency, but because of the fact that it is discriminatory in character.

The members of the motorbus industry are engaged in a highly competitive business, and for them to be singled out among the passenger carriers for special taxation resulting in increased operating costs will seriously handicap them in furnishing the public with a high-class and necessary service.

I shall appreciate it if you will file the enclosed copy of our statement with the Finance Committee and bring it to the attention of the members of the committee.

Respectfully yours,

A. W. KOEHLER, *Secretary-Manager.*

Encl.

STATEMENT OF NATIONAL ASSOCIATION OF MOTOR BUS OPERATORS ON PROPOSED ADDITIONAL INCREASE IN FEDERAL GASOLINE TAX

In a statement submitted to the House Ways and Means Committee in opposition to any further increase in the Federal gasoline-tax rate, the National Association of Motor Bus Operators stated its belief that those engaged in commercial highway transportation cheerfully should pay their full share of the cost of national defense. The National Association of Motor Bus Operators now reaffirms that belief but hopes to give it greater emphasis by pointing out that it would be unfair to compel commercial highway transportation to bear a disproportionate share of national-defense costs.

The National Association of Motor Bus Operators always has tried to avoid being known as a chronic complainer. It has been the policy of our organization never to express opposition to public policy unless we sincerely were convinced that the policy was unsound or inequitable. For example, motorbus operators accepted without complaint the increase in the Federal gasoline tax and other automotive levies enacted by the Revenue Act of 1940, even though those increases were most substantial, because as patriotic citizens they recognized the critical need for more revenue and were ready and willing to bear their rightful share, and more, of the burden.

Ever since the proposal to increase further the Federal gasoline-tax rate from 1½ to 2½ cents a gallon first was suggested; however, bus operators—individually and as a group—have felt that enactment of this proposal would be both unsound and inequitable. The viewpoint of these men is the viewpoint of their national association. In their behalf, therefore, the National Association of Motor Bus Operators has felt that rightfully it should make known this viewpoint, and the considerations on which it is based, to the legislative authorities weighing the expediency of this proposal.

The National Association of Motor Bus Operators believes that a further increase in the Federal gasoline tax would be unsound because—

1. The gasoline tax is a good tax measure only when used as a "benefit impost." The volume of gasoline consumed by an individual determines the amount of tax he must pay. To be a sound measure of tax responsibility the consumption of gasoline should either reflect the taxpayer's ability to pay or his benefits received. Obviously gasoline consumption does not indicate ability to pay, because the small farmer may consume many times more gasoline in earning his living than does the fabulously paid moving-picture actor. On the other hand, gasoline consumption does measure with reasonable accuracy one form of special benefit received by the taxpayer, namely, road benefits. A gasoline taxpayer's consumption of gasoline, roughly, is proportionate with his use of the roads. As a road tax, therefore, the gasoline tax is a sound tax measure, but it does not possess the characteristics that determine a good tax measure to raise revenue for general governmental purposes.

2. The taxation of gasoline is primarily a State tax field. The gasoline tax was originated by the States, and each of the States already had come to rely heavily on this impost long before the Federal Government first levied a tax on gasoline. Moreover, it has been shown that the gasoline tax most properly should be used as a benefit tax and is most favorably suited to financing highway construction and maintenance. Since the provision of highways still is primarily a State function, the continued and successful use of the gasoline tax by the States should not be jeopardized by an excessive duplicating Federal gasoline-tax rate.

3. Gasoline consumption is not "luxury consumption" and therefore should not be taxed as such. To classify gasoline with liquor, tobacco, cosmetics, and other luxuries for the purpose of justifying comparable tax rates is erroneous and misleading. Actually, as was pointed out to the House Ways and Means Committee time and time again, the major portion of the gasoline consumed by motor vehicles in this country is consumed on "necessity trips." A tax on gasoline, therefore, is a tax on "necessity transportation," not on the Suday ride.

4. Excessive taxation of gasoline impedes the full development of highway transportation. Since the fullest possible development of transport facilities is essential to the national-defense effort and the conduct of civilian life, it is imperative to consider the fact that excessive taxation of gasoline would impede this development. The motorbus, for example, is depended on today to carry workers to factories engaged in defense work. There are today some 48,000 communities throughout the United States that are dependent entirely upon the motorbus for their public passenger transportation. Since the cost of fuel is one

of the most important factors in motorbus operation, excessive gasoline taxes increase operating costs very substantially and discourages the fullest possible development of this new flexible and low-cost form of transportation.

The National Association of Motor Bus Operators believes that a further increase in the Federal gasoline tax would be inequitable because—

1. The revenue bill of 1941 already provides for the payment of a fair share of the new defense-tax burden by the automotive groups, including bus operators. Last year the increases in the Federal automotive excise-tax rates which were enacted were considerably more severe than those enacted for excise rates on other commodities. This year it is proposed to increase again all these Federal automotive tax rates, except the Federal gasoline tax. Combined with the increases enacted last year, these new proposed automotive-tax increases still are considerably higher than those for any other tax subject. In place of an increase in the Federal gasoline tax, an annual "use" tax of $5 for each vehicle on all motor vehicles is proposed. These new automotive tax rates will exact from the automotive group in excess of $285,000,000 each year in addition to the more than $500,000,000 in Federal excise taxes already paid by this group. Of these amounts, motorbus operators even now pay more than their proportionate share per vehicle because of their extensive use of automotive equipment and fuel. To superimpose on these proposed Federal excise-tax increases and the new "use" tax a further increase in the Federal gasoline tax would compel the automotive group to bear a disproportionate share of defense costs.

2. Motor-bus operators already bear an unusually heavy tax burden. Authoritative studies disclose that the average motor bus now pays about $1,200 annually in operating taxes and licenses. This figure does not include income and profits taxes, property taxes, and other general imposts. The larger motor-bus companies, operating in interstate service, pay in operating taxes and licenses an average of $3,392 for each bus. The extent to which such taxation is a burden on bus operation may readily be appreciated when it is understood that these taxes now comprise about 15 percent of the total variable operating costs of the motor-bus operator. Inasmuch as the cost of gasoline is one of the most important factors in bus-operating costs, the excessive taxation of gasoline becomes particularly burdensome on motor-bus operators.

3. An increased Federal gasoline tax would add to the excessive tax which gasoline now bears. Concerted opposition has been voiced against proposals that a Federal general sales tax be imposed, on the grounds that it severely would penalize persons of modest means. Usually it has been suggested that such a general sales tax should be imposed at the rate of 1 or 2 percent of the sales price. Yet, even at present rates, the Federal gasoline tax rate represents a special sales tax of about 12 percent. If the Federal gasoline tax were increased an additional 1 cent a gallon, it then would represent a sales tax of 20 percent. Including State and local gasoline taxes, consumers of gasoline now pay a special sales tax of 47 percent.

4. Bus transportation, which more than pays its way, would be compelled to assume a much greater tax burden than its competitors who receive governmental subsidies. The Federal Eastman report on Public Aids To Transportation revealed that highway transportation, including bus transport, was the only form of transportation, other than pipe lines, which pays its way and more. This report found that large busses paid special taxes that exceeded their share of highway costs by as much as $249 per vehicle per year. General tax payments by busses, of course, were in addition to these special taxes. The fare charged by bus-transportation companies are fixed by franchises or regulation. Obviously, the new 5-percent tax proposed for passenger fares will affect all competing forms of transportation in the same manner. But if another increase in the Federal gasoline tax is imposed, only those forms of transportation using gasoline as fuel, principally highway transportation, would be compelled to bear the extra cost. With the fares they can charge rigidly inflexible, bus operators then would be at a competitive disadvantage. It would be inequitable to impose a burdensome tax on one form of transportation and thus place it in an unfavorable position in its field of competition.

MURPHY, LANIER & QUINN,
Washington, D. C., August 20, 1941.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
Washington, D. C.

DEAR SIR: We ask the privilege of filing, for the consideration of the Senate Finance Committee, the attached memorandum in regard to joint Federal income-tax returns for husbands and wives and that the same be incorporated in the record of the proceedings before your committee.

We represent a great many individuals who would be affected by this proposed provision. It appears to us that the proposal now before the Senate Finance Committee to tax jointly income received from property but to exempt earned income is just as unconstitutional as the proposal contained in the House bill to tax jointly all income received by husband and wife.

Very truly yours,

IKE LANIER.

Encl.

MEMORANDUM RE JOINT TAXATION OF INCOMES OF HUSBAND AND WIFE

It is our purpose in this memorandum to develop the historical background and development of women's rights as they now exist, to point out their present status, and to indicate those considerations which we believe controlling with reference to the question of the proposed joint taxation for income-tax purposes.

HISTORICAL DEVELOPMENT

At common law, the wife's personalty in possession vested exclusively in her husband, without any act on his part, and, on his death, passed to his personal representatives. This was true as to personalty owned by her at the time of the marriage, personalty acquired during coverture, personalty in her actual possession, and personalty in the actual possession of some third party holding adversely. This property became as much the husband's as if it had been acquired by him originally. He could dispose of it as he saw fit; it could be seized by his creditors and subjected to the payment of his debts; and on his death it went to his personal representatives, even though the wife was the survivor. The husband's right to his wife's personalty in possession was the result of the marriage and depended upon nothing else. The right lasted as long as the marriage relation lasted.

At common law, the husband was entitled to his wife's choses in action if he reduced them to possession during coverture but not otherwise. To reduce them to possession he had only to exert some act of ownership over them, with the intention of converting them to his own use.

At common law the husband had the enjoyment of his wife's chattels real (leases and terms of years) during his life, with the power to dispose of or encumber them, and they were liable for his debts. If undisposed of upon his death, they belonged to the wife. If the wife predeceased him, they passed to him as administrator.

Where, at the time of marriage or during coverture, a woman was seized of an estate of inheritance in land, the husband was entitled to its usufruct. His estate lasted at least during coverture; and in case there was issue of the marriage born alive and capable of inheriting her estate, his estate continued as tenant by the curtesy initiate during the wife's life, and as tenant by the curtesy consummate after her death, for the remainder of his life. The husband's estate extended only to the use of the land. He was entitled to the rents, issues, and profits, and upon his death the emplements growing upon the land went to his representatives (*Breeding* v. *Davis*, 77 Va. 639, 46 Am. Rep. 740).

A married woman at common law had no power or capacity to contract other than her right in equity to contract with reference to her equitable separate estate so as to bind it (but not herself personally). Her attempted contracts were not merely voidable but were absolutely void.

The only way that a wife could hold property as a feme sole, free from the control of her husband, was to have a conveyance settled to her sole and separate use. To create such an equitable separate estate in the wife there had to be an intention on the part of the settlor that the wife should take and that the husband should not.

The above rules are of some historical interest, but of historical significance only. The law relating to the capacity of a married woman to own and control property and to contract has been almost completely remade since the beginning of the development of American law. This remaking has been accomplished by both legislation and judicial decision. The development of the present law of this subject has been a most interesting process, but the process has so definitely reached its conclusion in so large a majority of American jurisdictions that it is now universally accepted. This is a long step from the common law, where, as Blackstone puts it: "*By marriage the husband and wife are one person in law;* that is, the very being or legal existence of the woman is suspended during the marriage, or at least is incorporated and consolidated into that of the husband." (Italics supplied.) (See further Pollock and Maitland, History of English Law (2d ed.), ch. 7, sec. 2.)

Statutes have been enacted in practically every State providing that all property, real or personal, owned by a married woman at the time of her marriage, or acquired by her thereafter, should be and remain her separate property, free from the control of her husband.

In most States the statutes, either expressly or by construction of the courts, give married women the power to convey or dispose of their property, real or personal, but in a number of States the statutes require that the husband join in a wife's conveyance of her land in order to make it valid. In some States a husband has an inchoate interest in his wife's land, such as curtesy, statutory dower, or homestead, which is not divested by her conveyance of her lands, unless he releases such interest by joining in the conveyance or otherwise.

These changes were brought about by the statutes, known as the married women's acts, which have been everywhere adopted, though in varying terms and with varying effects, with the purpose of eliminating or modifying the harsh doctrines of the common law with reference to the legal status of married women. This legislation began in many of the States around the year 1850. As early as 1839 such a statute was enacted in Mississippi (Laws of 1839, ch. 46), Maryland (ch. 161 of Laws of 1841), Michigan (No. 66 of Laws of 1844).

In some States there are even constitutional provisions intended to secure the property rights of married women (Constitution of Arkansas, 1874, art. 9, secs. 7 and 8; Constitution of South Carolina 1895, art. 17, sec. 9; Constitution of West Virginia, art 6, sec. 49).

Under the statutes as they now exist, it has been held that a married woman has a separate estate in property acquired by gift (*Salisbury* v. *Spofford*, 22 Idaho 393; *Chorn* v. *Chorn's Adm'r.*, 98 Ky. 627; *Hess* v. *Brown*, 111 Pa. 124). A husband who executed a note to his wife for money received by her as heir of her mother, thereby made the note the wife's separate property, and deprived himself of any right to or interest in either the money or the note, though it did not in terms recite that it was for the wife's separate use (*Bennett* v. *Bennett's Adm'r.*, 134 Ky. 444). A wife acquires land as her separate estate if the consideration used in paying for the property was hers (*Johnson* v. *Johnson* (Taxes), 207 S. W. 202). Where property was paid for by the husband's checks, it is nevertheless the wife's property if the actual purchase money was funds of the wife previously given to him (*Conron* v. *Cauchois*, 242 Fed. 909). The property is hers, if purchased with her money, even though title is taken in the name of the husband (*Adone* v. *Spencer*, 62 N. J. Eq. 782, 50 L. R. A. 817; *Gooch* v. *Weldon Bank & Trust Co.*, 176 N. C. 213). In most States her earnings in activities not connected with her household duties are hers (*Nuding* v. *Urich*, 169 Pa. 289, 32 A. 409). In practically all States such damages as she may recover for torts committed against her are her separate property (*Blacchinska* v. *Howard Mission & Home for Little Wanderers*, 130 N. Y. 497, 15 L. R. A. 215; *Harmon* v. *Old Colony R. Co.*, 165 Mass. 100, 30 L. R. A. 658).

DISCUSSION

In any discussion relating to the separateness of the taxing entities—husband and wife—we must, of necessity, make careful differentiation of statutory and constitutional aspects. What the statute now provides, and the respective interpretations and troubles that have arisen thereunder, is one thing; what the statute may or can provide under the Constitution, is another thing. In the present case, the constitutional aspect is the more important. Many cases having a bearing on the construction of the statute do not reach the underlying constitutional principles involved; and our discussion must avoid these, yet cover those

cases which indicate, through an interpretation of the statute, the true condition of the basic constitutional mandate.

As we have pointed out, the early rule was that husband and wife were one, and that that one was the husband. Whatever may be said about the inequality and undesirability of such a rule of law, it definitely contemplated marital economic unity. The law has now developed, in the United States, to the point where the wife and husband are separate persons.

Under the modern taxing concept of a wife's status, she is liable for the tax on the income from her property, and remains, for tax purposes as otherwise, separate from her husband. This is true in community property States (*Poe* v. *Seaborn*, 282 U. S. 101), as well as in other States (*Margaret A. Holmes*, 27 B. T. A. 660). The income-tax statute taxes the "net income of every individual." The phrase has been construed so that "of" means ownership (*Poe* v. *Seaborn*, *supra*). In other words, the ownership of capital, which is one of the principal sources of income, determines the identity of the taxpayer who shall bear the burden of taxation with respect to such income (*Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85; *Helvering* v. *Helmholz*, 296 U. S. 93; *White* v. *Poor*, 296 U. S. 98). This has been most clearly illustrated in the cases relating to the assignment of income. Unless the corpus which produced the income was also assigned, the assignor was not relieved of income-tax liability. (*Lowery* v. *Helvering*, 70 Fed. (2d) 713, and the cases cited immediately above). It has been held further that the law may not make a different rule for husband and wife from the rule which obtains with respect to other parties equally separate in the eyes of the law (*Tracy et ux.* v. *Commissioner*, 70 Fed. (2d) 93). The very premise of all these decisions, and many others which might be cited, is the legal separateness of husband and wife. There would be no need to resort to ownership as a test of tax incidence if the husband and wife were a taxable unit; it would be a simple matter to distinguish the husband and wife cases from the general rule where ownership is the test. The historical fact is that the ownership test rule originated in the husband-and-wife cases; and that because husband and wife had developed legal separateness, it was necessary to establish the ownership test.

We might further point out that the courts have deemed it incumbent upon them to define ownership in a substantial, as distinguished from a narrow and technical, sense. Dominion and control and actual command over the property, and not mere refinements of title, control (*United States* v. *Robbins*, 269 U. S. 315; *Harold G. Parker*, 39 B. T. A. 423; *Richardson* v. *Smith*, 102 Fed. (2d) 697).

So many cases have been decided relating to the separateness of husband and wife, with reference to deductions for payments made, one to the other, that the matter is almost axiomatic. Where the payments are reasonable, and the transactions bona fide, no question arises.

The procedural rules and requirements relating to income tax carry further the idea of legal separateness. Husband and wife are separate persons for the purposes of board appeals (*Ethel Weisser*, 32 B. T. A. 755). See also rules 5 and 6 of the United States Board of Tax Appeals, 1941 revision. It has been held that a notice of deficiency sent to the husband is not notice to the wife (*Reynolds* v. *Glenn*, 1935 C. C. H., par. 9415). Further, the Commissioner may not credit a husband's account, without special consent, with a refund due to a wife (*Krug* v. *U. S.*, 18 F. Supp. 242).

It is true, as pointed out by some, that England taxes the combined incomes of husband and wife (44 Harvard 988; 32 Columbia 374; 13 Tax Magazine 198), but it must be remembered that every time a new law is enacted by the English Parliament a change is made, to that extent, in its Constitution. Hence, their income-tax law represents a derogation from the rights attained by women under the married women's acts. This follows the theory of Holmes in the *Hoeper case*. Such a change cannot be made by legislative enactment in this country—first, the State constitutions would have to be changed and the Federal Government granted that power, perhaps through a constitutional amendment, for Congress now has no such jurisdiction over the marital status.

It would seem clear that the status of husband and wife must be determined in the light of their status as established as a fact by State law. (Cf. Divorce cases, differences in State laws controlling, etc.) This seems to be indicated even on principle, and seems recognized by the *Robbins case*, wherein the Supreme Court stated its understanding of its "duty" to follow the rule adopted, or settled opinion of the California courts as to the community property status of husband and wife. The Supreme Court has unequivocally re-

fused to disregard a State rule of property to work uniformity of incidence and operation of the income tax in the various States with relation to married people, holding that the constitutional requirement of uniformity is not intrinsic, but geographic (*Poe* v. *Seaborn*, 282 U. S. 285). We do not believe that the theories set forth in *Lyeth* v. *Hoey* (305 U. S. 188); *Helvering* v. *Hallock* (309 U. S. 106); and *Helvering* v. *Reynolds* (1941 P. H., par. 62046); in any way affect the validity of this statement. This may well be summed up in the words of Justice Frankfurter to the effect that "The feudal laws of property must not interfere with modern fiscal practice." We are not here dealing with the feudal laws, but rather those current constitutional rights of women which have arisen with the growth of American jurisprudence.

CONSTITUTIONAL CONSIDERATIONS

We have dealt above with the development of the modern position of man and wife, and the treatment of that status under the modern taxing statutes. The real question is whether Congress may validly, for Federal tax purposes, discard this modern philosophy of marriage. The one leading case on this subject is that of *Hoeper* v. *Tax Commission of Wisconsin* (284 U. S. 206). (Noted in 32 Columbia 374; 45 Harvard 740; 9 N. Y. Univ. L. Q. R. 490, 492; 30 Michigan L. R. 810; 44 Harvard 988.) In this case, the State of Wisconsin, one of the pioneer States in income-tax legislation, realizing the opportunity afforded by separate returns for minimization of tax liability, enacted a statute which attempted to tax a husband upon the combined total of his and his wife's income as shown by separate returns. The amount of the tax on the combined incomes assessed to the husband exceeded the sum of the taxes which would have been due if their taxable incomes had been assessed separately.

Objection was made to this assessment, on the ground that it was a violation of the due-process and equal-protection clauses of the fourteenth amendment to the Constitution. The Supreme Court majority opinion, written by Mr. Justice Roberts, upholds this contention of the husband. After coming to the conclusion that under Wisconsin law the wife's income is in the fullest degree her separate property, and in no sense that of her husband, the opinion views the question presented as one of the power of the State, by an income-tax law, to measure the husband's tax, "not by his own income, but, in part, by that of another."

Mr. Justice Roberts, early in his opinion, cites certain language from *Knowlton* v. *Moore* (178 U. S. 41), which he believed apposite:

"It may be doubted by some, aside from express constitutional restrictions, whether the taxation by Congress of the property of one person, accompanied with an arbitrary provision that the rate of tax shall be fixed with reference to the sum of the property of another, thus bringing about the profound inequality which we have noticed, would not transcend the limitations arising from those fundamental conceptions of free government which underlie all constitutional systems."

Then follows this interesting language:

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the fourteenth amendment. *That which is not in fact the taxpayer's income cannot be made such by calling it income.*

* * * * * * *

"It is incorrect to say that the provision of the Wisconsin income tax statute retains or reestablishes what was formerly an incident of the marriage relation. Wisconsin has not made the property of the wife that of her husband nor has it made the income from her property the income of her husband. *Nor has it established joint ownership.*

* * * * * * *

"What Wisconsin has done is to tax as a joint income that which under its law is owned separately, and thus to secure a higher tax than would be the sum of the taxes on the separate incomes." [Italics supplied.]

Mr. Justice Holmes wrote the dissenting opinion (Brandeis and Stone concurring) on the theory that Wisconsin was seeking to take away some of the rights which had been previously conferred upon married people. We might

here point out that the current court would have a difficult time hanging its hat upon this peg as the United States Congress has no right to regulate marriage in any such manner.

From the above language of the Court, it is plain that that which was unconstitutional in the Wisconsin statute was the fact that one person was taxed upon the income of another. The provision in the proposed current Federal act which provides for allocation of liability for the tax is an obvious attempt to sidestep this very issue, and to protect the proposed act from the pitfall looming in the shape of the fifth amendment. It is our belief that this is not sufficient. Assume a case in which husband and wife were, separately, liable for a tax of some $2,000 each on separate returns. When the returns were combined, because of capital gains and losses, the additional tax amounted to only $1,000. How will this be allocated? Recollections of the difficulties experienced in returns of affiliated corporations under the revenue acts prior to 1928 immediately arise. Can it be said that merely because the man has a wife, he must pay the additional $500? Certainly this is the very thing which the Court in the *Hoeper case* found wrong—the husband is being taxed upon the income of the wife. So long as there is an increase in the tax, then there will be one or the other spouse paying a tax upon income which is not his. This is so clearly an unconstitutional provision as to leave no room for argument.

Before attempting to set forth those arguments which are here deemed controlling, certain further considerations should be noted with reference to the Constitution. Constitutional questions were few in the beginning of our modern income-tax era. The validity of the tax, in a generic sense, was settled by the Supreme Court in 1916 (*Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S. 1, 36 S. Ct. 236). The preponderance of cases since that time has ruled in favor of the provisions attacked; but the courts have steadfastly refused to violate clear-cut and long-established principles which permit no escape from a conclusion of invalidity. It is true that the Supreme Court is reluctant to declare or enlarge by construction limitations upon the sovereign power of taxation (*Bromley* v. *McCaughn*, 280 U. S. 124); but the sixteenth amendment is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used (*Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628). The existence of constitutional power is not to be determined by the extent of the exercise of the authority conferred upon Congress (*Smith* v. *Kansas City Title & Trust Co.*, 255 U. S. 180).

One point must be made plain, for it bears directly upon the question at issue. The motives and purposes of Congress are not open to inquiry in considering questions of constitutional power (*McCray* v. *United States*, 195 U. S. 27). It has been clearly stated that questions of policy are no concern of the board or courts (*State Board of Tax Commissioners* v. *Jackson*, 283 U. S. 527; *United States* v. *Adams*, 11 F. Supp. 216). However, questions of fairness will be taken into consideration in determining what is a constitutional right. As Justice Learned Hand states:

"* * * Were the fifth amendment a remorseless pattern which all legislation must fit, the argument might even so be troublesome; might indeed be conclusive. But constitutional limitations are not indifferent to the occasions of the statutes they effect. They represent a mood rather than a command, that sense of moderation, of fair play, of mutual forbearance, without which states become the prey of faction. They are not the rules of a game; their meaning is lost when they are treated as though they were." (*Daniel Reeves, Inc.*, v. *Anderson*, 43 Fed. (2d) 679.)

Further, taxes are practical matters, and statutes imposing them must be tested by practical results (*Nichols* v. *Coolidge*, 274 U. S. 531). Considerations of policy sometimes carry substantial weight. So, perhaps, do economic considerations, as distinguished from absolute and conceptualistic reasoning (44 Harvard 651).

We have suggested that this proposed tax is violative of the fifth amendment. This amendment provides that no person shall be "deprived of life, liberty, or property without due process of law". This clause is not a limitation on the taxing power. (Cp. *Cohan* v. *Commissioner*, 39 Fed. (2d) 540). If it were so interpreted, the Constitution and the amendments as an aggregate organic document would be self-destructive and would conflict with itself by taking away with one hand power conferred with the other hand. (See Arthur A. Ballantine, 29 Yale L. J. 625, 632.) A statute is not unconstitutional under the due process clause unless it is so arbitrary and capricious that it is not the exercise of taxation, but a confiscation of property (*Heiner* v. *Donnan*, 285 U. S. 312;

Nichols v. *Coolidge, supra*). In other words, it must be so wanting in a reasonable basis for classification as to produce a gross and patent inequality. (See 33 Colorado L. R. 791; *Brushaber* v. *Union Pacific R. R. Co., supra.*) It has been stated that the question is: Is the means adopted appropriate to the end? (*Helvering* v. *City Bank Farmers Trust Co.* 296 U. S. 85). These theories naturally lead to the conclusion that the question is one of degree. Certain classifications have been approved: (1) Domestic and foreign corporations (*Barclay* v. *Edwards*, 267 U. S. 442); (2) inequalities as to intestate successors and legatees (*N. Y. Trust Co.* v. *Eisner*, 256 U. S. 345); (3) interest on exempt securities (*Denman* v. *Slayton*, 282 U. S. 514); (4) corporations and individuals (*Flint* v. *Stone-Tracy Co.*, 220 U. S. 107); (5) individual proprietorships and partnerships (*Wm. Guy*, 13 B. T. A. 51, 53); (6) things foreign and domestic (*Billings* v. *United States*, 232 U. S. 261).

The matter is well summed up in *Burnet* v. *Wells* (289 U. S. 670):

"A margin must be allowed for the play of legislative judgment. To overcome this statute the taxpayer must show that in attributing to him the ownership of the income of the trusts, or something fairly to be dealt with as equivalent to ownership, the lawmakers have done a wholly arbitrary thing, have found equivalence where there was none nor anything approaching it, and laid a burden unrelated to privilege or benefit."

Based upon the foregoing conceptions, it seems plain that an attack upon the proposed bill might be successful if it were possible to show that the bill constituted an unreasonable classification which resulted in an arbitrary and capricious confiscation of property without due process. We believe that such a showing is entirely possible in this case. This brings us to our second conclusion of unconstitutionality, namely, that Congress is here arbitrarily taxing married people at higher rates than other individuals.

The only appropriate method of taxation under the sixteenth amendment is to tax as citizens—not in groups—and most certainly those citizens must be taxed equally unless a real basis for separate classification exists. (Cf., the language immediately above from *Burnet* v. *Wells.*) While we have pointed out above that the mode and manner of apportionment suggested will involve one spouse paying tax upon the income of another, let us assume for the moment that such an apportionment is constitutional and that a perfect apportionment of liability is possible. The ideal in this respect, would be that of a husband and wife with absolutely identical incomes and expenses—no discrepancies whatsoever—whose tax liability, of course, would be identical. Now, if these two people are forced to pay upon their joint income, one or the other, or both (based upon the apportionment rule), would have to pay a higher tax than other individuals (citizens) not marrried. Thus, the proposed bill in reality constitutes but an increase in the rate of taxation upon married people and, as such, is clearly violative of the provisions of the fifth amendment.

SUMMARY

It is our position, predicated upon the foregoing considerations, that the proposed taxation of husband and wife, living together, on a joint return, is both unconstitutional and ill-advised. Our beliefs might be tabulated as follows:

I. The proposed bill violates constitutional guaranties:

A. In that it attempts to force one person to pay a tax upon the income of another.

B. In that it is an attempt on the part of Congress to deny to married women those rights which are guaranteed to her by State statutes and constitutions.

C. In that it attempts to arbitrarily and capriciously increase the rate upon married people without reasonable basis for such a classification.

II. The proposed bill is ill-advised:

A. In that most charitable contributions come from those in the higher brackets, and the first cut will be in contributions, thus levying a larger burden upon public charities.

B. In that its obvious purpose is to strike at the few community-property States, and thus constitutes a backhanded method of avoiding the rule in *Poe* v. *Seaborn*, a method not commensurate with American standards.

C. In that the general impression that this provision will apply only to wealthy individuals and community-property States is incorrect. The greatest hardships caused by this provision will be borne by countless thousands of

husbands and wives both of whom are compelled to work in order to maintain their families. In those instances the added burden of this tax will create a most unhealthy economic condition.

D. In that its secondary purpose is to increase revenue, and the discontent and hardships which will result inevitably will leave the game hardly worth the candle.

MURPHY, LANIER & QUINN,
Cincinnati, Ohio.

The CHAIRMAN. We will recess until 2 o'clock this afternoon.

(Thereupon, at 12 noon, a recess was taken until 2 p. m. this day.)

AFTERNOON SESSION

(Pursuant to adjournment, the hearing was reconvened at 2 p. m.)

The CHAIRMAN. The next witness is Mr. Kelly.

STATEMENT OF GEORGE TERBORGH, SECRETARY, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. TERBORGH. I am sorry to say, Mr. Chairman, that Mr. Kelly was unable to attend the hearing today. He has authorized me to appear in his place, however.

The CHAIRMAN. Will you give your name to the reporter?

Mr. TERBORGH. I am George Terborgh, secretary of the Machinery and Allied Products Institute. If it is agreeable to the committee, I shall present his statement.

The CHAIRMAN. Yes, sir; you may proceed. Do you want to read it into the record?

Mr. TERBORGH. I shall read it, sir.

The CHAIRMAN. All right, sir.

STATEMENT OF WILLIAM J. KELLY, PRESIDENT, ARTHUR J. O'LEARY & SON CO., CHICAGO, SPEAKING AS PRESIDENT OF THE MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. KELLY. Mr. Chairman and gentlemen of the committee, let me first of all express my appreciation for the opportunity to present the views of the Machinery and Allied Products Institute on certain aspects of the pending tax bill.

I say "certain aspects" advisedly, since I do not propose on this occasion to suggest how much the Government should tax for defense purposes or how the burden should be divided between direct and indirect taxes or between individuals and corporations.

This does not imply that the organization I represent is uninterested in such questions, or that it has no views on them. The contrary is the case. It means only that we prefer to forego their discussion at this time and to concentrate on certain aspects of the pending tax bill that are of peculiar interest and concern to the capital-goods manufacturers who compose our membership.

I propose therefore to deal only with certain inequities in the application of the corporation taxes proposed in the bill and to suggest measures by which they may be ameliorated.

Before proceeding to the discussion of these inequities, I wish to make it perfectly clear that the industries I represent do not protest

against the payment of equitable and reasonable taxes, however onerous. We realize that the defense effort calls for heavy sacrifices from all, and we are ready and willing to carry our full share.

We ask merely that the burden be distributed without discrimination. For various reasons, which I propose to discuss briefly, we believe that a large and important sector of industry is subject to an unintentional discrimination, both under the present corporation tax law and under the pending bill.

Effect of instability of earnings on relative tax burdens.—Let me begin my discussion with the basic proposition, which I believe no one will dispute, that the real test of the profitability of a business enterprise is its earning power over the life of the investment, normally a long period of years.

In computing its earnings we must, of course, subtract the losses incurred in poor years from the profits of good years, just as we subtract the losses of poor months from the profits of good ones in computing the net income of a single year.

It should be obvious that a corporation whose earnings are irregular, with loss years interspersed among the profitable ones, must make more profit during its good years than a corporation whose earnings are continuous if it is to offset its losses and return the same cumulated net income over a long period. In other words, the corporation with intermittent profits must earn during the good years alone as much as the company with continuous profits earns during the entire period plus enough additional to cancel the losses of poor years.

What is the bearing of this fact on the equity of income taxes as applied to the two corporations? If the basis of assessment is the net income for the entire period, then taxes are identical and there is no discrimination. If, however, the tax is assessed for each separate year in the period, the company with the intermittent earnings must pay a larger amount than the other.

It must pay not only on the net income as computed for the period as a whole but on the income canceled by losses within the period.

It is precisely this taxation of income canceled over the long run by losses that gives rise to the discrimination of which I am speaking.

By way of illustration, let us consider three hypothetical corporations with the following annual earnings and subject to a flat income-tax rate of 30 percent:

	Net income		
	Company A	Company B	Company C
Year:			
1931	$130,000	−$100,000	−$300,000
1932	80,000	−300,000	−500,000
1933	00,000	−200,000	−400,000
1934	110,000	−100,000	−200,000
1935	120,000	100,000	100,000
1936	130,000	250,000	300,000
1937	180,000	500,000	800,000
1938	160,000	350,000	300,000
Total for period	1,000,000	500,000	100,000
Taxable income	1,000,000	1,200,000	1,500,000
Tax in percent of net income	30	72	450

For the 8-year period covered by this illustration, the three companies have net incomes of $1,000,000, $500,000, and $100,000.

On the basis of annual assessments, however, the incomes subject to taxes during the same interval aggregate $1,000,000, $1,200,000, and $1,500,000, respectively.[1]

Consider what this means in terms of the relation between tax payments and net income for the period as a whole.

Assuming a tax rate of 30 percent. A pays exactly this percentage, B pays 72 percent, and C pays 450 percent.

Discrimination against capital-goods companies.—This discrimination might be unimportant in practice if all corporations subject to income taxation were substantially similar with respect to the regularity and stability of their earnings.

It is common knowledge, however, that this is not the case. There are large groups of corporations in what are popularly known as the "feast-or-famine" industries that respond with more-than-average sensitivity to the cyclical movements of economic activity and whose typical earnings record is an irregular alternation of profits and losses. As compared with corporations in fields of relative cyclical stability, those companies are subject to a systematic tax discrimination.

The most significant classification of industries with respect to the amplitude of their cyclical movements distinguishes those producing durable goods from those producing nondurable goods and services.

It is quite unnecessary to dwell at length on the basic difference in the economic behavior of these two groups of industries.

The durable-goods industries as a whole are subject to cyclical swings in activity several times as wide as those of the nondurable group.

While extreme cyclical instability is characteristic of the production of nearly all types of durable goods, and while, therefore, it is the durable-goods industries as a class that are the chief victims of the discrimination in taxation of which I am speaking, I wish to direct your attention primarily to a single subdivision of this class, namely, the industries producing capital goods, the facilities for production, distribution, transportaton, communication, and commerce—that is to say, business plant and equipment.

This happens to be the field in which the Machinery and Allied Products Institute is directly interested.

The extreme cyclical variability of profits in the capital-goods industries as compared with those in industries producing consumption goods such as food, clothing, drugs, and so forth, is too well known to require demonstration. It is confirmed by every compilation of corporate earnings which permits a comparison of the two categories.

By way of illustration, let me cite the results of an investigation by this institute covering 219 capital-goods companies and 181 consumption-goods companies for the period 1929–38.[2] Only in the worst year of the depression (1932) did the combined net profit of the consumption-goods companies fall below 55 percent of 1929. Only in that year did fewer than 70 percent of these concerns make a profit.

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[1] Assuming no provision for the carry-over of losses.

[2] Capital Goods Industries and Federal Income Taxation, pamphlet, 1940, Machinery and Allied Products Institute, Chicago.

For the capital-goods companies, on the other hand, 3 consecutive years showed a combined net deficit, while in the worst year fewer than 15 percent of the reports showed profits.

Classifying the concerns in each group as to the number of deficit years incurred during the 10-year period 1929–38, of the consumption-goods companies 48 percent had no net losses during the decade, the corresponding figure for capital-goods companies being 8 percent. Only 11 percent of consumption-goods companies had losses for 5 or more years, against 39 percent for capital goods. The average number of loss years for the two categories as a whole was 1.4 and 3.8 years, respectively. Those are truly striking contrasts.

Let us proceed a step further to classify these corporations according to the greatest number of consecutive years of net loss experienced during the decade. Here again the contrast between the two classes of corporations may be described as striking. More than two-thirds of the consumption-goods companies (68 percent) had no consecutive years of loss.

This can be said of only 19 percent of the capital-goods enterprises. The proportion with 3 or more consecutive-loss years was 18 and 65 percent, respectively, with 5 or more years 3 and 31 percent.

Nothing could show more clearly the fundamental disparity in the stability and continuity of earnings in these two areas of production.

It is obvious that this marked contrast in the gravity and duration of the deficits experienced by the two groups of corporations must have been reflected in extreme differences in their relative tax burdens. As I have already indicated, taxes must be paid (in the absence of provision for the carry-over of losses) on all the net income of all the profitable years in any period, that is to say, both on income that is offset by deficits within the period and on income that is not offset.

Since the proportion of income that is so offset is greater for capital-goods companies than for consumption-goods companies, the former necessarily pay in taxes over a period of years a larger proportion of their income in excess of deficits.

If we compute taxes paid as a percentage of the excess of income over deficits, we obtain what may be called the "effective" tax rate applicable to capital-goods and consumption-goods companies.

The statistical investigation just referred to demonstrates that for the 8 years 1931–38, consumption goods companies as a whole paid 16 percent of their net profit for the period in Federal income taxes, while capital goods companies paid 29 percent.

This proportion of net profit paid in Federal income taxes is 185 percent (not far less than double) the proportion paid by the consumption goods companies. Forty-one percent of the capital goods companies had a net deficit, yet paid taxes on one or more years of income; of consumption-goods companies only 15 percent fell into this category. Moreover, 11 percent of all Federal income taxes paid by the capital-goods companies were paid by the deficit concerns, while the corresponding figure for consumption-goods companies is only one-half of 1 percent.

While 77 percent of the consumption-goods companies had less than a fifth of their net profit absorbed in taxes, only 47 percent of the capital-goods companies were so fortunate.

On the other hand, 21 percent of the latter paid out more than two-fifths of their profit, against 5 percent of the former. There were even a few capital-goods companies that in the 8-year period 1931–38, paid in taxes more than their entire profit.

Recommendations for reducing the discrimination.—While we are under no illusion that our recommendations, if adopted, will eliminate the discrimination I have been discussing, we wish to advance four proposals which we believe will substantially reduce it, and thereby bring the tax burden of the capital-goods industries more nearly to parity with those of the consumption-goods industries. These recommendations are as follows:

1. Carry-over of corporate net losses for income-tax purposes should be permitted for a minimum of 6 years.
2. Carry-over of unused excess-profits-tax credits should likewise extend over a period of 6 years.
3. Corporate normal income-tax rates should be raised, or a surtax on normal income levied, in preference to increasing the present excess-profits-tax rates.
4. The base years for computing the excess-profits-tax credit under the income alternative should be changed from 1936–39 to 1935–39, with the privilege of selecting 3 of these 5 years in computing the average income credit.

Let me comment very briefly on each of these recommendations.

1. *Carry-over of corporate net losses for income-tax purposes should be permitted for a minimum of 6 years.*—If the inequity previously discussed is to be ameliorated so far as income taxes are concerned, provision for the offsetting of losses against the income of later years is a prime requisite.

In our judgment, there is no alternative that so well meets the tests of practicability and of impartial application to all corporate taxpayers.

It is quite obvious from the foregoing comparisons, however, that a loss carry-over period sufficient for corporations in the consumption-goods industries may be wholly inadequate for concerns producing capital goods.

It is the requirements of the latter that must govern the carry-over provisions of the revenue laws if a substantial equalization of tax burdens is to be achieved.

I am not going to propose that the allowable carry-over period should be unlimited, or that it should secure a complete offsetting of losses in every case. What I wish to suggest is a practical compromise that will make possible a complete offset for the great majority of capital-goods companies and other companies with similar income characteristics.

For this purpose the present provision for a 2-year carry-over, continued in the pending bill, is clearly inadequate.[3] If this provision had been in effect during the decade 1929–38,[4] it would have permitted only 19 percent of the capital-goods companies in our sample to make

[3] A 2-year carry-over was provided for in the Revenue Acts of 1921, 1924, 1926, and 1928. The Act of 1932 reduced this to 1 year, and the Act of 1933 abolished the carry-over entirely. The 2-year provision was revived in the Act of 1939, and is now in effect.

[4] It was effective during the early years of the period, but was of little practical consequence.

a complete offset of losses. The percentages covered by longer carry-over periods would have been as follows:

Carry-over period in years:	*Percent of companies offsetting losses*	Carry-over period in years:	*Percent of companies offsetting losses*
3	30.6	7	80.3
4	42.5	8	94.0
5	56.6	9	99.5
6	66.2		

If the experience of these corporations during the decade 1929–38 is a valid criterion of the length of the carry-over period required—and we believe it is—the conclusion follows that nothing less than 6 years will suffice to meet the test of a complete offset of losses for the large majority of capital-goods companies.

It may be noted in this connection that in Great Britain the Royal Commission on Income Tax (1920), after a careful study of the whole question, recommended a 6-year carry-over, a recommendation that was adopted in 1926. The provision has since remained in effect, and has even been liberalized by later legislation.

2. *Carry-over of unused excess-profits tax credits should extend over a period of 6 years.*—It should be evident to anyone who has followed the foregoing discussion of the need for an extended carry-over of losses for income-tax purposes that there is an even greater need for a long carry-over of unused excess-profits tax credits.

Since capital-goods companies must earn more in good years than consumption-goods companies if they are to come out even with them in the long run, they are forced to pay excess-profits taxes in such good years much heavier than those levied on the consumption-goods enterprises. Especially is this true when the excess-profits tax rates are graduated upward with the size of the taxable income, as under the present and proposed law.

Unless these heavier taxes can be compensated for by offsetting the unused excess-profits tax credits of poor years against the excess-profits income of later years, capital-goods companies must pay in excess-profits taxes a larger share of their long-run-average profits than consumption-goods concerns having equal long-run earnings. They are subject, in other words, to a tax discrimination.

Since the present excess-profits tax is of recent origin, it is impossible to present an historical analysis of the extent of this discrimination such as we have made in the case of the income tax. By the same token, it is impossible to say how long a carry-over period would be required to offset the unused excess-profits tax credits that would have accumulated during the depression had such a tax been in effect.

We have no doubt, however, that this carry-over would need to be even longer than that necessary to offset income-tax losses against the net incomes of the post-depression years.

Certainly the 2-year carry-over provided in the present law and continued in the pending bill is wholly insufficient, and we therefore recommend six years as a minimum.

Even this relief is inadequate. May I call your attention to the fact that the British excess-profits-tax law allows not only an unlimited carry-over of unused excess-profits-tax credits against the excess-profits income of later years but also the offsetting of such unused credits against the income of earlier years. This combined

offset, both backward and forward, assures that, in the language of the Chancelor of the Exchequer—

> The aggregate amount of excess-profits tax payable throughout the whole operation of the tax will be the tax corresponding with the net excess profits *over the whole period*, after allowing for any falling off of profits in any year.[5]

This thoroughgoing offset of unused credits makes our proposal for carrying them forward 6 years seem very modest indeed.

3. *Corporate normal income tax rates should be raised, or a surtax on normal income levied, in preference to increasing the present excess-profits-tax rates.*—I recur again to the basic proposition that companies with intermittent profits must earn more during the fraction of the time when they are making profits than companies with steady earnings must make in their good years if the two classes are to pay out equally in the long run. It follows that a rate of profit that may properly be considered "excess" for concerns with stable earnings may be only "normal" for a company with intermittent earnings.

The present excess-profits tax does not discriminate between the two, but applies a uniform rate of 8 percent on invested capital as the dividing line between normal and excess profits.

It is certainly correct in principle to draw this line for companies in industries of the feast-or-famine type at a substantially higher level than for concerns in relatively stable industries. This is not only because a higher rate of profit in good years may properly be regarded as normal in their case, it is also because enterprises of this type have generally suffered a far greater depletion of invested capital from operating losses during the depression than have companies in less fluctuating lines.

We are not prepared to say, however, that in practice it is administratively feasible to apply a variety of standards as to normal and excess profits, however correct in principle such a differentiation may be. Since there is grave doubt that this is practicable, we are impelled to the view that if additional revenue is to be raised from taxes on corporations it is more equitable to do this by an increase in normal or surtax rates than by further increases in a levy that falls with such discriminatory effect on capital goods companies as does the present excess-profits tax.

We reach this conclusion despite the fact that the average-earnings credit is available to capital-goods manufacturers as an alternative to the credit based on a standard rate of earnings on invested capital. The base period for computing average earnings, 1936–39, was, we believe, much further from normal for capital-goods companies than for consumption-goods concerns.

The recovery under way in the heavy industries during the early part of this period was only partial at its best level and was followed, late in 1937, by one of the most rapid and drastic declines on record, and by a depression which lasted for most of the remainder of the period.

As a result, the period as a whole was overweighted on the low side. A tabulation of the profits of 301 capital-goods companies and 368 consumption-goods companies from data assembled by the

[5] Italics ours. Quoted from the Bankers' Magazine (London), May 1940, p. 706.

National City Bank shows an average annual return on net worth for 1936–39 of 7.5 percent and 9.1 percent, respectively.

The earnings of the capital-goods companies thus ran substantially below those of the consumption-goods enterprises for the base period. The true picture is even more unfavorable to the capital-goods companies than this comparison suggests, because write-offs and write-downs of their invested capital during the depression were generally more severe than in the case of the consumption-goods concerns.

Since we have already seen that the capital goods companies must be allowed a higher rate of return free of excess-profits tax if their tax burden over a period of years is not to exceed that of the consumption goods concerns, it is evident that in general they cannot escape discrimination by electing to use the average earnings credit computed on a period in which their return averaged lower than that of the consumption goods companies.

It is evident that the pending bill runs counter to our recommendations that further increases in the tax burdens of corporation be concentrated in the income tax and surtax rather than in the excess-profits tax. The bill proposes not only an increase in the rates applicable to excess profits but by making these rates apply to income before income taxes, through the reversal of the present order of deductions, it increases the burden of the excess-profits tax out of all proportion to the increase in the rates themselves.

In addition it lowers the invested capital credit (on capital in excess of $5,000,000) and imposes a new tax of 10 percent on the amount by which the excess-profits net income computed with the use of the income credit exceeds that computed with the use of the invested-capital credit. Believing as we do that the discrimination against capital goods companies even under the present statute is repugnant to equity and fairness, we respectfully urge that it be not further extended by the enactment of the bill under consideration.

4. *The base years for computing the excess-profits tax credit under the income alternative should be changed from 1936–39 to 1935–39, with the privilege of selecting 3 of these 5 years in computing the average income credit.*—I have previously pointed out that the 4-year period 1935–39 was on the whole an unfavorable one for the capital goods companies as compared with concerns in the consumption goods field. The average income of these years does not constitute for these companies a proper criterion of normal earnings, above which income can be considered "excess." By way of a partial correction—and I wish to emphasize that it is only partial—we propose that the taxpayer be permitted to choose the best three of the 5 years 1935–39. We believe that this modification of the present law will help to reduce the inequities of which I have spoken and will afford a fairer test of where excess profits begin.

Mr. Chairman and gentlemen of the committee, let me close by repeating that we ask no favors for the capital goods industries or for any other group of taxpayers. We feel privileged in assuming our fair share of the burden of national defense and ask only for a measure of relief from discriminations which we believe are simply an unintentional result of the practice of assessing in time units of 1-year income that can be properly determined for tax purposes

only over a longer period. We appreciate the privilege of presenting our case, and shall be glad to respond to any request you may make for material bearing on the subjects of these remarks.

The CHAIRMAN. Are there any questions?

(No response.)

The CHAIRMAN. Mr. Howard B. Minier.

STATEMENT OF HOWARD B. MINIER, OF FORT WAYNE, IND., INTERNATIONAL HARVESTER EMPLOYEES' BENEFIT ASSOCIATION

Mr. MINIER. My name is Howard B. Minier. I live in Fort Wayne, Ind., and work for the International Harvester Co.'s Fort Wayne works as a machine operator.

I am the elected trustee from Fort Wayne works of the Employees' Benefit Association of International Harvester Co. and affiliated companies. We call the Employees' Benefit Association the E. B. A.

I am also active in the affairs of our local of the United Automobile Workers.

I am here as trustee of the E. B. A., and I am grateful to you gentlemen for the opportunity you are giving me to tell you something about our problem.

The E. B. A. is an old organization. It was established in 1908 as a voluntary, unincorporated, nonprofit association. It was set up to provide a fund to pay sickness, accident, and death benefits to employees who belong to it, at all the United States and Canadian operations of the company. Nobody has to join the E. B. A., but practically everybody does. Any employee who passes the physical examination can join. Right now the E. B. A. has more than 60,000 members.

From the time it was set up in 1908 to the end of 1940 the E. B. A. had paid out to members $9,362,000 in death benefits and $9,326,000 in disability benefits.

Senator TAFT. How is it taxed? By this bill or by the Internal Revenue?

Mr. MINIER. By the Internal Revenue Code.

Senator TAFT. There is nothing in the present bill regarding it?

Mr. MINIER. No, sir.

The CHAIRMAN. There is no change in the House bill that affects you?

Mr. MINIER. No.

Senator TAFT. What are you taxed now?

Mr. MINIER. The corporate income tax is involved.

The CHAIRMAN. If over 85 percent of your income was derived from dues or assessments, you would not be subject to the tax.

Mr. MINIER. Yes; that is correct.

The interpretation of the Internal Revenue Bureau is that if the company contributes more than 15 percent to the E. B. A., they are subject to the tax.

The CHAIRMAN. I expect you cover the point in your statement?

Mr. MINIER. Yes. The exemption has been an important thing to us, and we would hate to see anything happen to it.

The E. B. A. set-up is this. The association is composed of the employees who belong to the E. B. A. and the Harvester Co. and its

affiliated companies in this country and Canada. It is controlled by a board of trustees. Half the trustees are appointed by the company and the other half are elected by the employees who are members. That is how I came to be a trustee.

The E. B. A. gets its money in three ways—what the employees pay in, what the company pays in, and what we are able to earn in the way of interest or dividends on money we invest. Almost all our money comes from the employees and the company and comparatively little from investments.

An employee who belonged to the E. B. A. used to contribute 1½ percent of wages to the E. B. A. and the company put in a flat sum of $50,000 a year. The idea was that the company's payment would cover administrative costs. As a matter of fact, it usually did a little better than cover them. We ran along on that basis until 1936.

In 1935 the trustees engaged a competent actuary who made a thorough study of just where the E. B. A. stood at that time, with reference to its finances. We found out that we were just about insolvent from an actuarial standpoint. There were two big reasons for that—first, the average age of the employee members had increased steadily from about 30 years old to nearly 38 years old; and, second, there was greater stability of employment, with fewer people leaving the company.

I don't imagine I need to explain to you men in detail why that happened. You all know that during and after the depression—and right down to the present time—men don't move around from job to job like they used to do. The way things have been, if a man had a reasonably good job, he stayed with it.

The result was that our reserves, which had been good enough for a group of members averaging 30 years old, with a large turn-over, were not big enough for a group almost 8 years older, with a slower turn-over.

The only way to meet that situation was to increase the contributions of the members, both the employees and the companies.

On May 22, 1936, we raised the contribution for employee members from 1½ to 2¼ percent of their annual wages or salaries up to a maximum of $2,080 annual inome, and the company, instead of furnishing a flat $50,000 a year, began to contribute an amount equal to 20 percent of what the employees paid in.

When that was done the company's payments went up to an average of about $393,000 for the years 1936 to 1940, inclusive.

That increase, plus the higher payments made by the employees, put us back to a sound actuarial condition. Our reserves have increased every year since 1936. We still have less than an actuary would say we needed for complete soundness, but we are a lot better than we were, and getting better all the time.

Just as we are getting into a better position we ran into this tax question that is troubling us now. We have always thought the E. B. A. was exempt from taxation, the same as a lodge or a fraternal organization. But the Bureau of Internal Revenue has handed down a ruling that we are not exempt, beginning with 1935, and has proposed to put in a claim for tax payments of over $500,000 for the years 1935, 1936, and 1937. If similar tax assessments should be made for the years 1938,

1939, 1940, and 1941, more than $1,500,000 of additional taxes would also have to be paid, making a total of $2,000,000.

As I understand it, the law (sec. 101 (16) of the code) says that at least 85 percent of the E. B. A. funds have to be received as contributions from members. The Bureau claims that the company is not a member of the E. B. A., although E. B. A. regulations say the company is a member. The Bureau says that the money the company has put into the E. B. A. since 1935 is not a contribution from a member. If the contribution of the company is not figured as a contribution by a member, we don't qualify under that part of the law.

I can't believe Congress intended to prevent a company from putting money into an organization like our E. B. A. The whole purpose of the law, I would think, was to make it possible for us to have such organizations by exempting our funds from taxation. But if what the company contributes is to be taxed, organizations like ours will not be able to get along.

I never heard of a benefit association like ours that did not receive considerable support from the company concerned. They can't run any other way.

The only reason I can see for that 85-percent provision of the law would be to keep the E. B. A. or similar organizations from branching out into a side line of business and earning a big profit that would be tax free. We certainly have not done that.

If the Bureau of Internal Revenue is allowed to collect the tax they want to collect from us, it will take just about every cent the company has been paying to the E. B. A. to meet taxes.

Then we would have to make up the loss by putting on heavier assessments on the employee members, and we can't get away with that. It would cost our members too much. We would have a lot of members drop out of the E. B. A., and that would make it tougher on the ones who stayed in, because they would have to pay just that much more.

At the worst, the E. B. A. would quite likely have to fold up entirely. And at best we wouldn't be doing what the E. B. A. set out to do and was organized for—that is, to furnish low-cost insurance protection to employees.

There's another thing, too. The Government wouldn't get very much money by taxing the E. B. A. and other organizations like it out of existence. The Bureau of Internal Revenue might take away from us the $2,000,000 in taxes, but it would probably be the last money they would ever get from us. Taking that amount from the E. B. A. would practically force us into liquidation.

We think our organization has been doing a good job, doing it for more than 30 years. I know what the E. B. A. has meant to me and the men I work with every day. We would certainly hate to lose it or have anything happen to kill it. That insurance protection is important to us. And I don't believe Congress ever intended to make it impossible for the company to contribute money for the protection of employees.

Naturally, our association has consulted legal counsel regarding this tax calamity now overhanging us and other similar associations. Our counsel advises us that they believe it was the very purpose and intent of Congress (when it passed the law in 1928 exempting employee benefit associations) to exempt associations like ours. They believe this because, with few exceptions, all employee-benefit asso-

ciations then in existence were receiving substantial support from employers. These must have been the associations Congress had in mind to encourage by tax exemption.

It does not seem reasonable to suppose that Congress wished to discourage employers from helping these associations. It is more reasonable to believe that the act was intended to deny exemption when the income from investments exceeded 15 percent of the annual income, and the contributions were less than 85 percent of the total.

This view is strengthened when we consider that there is no real difference between contributions to the association paid by deductions from employees' wages and contributions paid by the company by agreement with and for the benefit of its employee members. These latter contributions could have been credited to the employees as additional wages and turned over to the association on their behalf, but this would only have involved additional bookkeeping.

This is a brief, nonlegal statement of the question as I understand it. If your committee desires a detailed legal brief, our association's counsel will be glad to file one.

As matters now stand, unless Congress gives relief, our association and every other similar association will be faced with insolvency and employers will be practically forbidden, under threat of heavy taxation, to help associations which are not operated for profit.

No legislation taking effect as of the present time would meet the situation, as heavy taxes for past years are already in course of being imposed. The only thing that would help us would be an early amendment to section 101 (16) of the Internal Revenue Code declaring what we believe to have been the intent of Congress in 1928 when that section was passed, namely, that employers' contributions on behalf of employees should be classed with employees' contributions in determining the right to tax exemption.

We suggest that section 101 (16) be amended so as to provide that, in determining the right to tax exemption under this section 101 (16) of the Internal Revenue Code, irrevocable contributions by an employer to an employees benefit association made for the purpose of reducing the expense and contributions of employees shall be treated as contributions made on behalf of and for said employee members, this amendment to be interpretative and declaratory of the language and intent of said section as originally enacted in 1928.

I wish to thank you for your courtesy in allowing me to appear here and tell our story.

The CHAIRMAN. Are there any questions, gentlemen?

Senator DANAHER. I have one, if you please.

Has a member, upon leaving the employ of the company, the right to withdraw from the association?

Mr. MINIER. Yes, sir.

Senator DANAHER. And does he recover at that time the back payments charged against him, or the contributions he made by way of dues and assessments?

Mr. MINIER. At the present time he does not. He is allowed to get death benefits by keeping up his payments. Past payments for disability benefits only cover the cost of the protection. Depending on what takes place in the passage of this exemption, we have a very broad plan, which is to go into effect the first of the year, depending on the outcome of this, where he will be able to do that. Under this plan we would draft new rules and regulations.

Senator DANAHER. Would you therefore say that the company has the right to do the same thing, if it be a member?

Mr. MINIER. Well, I would not say so; no. We state that they are giving these contributions and they are irrecoverable. They are doing that in an attempt to furnish low-cost insurance to the members.

The CHAIRMAN. You very well stated your case. Your whole position is this, that the company contributing more than 15 percent is really contributing to the membership of the trust, of your benefit association.

Mr. MINIER. Yes.

The CHAIRMAN. And that it ought not to be taxed, nor make your association taxable, bring it into the taxable class, simply because the company may contribute 20 percent?

Mr. MINIER. That is right.

The CHAIRMAN. You have a right to get 15 percent of your income from sources other than contributions from your own members or employees, so the company, if it wished to, could give you 15 percent of your income, or 10 percent, and you would still not be taxable, but the moment it gets above 15 percent, the Treasury has ruled that that is an income from sources other than the dues of the members.

Mr. MINIER. That is right.

The CHAIRMAN. And it makes your trust taxable. I think you have very well stated your case.

Senator TAFT. What meets your requirements is just to put in "or their employers" so it will read "contributions by members or their employers of 85 percent." It must be from members or their employers.

Mr. MINIER. Yes; that would cover it if the amendment is made retroactive or declaratory.

The CHAIRMAN. Well, thank you, sir. Unless there are some further questions.

Mr. MINIER. Thank you for allowing me to present our problem.

The CHAIRMAN. Mr. Cooper.

STATEMENT OF WALTER A. M. COOPER, WHITE PLAINS, N. Y., CHAIRMAN OF THE COMMITTEE ON FEDERAL TAXATION OF THE AMERICAN INSTITUTE OF ACCOUNTANTS

Mr. COOPER. Mr. Chairman and gentlemen of the committee: My name is Walter A. H. Cooper, of White Plains, N. Y., and New York City. I appear as chairman of the committee on Federal taxation of the American Institute of Accountants. In accordance with out established policy, the profession I represent takes no position on the matter of rate or type of taxation believing that we all must face, and are prepared to carry, a substantial tax burden and that our legislators and fiscal experts can well determine the necessary rates. However, we do wish to make certain recommendations concerning the bill H. R. 5417, now before you. These I summarize as follows:

I. We urge that all personal exemptions be eliminated and that the normal income tax be withheld at the source on all payments to individuals, partnerships, and trusts of salaries, wages, dividends, interest, and other fixed or determinable income.

II. With respect to the capital stock tax (which we have previously stated, and still believe, should be eliminated), if that must be retained, we urge that corporations be given the right to revise upward, adjusted declared values during the second and third years—as in 1939 and 1940.

III. The section dealing with the annual adjustment of declared value should provide for adding the net income, after deduction of income and excess profits taxes, rather than the amount before such tax deductions—as now proposed.

IV. In connection with the new 10-percent tax applicable to corporations using the invested capital credit method, provision should be made for a redetermination of base period income in abnormal situations described in section 722—which because of its limitations, will otherwise not be applicable.

V. The provisions of section 204 (e) should be eliminated so as to provide that the unused excess profits credit for any taxable year beginning prior to December 31, 1940 should be computed under the provisions of the Internal Revenue Code before amendment by the pending bill.

VI. The definition of "Corporation surtax net income" should be modified so that, in computing it, the limitation on the credit for dividends will be net otherwise subject to the surtax.

VII. The provisions for recognition of new capital (proposed section 718 (6)) should be modified in four respects.

I. *Elimination of personal exemptions.*—To repeat this recommendation—all personal exemptions should be eliminated in determining the income subject to normal income tax and the amount of such tax should be withheld at the source on the payment of all fixed and determinable income which would include among other things, and primarily, wages and salaries, interest, and dividends. We urge that for the five fundamental reasons, as follows:

1. The original reason for including in the income tax statute a personal or dependent exemption has disappeared.

2. Our defense is being developed to protect the right of everyone to live and to earn any income whatsoever and there is no reason why every person in the United States should not contribute a share of that burden, proportionate to the amount of income, if any.

3. The imposition of tax on all incomes without exemption would tend to prevent inflation of prices and probably would be more helpful in accomplishing the desired result in that respect than anything heretofore suggested.

4. The collection at the source will not involve administrative complications but, to the contrary, will make the problem of collection simpler than it is today with a limited exemption, and the objection to the reduction of exemptions because it would not produce enough additional revenue to justify the administrative cost of collection will disappear.

5. Such elimination of exemption would produce a very substantial amount of revenue.

1. *The original reason for granting any exemption has completely disappeared.*—The idea of allowing any so-called personal exemptions was first included in the 1913 Revenue Act. At that time we sought through the medium of an income-tax law to increase the revenues of the Federal Government by a comparatively few millions of dollars.

We sought, in other words, to add a little "gravy" to the Federal revenue at the expense of or as a charge against those of our citizens who had "gravy" of their own which they could share with Uncle Sam. Hence the law allowed substantial personal exemptions, ranging as high as $4,000 for a married couple, which on a comparable price basis would be equal to much larger exemptions at the present time.

Today, however, we are not seeking a little extra Federal revenue. The income-tax law is expected to and will produce the major portion of Federal revenues. Merely the additional revenues of three or four billion dollars we are now considering is many times the total revenue of the Federal Government when the first income-tax law was enacted and personal exemptions were first considered necessary.

2. *Every citizen should contribute a direct Federal tax.*—We are operating today on the basis that the very existence not only of those who have some income to any extent but even of those who have no income is dependent upon our developing our defences to insure the continuance of our way of life. We will defend not only those who have $800 or $2,000 of income but those who have less. Some of our citizens are satisfied with their smaller incomes and do not choose to work to produce more, and we shall be defending them in their right to continue to live on that basis.

It has been urged that exemptions be not eliminated or materially reduced because persons with incomes less than the exemptions do not have enough income to enjoy a reasonable living. It is noted, however, that the House committee report, while making such a statement, intimates that a substantial part of the tax on automobiles will be borne by persons paying no income tax because they have less income than the allowable exemptions, so a substantial part of our population receives insufficient income to enjoy a reasonable living, yet has enough income to operate automobiles.

Even assuming that low incomes are a matter of fortune or ability and not choice, those with low incomes will suffer more through price inflation rather than tax levies, which will retard price inflation.

Every citizen ought to pay a direct tax for many reasons which need not be repeated. The major part of the cost must be borne by even the lowest income group in one form or another—indirect taxes or higher prices. They will become more interested and better citizens if they pay it directly.

3. *Prevention of price inflation.*—Several divisions of our Government are concerned about price inflation. They should be, and so should all of us. We cannot deny or avoid the fundamental facts that the price level is the quotient resulting from dividing the available money by the goods that can be bought with it. When we increase the available money supply by operating printing presses, creating credit money or other so-called credit inflation, prices rise, but the same thing happens when we reduce the quantity of goods available to the supply of money.

Millions of our workers are today devoting their productive efforts to the creation of war and defense materials. Some of them are workers who were not employed before but many of them were formerly engaged in producing consumer goods. Hence, the quantity of consumer goods available today is materially less than before the defense program got under way, and it will continue to decline, not only as

more workers are absorbed by defense activities but also because commodity shortages and priority rules will reduce the production of consumer goods.

All the price fixing in the world will not stop that inflation. If it should be stopped in certain wholesale lines it will spread to the retail prices, and if it is stopped there with respect to major items it will spread to the minor and uncontrolled items. The money is there to be spent and unless absorbed in taxes or possibly a compulsory savings scheme, which would involve an even greater direct levy on all wages than an income tax, it will be absorbed in price increases somewhere along the line. The Federal Government may receive a substantial part of it eventually through the medium of excess-profits taxes but it will get far less than if a tax were directly levied on income at the source so that it is not available for spending, thus reducing the aggregate sum of money available to buy the same quantity of consumer goods.

The Secretary of the Treasury intimated that surtaxes should be increased for that reason but such a change will not affect the great majority of our citizens or the major portion of available money. The elimination of exemptions will.

Thus, whether the wage earner pays it in the form of taxes or higher prices it will go, but if it goes in the form of direct taxes it all goes to the Government. When it goes in the form of higher prices only a part of it eventually reaches the Federal coffers.

We believe, therefore, that a reduction in the amount of money available for the purchase of consumers' goods, by a direct tax without exemptions, will tend to retard price increases and accomplish more than price fixing, which may prevent immediate profiteering but will not stop the inexorable law of economics.

4. *The collection at the source is an essential and important part of our recommendation.*—A reduction of exemption is open to the very definite and important objection that the amount of tax to be collected will be too little in relation to the expense of collecing it, especially when it will result in creating many new taxpayers not in the habit of filing tax returns, paying small amounts of taxes. However, if any exemptions are allowed, withholding at the source cannot adequately and satisfactorily accomplish the desired result because those with less income from any one source than the allowable exemption escape any withholding even though they have income from several sources, the aggregate of which renders them liable to tax.

Such difficulties disappear when withholding is required on all payments of fixed and determinable income.

Senator DANAHER. Would you apply the same principle to rents?

Mr. COOPER. You cannot apply it to rents, because that is not net income, or ordinary income, because from that rent must be deducted taxes and all costs. That is why I use the term "fixed and determinable income," because the amount paid is the income itself.

Equally important is the fact that the tax is withheld as the income is paid, so that the recipient never has the income to play with or to spend. Its loss or the failure to receive it is not felt any more than if it were received and spent in the form of higher prices. Furthermore, there is no trouble when the ides of March roll around

requiring payment of a tax on a prior year's income which was received and spent and is not then available for the payment of taxes. Our Treasury has recently made available so-called tax-prepayment securities. How much simpler it would be to withhold the tax in the first place.

5. *The amount of tax that would be raised by the elimination of all exemptions would be substantial.*—I do not have available the necessary statistical data to estimate that sum but no doubt the Treasury experts can provide it. Should it be more than the revenue needs of the Government require, then excise taxes or other indirect taxes largely payable by the low-income citizens of our country should be eliminated or reduced.

II. *Redeclaration of capital stock value for capital stock tax purposes.*—Two years ago it was realized that the speculative possibilities of the capital-stock tax and its related excess-profits tax, coupled with the uncertainties then existing with respect to future income which necessarily controls the value to be declared for capital-stock tax purposes, were such that fairness and equity required permitting an increase in adjusted, declared values. Accordingly the law was amended to permit taxpayers to revise adjusted declared values upward, if they saw fit so to do.

Future income potentialities are today even more uncertain than they were 2 years ago. Price inflation is one factor not then present. Defense-production activities and the availability, or otherwise, of materials for consumer goods production are other important new factors. Corporations now faced with the problem of declaring a value for capital-stock tax, which must take into account the potential net income, before taxes, for the next 3 years, are faced with an almost impossible situation. To reduce speculation to a minimum, corporations should be permitted to declare a value, in the returns to be filed before the end of September, knowing that they can increase such declared value as subsequently adjusted, if future developments indicate such a redeclaration should be made. The law was changed 2 years ago to permit that and all the reasons that prompted such a change 2 years ago are present today, as well as several new and more important factors which were not present 2 years ago.

We urge, therefore, that the law be amended now, before values have to be declared for the tax year 1941, so that taxpayer corporations will have the right to declare a new value, higher than the adjusted declared value, in returns to be filed in 1942 and 1943.

We also urge, though it may not seem important at the moment, that the statute be amended to permit the Commissioner of Internal Revenue to grant extensions beyond 60 days from the ordinary due date for the filing of capital stock tax returns. Normally 60 days should be adequate. Because of the present uncertainties, the Commissioner of Internal Revenue has already granted the maximum extension of time permitted by the statute, yet the law under which the return must be filed is still pending before you. Should it be passed before the end of this month no further extension should be necessary. If, as now seems likely, the law will not have our President's signature until well into the month of September and perhaps not until October, taxpayers will be forced to declare a value under a law not yet enacted or enacted so recently as to leave insufficient

time for all the necessary officers or other employees to give the matter adequate consideration. Hence, we urge that the statute provide that if it be not finally enacted before the 1st of September the Commissioner of Internal Revenue should be authorized to grant extensions up to 60 days beyond September 29, 1941.

III. *Adjustment of declared values.*—The bill pending before you provides that the declared capital-stock value shall be adjusted by adding thereto the net income computed before the deduction of income and excess-profits taxes. It follows the form we have had ever since the imposition of the capital-stock tax on the present basis. It has been unsound from the beginning, but when we were dealing with an income tax of 15 percent it was not serious.

Today, however, income and excess-profits taxes will take up to 72 percent of net income. Yet, despite the fact that only 28 percent of it may remain to be added to a corporation's surplus, 100 percent of the income must be added to the value originally declared for capital stock. Nothing could be more unsound. The statute should provide for an addition to declared value, subject to reduction for dividends or other distributions, of net income after deducting therefrom all income and excess-profits taxes. Fundamentally that is all that can possibly be added to the taxpayer's capital. There will be no mathematical or accounting difficulty in applying such a provision.

IV. *Adjustment of base-period income for the new 10-percent tax.*—The pending bill proposes to add to our taxing scheme a new tax which will affect corporations using the invested-capital method of determining excess-profit tax credit. One of the bases for its computation is the average income during the base period.

Early this year it was recognized that certain abnormal events may have occurred during the base period or abnormal conditions have existed during all or part thereof so as to result in net income that did not measure fairly the earning capacity of the taxpayer corporation. Accordingly, a new section was inserted in supplement E, No. 722, which provided for a redetermination of the income for all or a part of the base period during which the abnormal events occurred or abnormal conditions prevailed. To avoid adjustments and claims involving comparatively limited amounts, which, of course, had no effect unless the credit as revised exceeded the invested capital credit, certain limitations were placed on the application of section 722. However, those limitations should not apply in determining the new 10-percent tax. If a taxpayer is to be charged an added tax because it uses the invested capital-credit method, when it did not earn during the base period a comparable income, it should be permitted, without limitation, to readjust or redetermine the base period income to exclude the effect of abnormal events or conditions.

We urge, therefore, that the provisions of section 722 be made applicable, without tax limitation, to the determination of the base-period income in the computation of the new 10-percent tax provided for in section 201 of the pending bill.

V. *Elimination of section 204 (e) of the pending bill.*—The several amendments proposed will materially increase the income subject to the excess-profits tax. While we of the accounting profession believe that at least one of the changes is fundamentally unsound (I refer here

to the nondeduction of the income tax in figuring the amount which may be subject to excess-profits taxes), we are not urging any change because in the final analysis it will affect all corporate taxpayers alike. We do believe, however, that the requirement to recompute the unused excess-profits-tax credit for the year 1940 on the basis of the amendments applicable to 1941 is a most inequitable proposal. It resolves itself into the situation that taxpayers who earned excess profits in 1940 were enabled to avail themselves of the more favorable credit computed under the 1940 provisions while other taxpayers who were not able to earn excess profits in 1940 cannot avail themselves of a credit computed under the 1940 statute but must use the less favorable 1941 basis. Thus, in result, the amendments are made applicable to some taxpayers for 1940 and to others for 1941 only. Such a discrimination is in our opinion entirely unwarranted, particularly when it involves a tax that will take as high as 60 percent of the income subject to tax. We urge, therefore, that the new provisions relating to the determination of excess-profits net income and the credit thereagainst be made applicable, in computing the unused credit carry-over, only for years beginning after December 31, 1940.

VI. *Corporation surtax net income.*—In defining "corporate surtax net income," for the new 6 percent tax, new section 16 permits a deduction for the same dividend credit as is allowed for the normal tax of 24 percent. That dividend credit—generally 85 percent of the dividends—is limited to and cannot exceed 85 percent of net income minus the credit for certain Government interest.

For surtax purposes the Government interest credit is not to be allowed. Hence the limitation on the dividend credit for the purpose of that tax should be 85 percent of net income—including the Government interest which is to be subject to the surtax.

VII. *Provisions for recognition of new capital.*—In computing invested capital greater weight is to be given new capital. That is a sound policy. We believe, however, that some changes ought to be made in section 205 of the pending bill, to wit:

1. It should not be limited to new capital paid in after the start of a tax year beginning after December 31, 1940. It should cover new capital acquired after January 1, 1940 or the equivalent tax year. There is no sound reason to grant a special benefit to those who waited for the "encouragement" to acquire new capital and deny it to those who patriotically went ahead, last year and increased capital. If it is desired to tie this provision to the defense program—as is the amortization deduction, it could be limited to new capital acquired after June 10, 1940, the amortization date.

2. As now drafted this additional allowance applies only to corporations using the invested capital as the capital addition under section 713 (g) is limited to the amount of capital paid in computed (as to property) under section 718 (a) 2. Companies using the income credit method are entitled to just as much encouragement to obtain new capital and expand as are those who use the invested capital method.

Proposed new section 718 (a) (6) should therefore be made applicable to the income credit method in determining net capital additions. Otherwise it will be discriminatorily favorable to only some taxpayers and may, therefore, fail to accomplish its purpose.

3. The reduction of new capital, for increases in inadmissible assets, is good but there should be excluded from the amount of inadmissible assets any new investment which is not recognized as new capital to the recipient. Under the proposed rule (sec. 718 (6) (D)) if a corporation acquires bona fide new capital and invests it in turn, in another corporation, the increase in its inadmissible assets offsets the new capital and no additional credit results. However, if such second investment involves a certain type of reorganization, or the second corporation is a controlled company, it gets no new capital credit either (sec. 718 (6) (A) (B) and (C)). New capital has been acquired, in fact, and it should be recognized in the manner suggested.

4. The limitation of proposed new section 718 (6) (E) (ii) should not disregard (as is now proposed) taxable dividends after December 31, 1940 (or appropriate taxable year). If a corporation distributes its earnings for, say, 1941, and in 1942 acquires new capital, its new capital allowance is reduced by the earnings previously distributed. Similarly, if it acquires new capital at any time in 1941, any earnings distribution in 1941 or any later year will reduce its new capital allowance. The reason for this is not apparent, it certainly does not seem justifiable, and is likely to lead to nondistribution of earnings with a consequent reduction in personal surtaxes.

Conclusion.—May I say in conclusion that the accounting profession appreciates very sincerely the privilege of presenting its views, welcomes the opportunity to be of service, and is prepared to do anything else it can to help you. We understand procedural and technical problems will be considered later and we intend to suggest numerous technical recommendations at a later date.

The CHAIRMAN. Your suggestion is not for withholding the tax of, say, 3, or 4, or 5 percent, or whatever tax you fix, withhold it at its source and simply superimpose it on the present tax structure, you propose to simply do away with all exemptions so everybody begins to pay right from the first dollar?

Mr. COOPER. On the first dollar, and then provide that that tax be withheld by the person paying the income at the source, so as to avoid two things: The collection difficulties and get the income in faster than you do now. As it stands now, the tax on the income for the calendar year 1941, that is, income earned by the individuals, will not start to come in until March 1942, and with the withholding it would come in during 1941.

The CHAIRMAN. I understand.

Mr. COOPER. It would simplify collection. It would not be necessary to get every wage earner or individual to file a tax return, because, so far as income tax is concerned, it would be withheld at the source. You would not have to worry about that. As it is now, the Treasury has got to chase up people who have incomes and see whether they have filed returns or have not filed returns.

The CHAIRMAN. Thank you, Mr. Cooper.

Mr. Zick.

STATEMENT OF LEONARD O. ZICK, VICE PRESIDENT, MASTIC ASPHALT CORPORATION, AND SENIOR PARTNER OF THE ACCOUNTING FIRM OF ZICK, PRICE & CO., SOUTH BEND, IND.

Mr. ZICK. Mr. Chairman and members of the Finance Committee, I have come before you today to discuss with you the inconsistencies of the proposals of the Treasury and the great injustice that would be inflicted upon the thousands of small businesses in our country, if the Treasury proposal to abolish the elective privilege of determining a corporation's excess-profits credit on the basis of normal 1936 to 1939 average earnings were enacted into law.

The Treasury has said in presenting its proposals that--

1. All sections of the people should bear their fair share of the (tax) burden and that the additional tax burden necessitated by the emergency should be distributed equitably among the several segments of our population.
2. We (the Treasury) have proceeded on the assumption that we want the kind of Federal revenue system which can be readily adjusted to the Nation's requirements after the job is done and the emergency is past.

In these two foregoing statements I am sure most everyone is in agreement and we appreciate the difficulty before you gentlemen in determining the sound distribution of any new tax load.

However, when the Treasury proposes to abolish the elective privilege of choosing to report on the normal average earnings of the base period of 1936 to 1939 or invested capital method and instead recommend to restrict the determination of an excess-profits credit to be made on the basis of a corporation's invested capital only, then we are of the opinion that the Treasury is quite inconsistent and such action would lead only to the grave danger of the destruction of thousands of small businesses, through inability to accumulate a surplus to act as a shock absorber when the need arises.

My associate, Stanley R. Price (who is also professor of accounting and teaches income tax at the University of Notre Dame) and myself operate a small accounting firm in South Bend, Ind., which with eight employees perform a general accounting and tax service for many small businesses in our community. When I speak of small businesses, I mean those employing 250 workers or less engaged in manufacturing, wholesaling, retailing, and the like.

It is such businesses as these, gentlemen, that comprise 99 percent of all businesses and handle 65 percent of the Nation's commerce. They have been for the most part deprived of a fair share of Government defense business and are now beginning to feel the stranglehold of the priorities system, which will most seriously affect them.

Many of these businesses are operated as incorporated partnerships where the stock is closely held and others where the stock of the corporation is held rather widely but, of course, not listed on any national exchange—but all of them have a comparatively small invested capital.

Their accounting has been conservative over the years and it can be safely said they have no watered stock. What net surplus earnings many had accumulated during the twenties evaporated during the depression and this, too, has had an effect upon their invested capital in arriving at their excess-profits credit under the 1940 Revenue Act.

Now, to take away from them the elective privilege of arriving at their excess-profits credit on the basis of their average normal base period 1936 to 1939 earnings and force them to compute their credit on the basis of their invested capital would be well-nigh ruinous and would add to the confusion which will attend the readjustment of a war-exhausted and bankrupt world to some kind of a peace basis.

I wish I could show you, gentlemen, many specific examples of the inequity and unfairness of the Treasury's proposed elimination of the elective privilege in the determination of the excess-profits credit but time will only permit of one such example, namely, in the case of the Mastic Asphalt Corporation:

This manufacturing corporation began business in 1932, is associated with the building industry, has no direct Government contracts, and is only indirectly affected by the defense program, and that adversely, if at all. It has approximately 1,000 shareholders, its stock is unlisted, employs 123 people.

In its first few years of operation the company lost money, but began to recoup its losses in 1936, with net incomes during base period as follows:

1936	$11,800
1937	47,400
1938	202,200
1939	370,400

In 1940 its net income was approximately $340,000—a reduction of $30,000 from 1939 largely due to increased taxes, and if its normal tax net income for 1941 is equal to that of 1940, its net income, after taxes (as provided in the bill passed by the House recently) would be $290,000 or $50,000 less than in 1940 and $80,000 less than in 1939, in which year there were no indirect benefits of the defense program.

Now, what would happen to this company under the Treasury's proposal eliminating the elective privilege and providing for the computation of the excess-profits credit on the basis of invested capital alone?

This company's average invested capital January 1, 1940, was but $434,200, and its excess-profits credit (based on 8 percent of $434,200) was but $34,736, so that if this company's normal tax net income for 1941 were equal to that of 1940, its net income after taxes (under the Treasury's proposal) would be only $203,000 compared with $370,400 in 1939 and $290,000 under the House bill.

The unfairness and inequity of the Treasury's proposal can be cited in this instance in another way. This particular company's capital stock structure consists of 300,000 shares of $1 par value common stock, and it is this figure that is used in arriving at its invested capital, yet in 1940 most of the company's present shareholders paid $6.50 per share, this price having been arrived at on the basis of earnings and growth possibilities; 300,000 shares at $6.50 per share is $1,950,000, yet its invested capital for tax purposes would be only $434,200 under the Treasury's proposal. Is this fair to this company's new shareholders?

There is no question that, if excess profits are computed on the basis of invested capital alone, it would penalize many small corporations and favor their large competitors. A corporation or-

ganized in a period of low values, such as Mastic, would be discriminated against in favor of a corporation organized in a period of high values. Compare, for an example, any corporation organized in 1929 and one like Mastic Asphalt Corporation in 1932.

The identical assets may have been turned into each corporation. Yet such assets may be reflected in invested capital of one corporation at many times the value it would have in computing the invested capital of the other. It is well known that in some cases the mere accident of incorporation in 1 year, instead of 1 year later, meant savings in taxes of millions of dollars.

Then, too, one corporation's dividend policy may have been more liberal than that of another corporation, yet that corporation whose policy on dividends has been less liberal would be benefited, while the company which has cooperated with the Treasury and avoided an unreasonable accumulation of surplus under the Treasury's proposal would be penalized.

We believe the allowance of the alternative methods of computing of whom are competitors and the unfairness of the Treasury's proposal is clearly evident among them. There is much inequity that already exists in the Federal income-tax laws, let alone the proposed addition.

We believe the allowance of the alternative methods of computing the excess-profits credit (that is, either the invested-capital or the average-earnings method) have been justified by experience and are thoroughly sound and equitable.

The CHAIRMAN. Are there any questions, gentlemen?

(No response.)

The CHAIRMAN. Thank you, sir, for your appearance.

Mr. Ulmer.

STATEMENT OF FRED ULMER, TREASURER, MONSANTO CHEMICAL CO., ST. LOUIS, MO.

Mr. ULMER. Mr. Chairman and gentlemen of the committee, my name is Fred A. Ulmer, and I am treasurer of the Monsanto Chemical Co., at St. Louis, Mo.

When the defense of our country is the stake, heavy taxation must be expected. All should willingly contribute of their earnings and substance as well as render service for the preservation of the American way of living.

But certain principles of fairness and equity should, nevertheless, be observed in the levying of the tax burden. Regarding the tax bill now before Congress, I wish to point out a few instances which I think violate the principles of fairness, and furthermore, fail to meet the purposes of such provisions as expressed in the committee report.

1. According to the press, one cardinal principle of the present excess-profits-tax law has met with more administration criticism than any other, and that is the principle of measuring exempt income by means of 4-year average income.

I think the Ways and Means Committee of the House decided rightly that only with such alternative provision can this very severe and onerous excess-profits tax be made reasonably fair and equitable. The proponents of the exclusive use of the invested-capital method failed

to recognize that the invested capital of the corporate taxpayer, as defined by the taxing statute, often bears little resemblance to the true composite amount invested in the company's equity capital by its present stockholders. Present stockholders, in many cases, have paid several times the book value of the stock as shown by the corporation's books of account.

The result of this is, of course, that whereas the corporation may earn as high as 20 percent or 30 percent on its statutory invested capital, it is earning 5 to 10 percent and in many cases even less, on the basis of the stockholders' actual investment.

Even though the average income basis is retained in the law, the definition of invested capital governing those corporations which find it necessary to use the invested capital basis should be made as realistic as possible, and from this standpoint I wish to point out the inequity in section 718 of the excess-profits-tax law, defining invested capital. Here the express purpose is the measurement of invested capital, obviously of the taxpayer corporation, not a previous owner of all or part of the property.

The concept of tax deferment under section 112 of the Tax Code is not involved here, because that deferment is concerned only with the sale or other realization of the particular property acquired in a tax-free reorganization. Here in section 718 we are concerned with an excess-profits tax on regular operation income and profits, and for measuring the excess over normal, the invested capital must be expressed at its cost to the present corporate taxpayer.

Therefore, in the case of tax-free acquisitions under section 112, the invested capital value in acquiring company's hands should be the market value at the date acquired by the transferee company, not some previous owner's valuation, wholly unrelated to the present circumstances. This does not violate the concept of deferred taxation under section 112 for when such properties acquired under tax-free reorganization are sold or exchanged, profit or loss will still be measured by the tax basis in the hands of the transferor, and this proposed change in section 718 has nothing to do with such taxation of profits when realized.

In the measurement of invested capital for the very important purpose of exempting a portion of current income from excess-profits tax, the true financial and accounting concept of invested capital should be used, not a narrow and restricted definition.

A present excess-profits taxpayer corporation should not be penalized because of a low cost of property long ago, in the hands of a predecessor when the present owner's cost is much higher.

In many cases of older corporations, the failure of invested capital basis to fairly measure excess profits is because of this acquisition of property many years ago in a period of lower cost levels. And likewise, in many cases this fault would be corrected or alleviated if invested capital were measured by the cost of the capital stock to the present holders.

As long as the statute does not provide for a realistic measurement of invested capital, it is of the utmost importance in the interest of justice, that the alternative average income method be provided.

I urge that section 718 (a) (2) be amended so that valuation required is the actual cost basis instead of "an amount equal to its basis (unadjusted) for determining loss upon sale or exchange."

2. A manifest inequity of H. R. 5417 appears in its section 205. This section amends section 718 (a) of the Internal Revenue Code so as to increase by 25 percent the amount includible in equity-invested capital on account of new capital. The purpose stated in the committee report is to encourage investment of new capital. My criticism is that this same allowance should be made to corporations whose excess-profits credit is measured by base-period income as well as to corporations using the invested-capital method.

Within any industry there will be corporations using the invested-capital method and others using the average-income method, and it appears that discrimination is worked by section 205 to the detriment of corporations finding it to their advantage to use the average-income basis. Whether a corporation measures its excess-profits credit by base-period income or by the invested-capital method does not in all cases depend upon a corporation's actual invested capital; that is, what it paid for its assets. The statutory definition of invested capital is not in accord with the financial and accounting concept of invested capital, as I have pointed out earlier. This restricted definition of invested capital suffices to force many corporate taxpayers to the average-income basis. Therefore, it must follow that it seriously injures many taxpayers who have no recourse but to use invested-capital method, in that it seriously understates their true invested capital, which should be the basis for measurement of the credit.

Therefore, since in many cases it is merely fortuitous as to the time and method of acquiring its capital property whether the invested-capital or average-income basis must be used for determination of excess-profits tax, it seems only fair to extend to either type of taxpayer this incentive of 25 percent premium for investment of new capital.

3. I wish to submit for your consideration that United States industry should be relieved under the present uncertain and emergency conditions of the speculative requirements of the 3-year declaration of value under capital-stock tax section 600 of the Internal Revenue Code. It is understood that the purpose of this declaration of value for capital-stock tax is not only as a basis for the levying of the capital-stock tax, but also to act as a measurement of declared-value excess-profits tax in any case where 10 percent of the declared value is insufficient to cover the annual taxable income of the declarer.

This requirement has always been a severe imposition on companies in industry where it is difficult to forecast earnings.

But, in such abnormal and unpredictable times as the present, it would seem that this basing of a substantial rate of tax on pure guesswork cannot be justified. I believe this committee will agree that industry today cannot forecast earnings in 1942 or 1943 with any accuracy because they are so inescapably related to the national economic situation regarding war and defense.

I respectfully urge that the law be changed, at least during the period of the emergency, so that the declaration of value may be made annually.

4. After considerable experience with administration of the amortization section 124 of the Internal Revenue Code, I am thoroughly convinced that section 124 should be amended by the deletion of subsection (i). Subsection (i) relates to protection of the United States

in cases where a taxpayer has entered into direct Government contracts and seeks the privilege of deducting 5-year amortization of newly acquired plant facilities for the production of articles deemed necessary under the defense program. Although it is perfectly proper to enforce the protection of the United States against unreasonable and excess prices under contract, I submit that the place to do this is not in a taxing statute. I believe I can cite an actual instance proving that in certain cases subsection (i) makes the amortization provision practically inoperative.

The amortization section was included in the Second Revenue Act of 1940 by Congress in response to the reasonable request of industry that it be allowed to reimburse itself through tax credits for the amounts outlaid for additional plant facilities found necessary to implement the defense program.

It was deemed reasonable by Congress that such plants with questionable postemergency utility should be written off against the income they earned, and not left as a burden against long future income with which such facilities might have no relation and which postemergency income might be far insufficient to cover.

This being the case, it should be possible for the corporate taxpayer to receive assurance of amortization through the medium of certificates of necessity before embarking upon the extensive acquisition of new assets, and the law does so provide in cases where sale of products from such emergency plants is not made direct to the United States Government in any of its branches; but where there are direct Government contracts, the taxpayer must further secure a certificate of nonreimbursement, as well as a certificate of necessity, before he has any assurance of obtaining the amortization write-off.

As a condition precedent for filing an application for a certificate of nonreimbursement, a Government contract for sale of product must be entered into.

It is obvious that after entering into such Government contract the taxpayer must proceed with the acquisition of the facilities in order to fulfill the contract. Therefore, he is committed to the expenditure for new facilities whether the administrators of the amortization act see fit to issue the certificate of nonreimbursement or not. It is quite evident that if this amortization is to act as definite assurance that amortization will be granted to those who expand their facilities for defense purposes, the necessary certificates should be granted prior to any commitment on the part of the taxpayer to acquire the facilities.

Basically this provision for Government protection under subsection (i) should not be activated by means of actual or threatened loss of the amortization privilege. Therefore, I urge that subsection (i) be deleted.

Gentlemen, I thank you.

The CHAIRMAN. Thank you very much, Mr. Ulmer, for your appearance.

The next witness is Dr. George S. Benson, of Searcy, Ark. Senator Caraway.

Senator CARAWAY. Mr. Chairman, I would like to say I have known Dr. Benson quite well. He is a noted educator in our State, and he has some very decided views on the tax question. He appears for no

group of people. He is here just on his own. I would like to introduce Dr. Benson.

The CHAIRMAN. Come around, Doctor.

STATEMENT OF DR. GEORGE S. BENSON, PRESIDENT, HARDING COLLEGE, SEARCY, ARK.

Dr. BENSON. Thank you, Senator Caraway.

Mr. Chairman and members of the Finance Committee, I am appearing before you just as an average American citizen, not representing any particular group but interested in the welfare of the Nation as a whole. I think my prepared statement will possibly provoke some questions that will be answered as I proceed with the statement, so if I may complete the prepared statement before you ask questions, I think it will save you some time.

I wish to discuss the importance of paying for the present defense program as far as possible as we go, and I wish to discuss two methods which I think would assist in doing so.

Why should we pay as we go? Because if we don't we are headed straight for inflation, dictatorship, and revolution. This statement might seem startling or exaggerated to businessmen, but to makers and students of history like yourselves, it is practically self-evident.

You well know that in one century in Europe there were six revolutions—England, France, the Netherlands, Spain, Portugal, and Naples—all having a financial origin. The last World War was followed by revolutions in Germany, Italy, Austria, and Russia, all of which were preceded by inflation.

In view of the revolutionary spirit prominent in our world of today, and in view of known socialistic and communistic activities in our own country, I am certain you gentlemen realize the absolute necessity of having our own financial system in the safest position possible.

This means that we must have the smallest possible debt at the close of the present war in order to avoid extreme inflation and heavy taxes at a time when people can't pay them and when many would repudiate heavy taxes, thus starting severe disorder.

Personally, I like Mr. Morgenthau's expression "all out" taxation. In my opinion it is not only advisable, but imperative that we pay for the greatest possible part of this war as we go. It is advisable because national income and patriotism are at a high peak during the war; and accordingly high taxes can be collected easier than at any other time. It is imperative because we must avoid inflation, dictatorship, and possible revolution at the close of the war. We want to preserve, if possible, the unequaled freedom and prosperity of the American people.

My two suggestions for paying as we go are—

1. Increased tax revenue, and
2. Reduction of nondefense expenditures.

Increasing tax revenue.—Many suggestions are being offered for increased revenue from taxation. Regarding most of these, I am not in the position to offer suggestions. It does, however, seem vitally important to me that we broaden the base by lowering the exemption on income tax.

I do not know the attitude that wealthy people have regarding their part in paying for the defense of America, because 365 days in the year I associate with those having small incomes. I do know their viewpoint and if the loyal patriotism of our Askansas people is representative of those throughout the Nation, then I know that the vast majoriy of our citizens whose incomes are less than $1,800, want to have a vital part in the necessary defense of that Nation which has brought to them the finest living conditions ever enjoyed by the masses anywhere. They know that it is only in America that people of moderate incomes can enjoy convenient homes, own an automobile, a telephone, and a radio. They are anxious to do their part in preserving a prosperity which is illustrated by the fact that while we have about 6 percent of the world's population, we have 32 percent of the world's railway mileage, 44 percent of the world's radios, 76 percent of the world's automobiles, and 50 percent of the world's wealth. Allow me to illustrate our prosperity in another way.

My two daughters were born in China. They attended Chinese schools, and knew their China, with all of its poverty. They saw children whose hunger was never satisfied, beggars in filth and rags, glaring poverty everywhere. Upon leaving China for America in 1936, they came by way of India and Egypt where they observed similar poverty. But upon arriving in New York City and observing those great skyscrapers, those clean, wide streets, those beautiful new automobiles, the well-fed and well-dressed people, Lois exclaimed: "Daddy, I just hope Heaven will be this nice."

The people whose incomes are less than $1,800 know that they are already paying a liberal share of the tax bill through indirect taxation, but they would realize more satisfaction from paying it by direct taxation. Direct contribution improves morale. You gentlemen know that we give of ourselves to those causes which we support financially. We get out only what we put in.

These people are also becoming more and more aware that this indirect taxation increases their living costs more than direct taxes would. They believe that any sudden large increase in taxes or in wages which is forced upon a large industry results in increasing the price to the consumer more than the amount of the increased taxes or increased wages. In other words, they are beginning to realize that a tax at the source of production always costs the consumer more than a direct tax would cost him, such as a retail sales tax or a personal income tax which would yield an equal amount to the Government.

Anyone who thinks that the average resident of Arkansas earning $1,800 a year or less prefers a hidden corporation tax or a hidden manufacturers excise tax to a direct tax is reflecting upon the intelligence of those people.

So I want to urge the lowering of the exemption on personal income tax for three reasons:

1. It will provide increased revenue to help pay for the war as we go, which is imperative.

2. Because people of low incomes have a patriotic loyalty which inspires them to want a direct part in paying for the necessary defense of their country.

3. Because a direct tax is the least burdensome to those in the smaller brackets.

Reducing nondefense expenditures.—I understand that nondefense expenditures are expected to cost about $7,000,000,000 for 1941 and 1942. This is almost twice the average national expenditures from 1922 to 1932. Approximately $1,000,000,000 of this increase is in relief measures no longer imperative. Part of this increase is to be found in downright waste which should be stopped.

I do not believe that extravagance ever resulted in efficiency, or increased the ability of those who became accustomed to it, and this belief is based upon years of observation and experience.

I am president of Harding College, a small college in Arkansas, a State where the per capita income is only $225 a year and the average family income only $969 a year. This college has no endowment, no income from taxation, no regular large gifts, and, as our students do not come from wealthy homes, we cannot charge high tuition and fees. Accordingly we can only balance our budget by economizing. Our experience proves this to be an asset. It has made our students more self-reliant, more dependable, more efficient—more in demand. Throughout the past 10 depression years, we have constantly had more calls for graduates than we could supply, even during the period when there were millions of unemployed youth including thousands of college graduates.

Waste and extravagance on the part of our Government is particularly painful to us. All of our professors are making sacrifices in order that the ideals of our institution may be maintained. We are able to hold Ph. D. professors at $100 a month when they are annually offered two or three times that amount elsewhere. Our highest salary is $1,800 a year, and we are holding executives who have actually been offered five times that amount. These professors also set an example of thrift and economy by living within their incomes.

This loyalty on the part of the faculty and students who economize so faithfully for the ideals of Harding College convinces me that the public officials of the United States and the general public will economize to the *n*th degree for the salvation of American democracy once they recognize the present need and witness such examples being set before them by our Congress. Accordingly I want to urge that the Federal Government take the lead in setting an example of thrift and economy to replace the present spendthrift psychology of the Nation by making a $2,000,000,000 immediate reduction in nondefense expenditures.

After recommending the broadening of the income-tax base Secretary Morgenthau told you that "we ought not to accept such sacrifices, even though willing sacrifices, from millions of people with low income * * * unless we" do five things. These five things are enumerated on pages 3 and 4 of the hearings before this committee. In my opinion, they do not include the most important item of all, namely, eliminating about $2,000,000,000 of nondefense expenditures.

Gentlemen, it is my opinion that this committee would be ashamed to ask these 2,500,000 additional people to make these sacrifices unless you can say to them that the waste and extravagance which they have witnessed on every hand is being stopped through your efforts, which they believe to be within your power.

Another imperative reason for paring nondefense expenses to the bone: Mr. Jesse Jones, I believe, anticipates a Federal debt of $90,000,000,000. We also already have other governmental debt, not Federal, of $20,000,000,000.

Now, honestly, gentlemen, how do you think that we are going to pay this $110,000,000,000 or more? What do you think will happen after the war ends? Well, there will be a drop in war production of at least $20,000,000,000 per year, also several million men will be laid off employment and several million soldiers probably will then be mustered out and with few jobs available. Is it then that we will begin to reduce the billion dollars per year that we are spending on W. P. A.?

No; I expect this appropriation to be greatly increased after the war. Will our tax receipts then exceed our desires to spend to such an extent that the surplus can be used to pay off our $110,000,000,000 indebtedness? On the contrary, is it not likely that there will be a strong temptation to wipe out the indebtedness through devaluing the dollar?

Will not some leaders explain that by revaluing the present dollar at 20 cents our $22,000,000,000 of gold will increase in value $88,000,000,000 and then recommend that this $88,000,000,000 be used to reduce the indebtedness?

Do you realize, gentlemen, that the interest on a $100,000,000,000 debt 5 years from now will probably be $3,000,000,000 per year and that during the 10 years ending in 1932 the total United States Government expenses averaged less than $4,000,000,000?

In other words, our interest alone would be three-fourths of the cost of the total Government back in 1932 and the 10 years preceding.

No doubt great pressure will be applied to wipe out this $3,000,000,000 interest charge, and the indebtedness, through dollar devaluation.

If from now until the end of the war, Congress and the administration have a spendthrift, wasteful psychology, I shall expect some such suggestions to be enacted; but if every unnecessary expense is eliminated, if Congress and the administration are just as much interested in eliminating waste as they are in raising revenue, this need not happen.

What are the facts, and where are we heading?

The great defense industries are expected to become a $24,000,000,000 per year business by next May. The Army and Navy are also absorbing many men. Accordingly many parts of the country are already facing a shortage of manpower. For the duration of this war there is no probability that we shall again have a problem of unemployment. We naturally will always have some unemployables who must be cared for, but the problem of unemployment which we faced a few years ago has vanished. Is there any question in your minds but that the relief bureaus, which were organized to help those who could not find employment, should now be discontinued? I refer particularly to C. C. C. and N. Y. A. On May 15 I suggested this to the Committee on Ways and Means of the House. At that time N. Y. A. had a budget of $99,000,000. A few days later its appropriation was increased to $160,000,000 and it now claims to be a defense organization. The elimination of N. Y. A. would be a severe financial blow to our college, but we believe that everybody should make some sacrifice and we are willing to make ours.

I also suggested the eliminaton of C. C. C., the budget for which is $265,000,000. With the expected shortage in labor, there surely is

no need for a relief organization to provide jobs for young men of draft age. Imagine my surprise later to find an expensive moving picture, produced by professionals at Government expense and shown in leading theaters throughout the country, seeking to prove that C. C. C. is a defense organization.

The C. C. C. was created to help young men who could not find employment and who were too poor to go to school—a worthy purpose, the need for which no longer exists. It has, however, proved a very expensive method of relief. Each boy in the C. C. C. has cost the Government $1,025 a year.

At Harding College we can board and educate four boys for that amount of money; if they work for the college just during the summer vacation. We can also board and educate three boys for that amount without their doing any work. If you will deduct the $30 a month which the C. C. C. pays to the boy or to his parents, you still have a cost of $665 a year for his keep and training. We can keep three boys for that amount at Harding College if they will work for us only through the summer vacation, or two boys on that amount without any work. Yet we have no endowment, no income from taxation, and no regular large gifts.

Relief agencies do not have a "thrift" psychology. They were created to listen to the calls of the needy and say "yes." They were a part of the "prosperity through spending" program. We need no part of that program today in civilian departments. Economy and thrift should be the watchwords, but how can this be done if Congress appropriates the money for these agencies to employ the most luxurious forms of publicity for the purpose of making us believe that they have changed from relief agencies to defense agencies?

Expenses which may be reduced or eliminated during the emergency.—The largest savings I believe could be made in the following:

	Present	*Proposed reduction*
Work Projects Administration, public works, and soil-erosion budgeted at	$2,088,000,000	$1,088,000,000
Civilian Conservation Corps budgeted at	265,000,000	265,000,000
National Youth Administration appropriation	160,000,000	160,000,000
Nonmilitary highways budgeted at	161,000,000	161,000,000
Total		1,674,000,000

1942 APPROXIMATE BUDGET ESTIMATES

Rivers, harbors, and flood control [1]	$121,000,000
National park improvements	10,000,000
Agricultural forests and trails	10,000,000
Rural rehabilitation	66,000,000
Food-stamp plan	100,000,000
Export bounties	100,000,000
Department publicity and franking [2]	39,000,000
National Resources Planning Board and Office of Government Reports	3,000,000
Total	449,000,000

[1] For several generations it has been assumed that this item contains political pork, which surely can be reduced during this emergency.

[2] Congress used for franking in 1928, $845,000; in 1940, $737,000; departments used for publicity and franking in 1940, $39,000,000. I understand that professionals are employed to prepare radio scripts and movie films and that the most luxurious types of publicity are included. If Harding College used such luxuries we could not educate two boys for the cost of keeping one boy in the Civilian Conservation Corps.

One-half to be reduced equals		$224,500,000
(I believe that approximately one-fourth of the next group could be saved during this emergency.)		
Agricultural Department expense	$114,000,000	
Department of Commerce	31,000,000	
Department of Justice	55,000,000	
Department of the Interior	70,000,000	
War Department nonmilitary activities	45,000,000	
Miscellaneous independent offices	66,000,000	
Refugee relief	18,000,000	
Total	399,000,000	
One-fourth is		100,000,000
Total		1,998,500,000

(The above figures are limited to nondefense activities and do not include aids to agriculture and civil aeronautics.)

I know that organizations in all sections of the country are seeking increased expenditures in Washington, but if the Federal Government would immediately and sincerely undertake to set an example of thrift and economy, I believe the entire Nation could be led to follow that example. At the present time Congress is besieged with appeals for appropriations which 10 years ago we would never have thought of carrying to the Federal Government. This is because the impression has been made all over the Nation that the head is off the barrel at Washington—that money is being poured out and that somebody is going to get it. Accordingly, every Congressman is urged to secure an appropriation for his district and thought to be a failure if he does not succeed in getting it. If an atmosphere of thrift were dominant at Washington, those appeals would cease to be made.

Where I have spoken in my State groups have voluntarily officially notified our congressional representatives of their desire for economy and have urged them to do their utmost to secure the type of nondefense reductions I have requested here today.

Gentlemen, we are today at the crossroads. Shall we continue on the pathway of waste and extravagance which leads to inflation—dictatorship and revolution? That depends largely upon the action taken by you—our Senators. If you immediately broaden the base—pay every possible dollar on the war as we go—and seriously economize in all nondefense expenditures; we can then weather this crisis and successfully preserve our freedom and our democracy.

Senator VANDENBERG. Dr. Benson, as far as I am concerned, I would like to congratulate you on a very splendid statement. I would like to express the wish that you run for Congress in the area in which you live and get yourself elected.

Senator CARAWAY. The folks at Searcy would like to hear that.

The CHAIRMAN. Are there any questions by any members of the committee?

(No response.)

The CHAIRMAN. Doctor, we thank you for your appearance here. Undoubtedly your statement ought to be made to the Appropriations Committee rather than this committee because we, unfortunately, have no control over expenditures, except as we may have some little influence as individual Members of the Senate. Of course, you realize—and I think all of us must realize—that without strong executive

leadership you are not going to have the economy that ought to take place in this Government.

Dr. BENSON. That is right, and I appreciate your kindness. I feel very much disturbed about the heavy spending program, with the expenses that the war certainly will entail, and I am very much concerned about an actual demonstration of economy that will inspire our people to follow. I believe our people will stand any amount of taxation, provided they believe the leadership is willing to bear the burden with them. So I am very much interested in a demonstration of economy, which I believe our Congress should actually make. I observe the tendency for each group to wait for everybody else to make the start in these reductions. Mr. Morgenthau says a billion dollars could be reduced, but he suggested no places for it to be reduced. Other groups talk about it being done, but nobody seriously takes hold to actually secure reductions or to put the machinery in movement that will secure them.

The CHAIRMAN. Thank you very much.

Mr. Hart.

Mr. HART. Gentlemen, may I ask the privilege of relinquishing my time to Mr. George Glassgold, who is slated to appear following me?

The CHAIRMAN. Yes; that is satisfactory.

Mr. HART. May I also ask permission to submit a brief?

The CHAIRMAN. Yes; hand it to the clerk of the committee.

(Mr. Hart's brief is as follows:)

MEMORANDUM SUBMITTED BY JOSEPH J. HART, NEW YORK, N. Y., FOR EMPIRE DISTRIBUTORS & JOBBERS BOARD OF TRADE, INC.

SUBJECT.—Tax on coin-operated amusement and gaming devices.

GENTLEMEN: I refer to section 3267 of the House bill 5417. The coin-machine industry recognizes the needs of the Government for funds to carry out the defense program and is desirous of contributing its full share. Therefore, may I state at the outset that in asking for certain changes in rates, distinctions between various branches of the coin-machine industry, and more equitable methods of computation and collection, I am doing so in the sincere conviction that these changes, distinctions, and methods of collection will offer a practical solution to the tax problem relating to the coin-machine industry.

I hope to point out, what careful investigation will prove, that these revisions provide the only method of obtaining a maximum of tax revenue from this industry.

It is only fair to start with the understanding that the operator who places coin-operated equipment of all kinds into various locations, does so by paying a commission to the location owner. A commission which is based on a percentage of the gross income from the equipment and that the operator will necessarily be called upon to assume the entire burden of any taxation which is levied.

Having started with that premise, it becomes quite evident that the entire picture of equitable taxation must be based upon the earning capacity of the various types of equipment.

This brings us, gentlemen, to the definite line of demarcation between various types of equipment, which has always been recognized in the trade but which, evidently, was not taken into consideration in the drafting of the House bill.

In the section of the bill referred to above, there have been thrown together, without regard to earning capacity or the original cost, or depreciation or general ability to pay, such widely diversified types of equipment as, on the one hand, slot machines and coin-operated gaming devices of all kinds and, on the other hand, legitimate amusement games, such as pinball games, antiaircraft guns, baseball practice games and a host of strictly legitimate games of skill.

Let us analyze, somewhat, the comparative original cost, rate of depreciation, cost of operation, and earning capacity between the gaming devices and the games of skill.

A pinball or other skill-game location whose weekly total revenue reaches $15, would be considered in the trade to be an exceptionally lucrative one. Whereas a slot-machine location which was productive of no more than $15 per week total revenue would be considered unusually poor.

The initial cost of a new slot machine is approximately $100. The initial cost of a new pinball game is likewise approximately $100. But that is where the similarity ends.

The average life of a slot machine in productive use is at least 5 years—there being on location today, any number of such machines which are 10 to 15 years old and older. Amortization and depreciation are figured roundly at the rate of a few pennies per week.

On the other hand, the life of a pinball machine rarely exceeds 4 months of top productive use, after which it must be placed in outlying areas where the income is greatly reduced. After several months additional use, its value is practically nil. The cost of a pinball machine must be entirely amortized within a period of from 9 to 12 months—the greatest portion of the depreciation and amortization taking place during the first 4-month period.

The average operator of pinball machines operating 25 to 30 new machines in the most desirable metropolitan areas will average, on his entire operation, a maximum of $7.50 to $8 per week per machine gross income before deducting any costs, such as operating expense, commission to location owner, taxes, association dues, etc.

Thousands of pinball machines are operated not in desirable metropolitan areas but in nonindustrial and rural areas where the yearly income from these machines rarely exceeds $50 to $75, and where it is therefore economically impossible to operate anything but second-hand and third-hand equipment which costs $10 to $15 per machine. (Such States as Alabama, Mississippi, Arkansas, etc., use a preponderance of this type of equipment.)

It is our firm conviction that on the basis of $25 tax per annum for each pinball or other amusement skill game, thousands of these machines will have to be removed from circulation—machines whose income could justify a smaller tax. It is our further considered opinion that only by taking into consideration these various elements of ability to pay will the pinball industry and other allied amusement and skill-game industries be privileged to provide their full share of the revenue required by our Government to carry on its program of defense.

Our request, therefore, is that slot machines and other gaming devices, because of their much greater earning capacity and negligible depreciation, be placed in a separate category in the bill.

We further respectfully request that pinball games and other amusement skill games be taxed at $10 per annum, so that instead of thousands of machines being removed from circulation because of inability to pay the tax these machines will remain on location and the Government will be the recipient of a maximum of taxation cheerfully paid.

In order to eliminate a further possibility of loss of revenue, we feel compelled to call to the attention of your committee the existence of several conditions peculiar to our industry which, if not taken into consideration in the bill, will surely result in loss of tax revenue.

Many amusement games are placed in locations commonly known as resort locations, where they are in use approximately 3 months out of the calendar year. These machines rarely earn enough during this short period to warrant the payment of a full year's tax and under the proposed method of taxation it would be found necessary to avoid this type of location entirely.

Furthermore, pinball games and other amusement devices, such as antiaircraft guns, etc., are frequently placed in locations which, after several weeks or a month, prove to be absolute failures as means of providing income. Under the proposed method of taxation, a full year's tax would be required on such locations. This condition is certain to reduce materially the number of taxable machines in circulation.

In view of the above, we therefore make the following request: That the tax on pinball games and other coin-operated skill games such as antiaircraft guns, baseball batting practices, etc., be collectible on a semiannual basis. We assure your committee that this method of taxation and collection will result in the very maximum of tax revenue from the coin-machine industry.

May we now call to your attention the problem of amusement arcades under the proposed bill. In amusement arcades the revenue is obtained predominantly from the operation of coin-operated amusement devices. There are a

number of such arcades which contain as many as 200 to 300 individual coin-operated machines. It is immediately apparent that even at a reduced rate of taxation, such places would be taxable at anywhere from $3,000 to $10,000 per year. This we assure you would be so prohibitive as to drive most of them out of business, thereby producing no tax revenue whatever from this source. We therefore suggest, with regard to amusement arcades, that the tax be placed at $10 per annum per machine up to 30 machines and that a maximum tax per annum of $300 be placed on amusement arcades where 30 or more machines are operated.

It is only fair, in making suggestions of this kind for your consideration, that we submit definitions for the purpose of classification of various types of coin-operated equipment. Therefore, in order that a clear distinction be made between slot machines and other gaming devices, on the one hand, and pinball games and other coin-operated amusement skill games, on the other hand, we offer the following definitions:

1. A coin-operated machine whose operation is controlled wholly by chance and which as the result of such operation, automatically pays out cash or tokens redeemable for cash or merchandise, and which operates without the element of skill, shall be termed a gaming device. Such a device shall be one which, if operated by a blind man, would obtain the same result as if played by a man having full and complete use of his eyes.

2. A pinball game or similar amusement device shall be one which is operated with an element of skill, where the player's skill helps determine the result, and which device does not automatically pay out money, cash, or tokens redeemable for cash or merchandise.

SUMMARY OF RECOMMENDATIONS

1. That slot machines and other gaming devices be placed in a different section of the bill from that of pinball games and other amusement devices of skill such as antiaircraft guns, etc., and that they be taxed accordingly.

2. That pinball machines and other amusement games of skill be taxed $10 per annum.

3. That the tax on pinball games and other amusement skill games be payable semiannually.

4. That a maximum tax of $300 per annum be placed on amusement arcades at the rate of $10 per annum per machine up to the number of 30 machines, with no additional tax over 30 machines. An amusement arcade being an establishment whose income is obtained predominantly from the operation of coin-operated machines.

5. That a distinction for the purposes of taxation, between slot machines and gaming devices, on the one hand, and pinball games and other amusement skill games, on the other hand, be clearly defined.

Respectfully submitted.

EMPIRE DISTRIBUTORS & JOBBERS BOARD OF TRADE, INC.,
JOSEPH J. HART.

The CHAIRMAN. Now, Mr. Glassgold, will you state for whom you are appearing?

Mr. GLASSGOLD. Yes; my name is George Glassgold and I appear for the Coin Machine Industries Joint Council.

The CHAIRMAN. Coin Machine Industries Joint Council?

Mr. GLASSGOLD. Yes.

STATEMENT OF GEORGE M. GLASSGOLD, NEW YORK, N. Y., REPRESENTING COIN MACHINE INDUSTRIES JOINT COUNCIL

Mr. GLASSGOLD. Gentlemen, I refer to section 3267 of the House bill 5417. At the outset, I wish to state that the coin-machine industry is not here to protest against the taxing of its industry and is fully cognizant of the need by the Government for funds to further the defense program. My purpose in appearing before you

is to obtain an equitable distinction between the various branches of the coin-machine industry.

The present section, as now worded, has thrown together legitimate amusement devices with slot machines and coin-operated gaming devices. In the first place, with respect to the taxable status, the gaming devices are operated by every variation of coins, ranging from 1 penny to a silver dollar. The income from the gaming devices is far in excess of the income from any amusement device; and since this tax should be an equitable tax, it places the amusement devices at a complete disadvantage. So much so, that it is very possible that the amusement device, commonly known as the pin-ball game, will be removed from many locations as a result of the tax, and cause many location owners to invite the installation of a gaming device—which in the majority of States and locales would constitute the housing of an illegal device. In other words, there will be created a situation similar to liquor bootlegging.

The pinball game or similar amusement device, is known in the trade as a novelty game, and its trade name indicates the status and life of such equipment. As a novelty game, the life of the machine is short, figured in months, and therefore is constantly changed by those people who operate the games. The resultant cost of maintenance is therefore very high. This is not true of the gaming device. It is well known that the life of gaming devices is measured, not in terms of weeks or months, but in terms of years. There is gaming equipment in operation which is as old as 10 to 15 years. It becomes apparent that a differential exists in the cost of operation between amusement devices and gaming devices.

Since it is a matter of obtaining revenue for the Government to maintain and put into effect its program of defense, we believe it is necessary that it be made certain that the maximum revenue be obtained from a given industry. It is imperative that no provision be made so that as a result, any group or large portion of the taxed industry is eliminated from the field. A tax differential should be created between the gaming and the amusement devices. Unless this is done, a large section or portion of the amusement devices will be compelled to drop out of the field and the gaming devices will become their substitute with much resultant damage.

We believe that the so-called slot machine or gambling device, since they use coins up to the size of $1, and are not continually changed in design, can readily pay an occupancy-use tax of $25 per annum or more. However, the pinball game or similar machine, since it is equipment which is constantly changing in design and becomes obsolete rapidly, and the usual coin for operation is the nickel, cannot compete against the gaming or slot machine. It cannot pay the annual tax as high as $25. The tax should be fixed at $10 per annum. This reduced tax will make it possible to keep as many of these games that are presently operated, in operation; and obtain the maximum of income to the Government. This is a national problem and tax—a cross section of the entire country must be taken in fixing this tax. Though it is true that in some of the larger metropolitan districts there are some pin-ball games in operation that have a large income-producing capacity, these locations are in a very small minority. The bulk of the machines in operation are scattered in

the outlying districts of metropolitan areas and in the rural districts, where the gross income is very small.

At its best, an operator services an average of 30 machines; and after paying the commissions to location owners, paying the cost of replacing machines, servicing the equipment, he is able to make a small weekly salary for himself.

We request that the bill provide for the taxing of amusement devices under a separate paragraph from that of the slot machine and gaming device. It has been a source of embarrassment and distress and hardship in having amusement equipment classified with the so-called gaming devices. A definite hardship when the question of taxation is brought up for consideration. Consequently, the amusement device suffers as it is suffering in this particular case.

Another matter that we request to bring to your attention is the method of taxation. Many of these games are placed in locations which are known as resort locations, and they are in use approximately 3 months out of the calendar year. In many instances it would be impossible to place the pinball game or amusement device in a location where the tax is the same as on a machine which is used for the entire 12 months. Furthermore, a machine may be placed in a location and after a month or 2 months found to have produced little or no income, and consequently that machine will be permanently removed and not replaced with another. It does not seem equitable that a tax for the full year should be paid when there was a usage of possibly 1 or 2 months. Not to prorate over the period on this tax would tend to lessen the number of games being placed on locations and decrease materially the income from the industry. This should not be done at this time in view of the defense needs of the Government.

A solution to the prorating of the tax and other problems would be to place the tax on a semiannual basis. In this way, most of the elements which now appear inequitable would automatically be eliminated.

Another existing condition that we should like to bring before the committee is the effect of the proposed tax on so-called amusement arcades, where the space is used predominantly for the operation of coin-operated amusement devices.

The CHAIRMAN. That is covered by this same section?

Mr. GLASSGOLD. Yes; it is. In such locations there may be as many as two and three hundred individually coin-operated amusement machines. It is apparent that if the $25 tax remains, an arcade may be subject to a tax of as much as $10,000 per annum. Such a tax would be absoluately beyond their capacity to pay, and the very purpose of this section would be defeated. May we suggest that a maximum tax per annum be placed upon amusement arcades, and that we believe the sum of $300 per annum would be a fair and equitable tax?

With regard to the definition of the amusement machine as distinguished from the gaming machinie, may we suggest that a coin-operated machine, whose operation is controlled wholly by chance, and which, as the result of such operation, automatically pays out cash, or tokens redeemable for cash or merchandise, and which operates with no element of skill, shall be termed a gaming device. A homespun definition would be that such a game, if operated by a blind man, would obtain the same results as if played by a man having full and complete use of his eyes. A pinball game or similar amusement device is such a game or

device as is operated with the element of skill, where the player's skill determines the result, and which game does not automatically pay out money—cash or tokens redeemable for cash.

That is my statement.

The CHAIRMAN. Any questions, gentlemen?

(No response.)

The CHAIRMAN. Thank you very much.

Mr. Scott?

STATEMENT OF ROBERT J. SCOTT, PHILADELPHIA, PA., REPRESENTING NATIONAL WHOLESALE HARDWARE ASSOCIATION

Mr. SCOTT. With your permission, may I read my remarks?

The CHAIRMAN. For whom are you appearing?

Mr. SCOTT. National Wholesale Hardware Association and the Edward K. Tryon Co.

I have been buying and selling fishing tackle for 35 years. I am associated with the Edward K. Tryon Co. of Philadelphia, who probably distribute a larger volume of fishing tackle, in a wholesale jobbing way, than any other firm in these United States. I also represent the National Wholesale Hardware Association, consisting of 300 members located in 34 States. This group represents the outstanding and most important wholesale jobbing distributors in hardware and sporting goods, a great many of whom sell fishing tackle. As a matter of fact, some of the larger outlets of fishing tackle are hardware organizations. I also represent several large houses that are exclusively fishing-tackle distributors.

We are asking you gentlemen to give most serious consideration to the proposed tax on certain items of fishing tackle in H. R. 5417, page 72, lines 2 and 3.

We do not believe anyone will seriously object to the proposed tax on rods and reels although—and we quote from your records as follows:

In the Report of the Subcommittee of the Committee on Ways and Means of the House of Representatives, Proposed Revision of Revenue Laws, 1938, there is a statement on page 23, as follows:

> The tax on sporting goods has caused administrative difficulties out of proportion to the revenue received.

If this has been true of sporting goods as a whole, the difficulties will be multiplied many times in the collection of a tax on artificial lures, baits, and flies.

We, however, do not now offer any objections to the proposed new tax on rods and reels although we feel you will be very much disappointed in the dollar-and-cents return. We do, as a group, however, object to the proposed tax on artificial baits, lures, and flies.

There are many reasons, among which is the fact that it will be almost impossible to collect from a great many so-called manufacturers of these items.

I hold in my hand my confidential list of fishing tackle factories containing 1,106 names, some of which are large, important factories with complete organizations but, by far, the great majority are small individuals located here, there and everywhere, with little or no

overhead and there are, no doubt, other names that I have not recorded. (A careful count indicates that 20 of these names will cover all of the manufacturers of rods and reels in this country.) There seems to be a great desire on the part of many sportsmen to be in the manufacturing of fishing tackle, especially baits and lures. In my State of Pennsylvania—and this is true of other good fishing States—in almost every town in the fishing area, you will find one or more fly tyers or bait makers who have no business organization of any kind, who do most or all of the work themselves, sometimes assisted by their families and, these "so-called" manufacturers would have a decided advantage in selling, over the large and better-organized factories.

You all know that it would be almost an impossible task for the Government to keep track of and collect taxes on artificial baits, lures, and flies from these small local factories. As a matter of fact, many of these so-called manufacturers have other employment and do this work for either a hobby or extra remuneration. Many retailers produce baits and flies in their spare time, not only for stock purposes but to supply special orders, and you would have a tremendous job, an almost impossible one, in keeping track of the tax.

During the season in Pennsylvania and other good fishing States, dealers have girls in their windows tying flies as an advertisement, and often customers walk in and have their flies tied while they wait and take them with them.

We have no hesitancy in saying that, in our judgment, there are probably more flies and baits made by these so-called local manufacturers than there are in the larger factories.

In days gone by we enjoyed a very large business in Pennsylvania on flies which is now almost negligible on account of the competition from these local factories. The amount of detail work necessary in a regular jobbing distributor's organization to keep a true record of the taxes on baits and flies would be enormous and the amount of return to the Government would be very small.

Then, another important point is that only the amount of the tax paid can be collected, and this would divulge the cost of the merchandise to the dealer and the consumer. The only way this could be overcome would be for the tax to be included in the cost of the merchandise at the source and not added separately.

I am submitting for your consideration a copy of the membership list of the National Wholesale Hardware Association, and also a copy of the catalog of the Edward K. Tryon Co., which will indicate to you the great variety of baits and flies that we sell, and you will note that their monetary value is comparatively insignificant.

We hope you will find it possible to eliminate the tax on artificial lures, baits, and flies.

The CHAIRMAN. Any questions?

Mr. SCOTT. I will leave this catalog here for the committee.

Senator DANAHER. Mr. Chairman, is that catalog going into the record?

The CHAIRMAN. No; he has just left that for the committee.

Mr. SCOTT. I have left it for the committee.

The CHAIRMAN. Mr. Haggerty.

STATEMENT OF JOHN B. HAGGERTY, CHAIRMAN, BOARD OF GOVERNORS, INTERNATIONAL ALLIED PRINTING TRADES ASSOCIATION, AND PRESIDENT, INTERNATIONAL BROTHERHOOD OF BOOKBINDERS

Mr. HAGGERTY. Mr. Chairman and members of the committee, this presentation, in behalf of the International Allied Printing Trades Association, comprising the 5 international unions in the printing industry, representing almost 200,000 skilled workers, favors the doubling of the taxes voted by the House of Representatives on net time sales to radio broadcasters.

It is our understanding that this revenue bill is to be based on the ability of the taxpayer to pay. The presentation of the opposition carefully avoids this question of the ability to pay.

The International Allied Printing Trades Association advocated the levying of this tax on the net time sales of radio broadcasters with two purposes in mind. First, the ability of the broadcasters, based upon their own reports to the Federal Communications Commission, to pay, and, secondly, to protect the job opportunities of printing-trades workers.

In the 10 minutes allowed me it is not possible for me to develop all of the reasons which we have incorporated in the brief which I have filed with your committee. I will, therefore, confine myself to the highlights, hopeful that we will demonstrate to your satisfaction that not only should taxes be levied, but also that the rates as voted by the House be substantially doubled.

The opposition to the levying of this tax presented no figures to disprove the contention we made of the ability to pay. They raise the cry that this is a tax on advertising. No one has advocated a tax on advertising.

The first question, as we understand it, before the committee in levying these taxes is the ability to pay. You will find citations in our brief which do not permit of anyone questioning the ability of the networks and the operators of the larger radio broadcast stations to pay. It is worthy of note that the two major networks, with a combined total investment of $4,614,000, had net profits of $59,509,549 for the 10-year period 1931–40, inclusive. Also, it might be of interest to the committee to know that the net profits for the years 1931–35, inclusive, were $19,017,613, while the net profits for the 5-year period following, 1936–40, inclusive, were $40,491,736, an increase in net profits of some 213 percent.

These net profits are after stated deductions for depreciation of some $10,182,021—1931–40, inclusive—and the payment of all taxes, including Federal income and all other operating costs.

In addition to these unusually high net profits, mainly in what were known as depression years, the networks principally and the larger radio broadcast stations allowed to be deducted by advertising agencies, in the form of rebates and discounts, an additional $20,000,000 yearly. These figures do not show in the financial reports of the networks or the radio broadcast stations, as the deduction is allowed before the presentation of the bills.

In order that there may be no question about this I will quote as an authority the attorney for the National Association of Broadcasters.

In the formal brief he presented, referring to gross sales, page 2, he said, I quote—

> The amount so received or accrued cannot logically include discounts or rebates actually allowed, of course.

Whether he was fearful that your committee might seek to tax such rebates or discounts or possibly having in mind that the Treasury of Federal Trade Commisison might see the wisdom of questioning such practices I do not know. However, you will note he sought to justify the continuance of these debates and discounts, free of taxation.

It is understood that your committee will recommend the levying of substantial taxes—increases of 200 percent and 300 percent—on incomes of wage earners and small businessmen, the very people least able to pay. The reason given is the need of additional revenue.

Further, we understand your committee has under consideration the lowering of the income-tax base, again calling upon those least able to pay to make up for the losses to the Treasury through the exemptions which are sought by those who operate radio broadcasting stations with their yearly net profits in excess of 100 percent.

We are opposed to the lowering of the income-tax base until such time as those of proven ability to pay are properly taxed.

The taxes which the International Allied Printing Trades Association have advocated will collect more net revenues than the total amount the Treasury will receive from taxes received through the lowering of the income-tax base, and, much of that which they would receive through substantial increases in the taxes of those least able to pay.

We understand that through the lowering of the income-tax base it is expected that the Treasury Department will collect some $19,000,000 and the cost of collecting will be some $15,000,000.

The taxes which we suggest be levied will raise at least $25,000,000. Of this amount some $20,000,000 could accrue through the elimination of these rebates and discounts, which do not show in the receipts of the radio broadcasting companies and the networks, and the payment of this money into the Treasury as taxes.

The networks, with their increased net profits of 213 percent for the period 1936–40, inclusive, alone can pay an additional $5,000,000 yearly. They would still have, according to the report of the Federal Communications Commission for 1939 and for 1940, some $4,000,000 yearly as net profits, after all taxes on their investment of $4,614,000. In addition, there are a number of other stations the net profits of which range from 63 percent to 133 percent.

The net profits of the entire industry as shown by the reports of the Federal Communications Commission, 1939, the last detailed report available, was some $24,000,000 on a declared value of properties worth $28,000,000.

Radio broadcasters would have you believe that the proposed tax on radio broadcasting stations is a tax on advertising. That they do not believe such themselves is best evidenced in the formal brief of the National Association of Broadcasters. You will find on page 18 they say "radio broadcasting is the principal source of entertainment in America." On the same page they emphasize their insistence that radio broadcasting is an amusement and entertainment enterprise

as you will note they say that radio broadcasting "enjoys the favor of half again as many people as its closest competitor, the motion picture, which is the chief attraction for 19.3 percent of the American people."

Surely, no one will contend that the motion pictures, radio broadcasting's closest competitor, is advertising. During the Finance Committee hearing, in response to a query as to placing a tax on advertising, Senator Bennett Clark said:

You cannot conceivably tax newspaper advertising under the Supreme Court decision in the *Louisiana case.*

Reference was made before the committee on Monday to the fact that the executive council of the American Federation of Labor had voted to oppose this tax. The A. F. of L. was not consulted by the Printing Trades Unions as to whether or not such tax should be levied. It is our belief that the people most vitally concerned are the Members of the Congress—House of Representatives and Senate—on whom lie the responsibility for deciding on the contents of the revenue bill.

(A brief submitted by Mr. Haggerty is as follows:)

PRESENTATION OF PRINTING TRADES UNIONS, BY JOHN B. HAGGERTY, CHAIRMAN, BOARD OF GOVERNOR, INTERNATIONAL ALLIED PRINTING TRADES ASSOCIATION, AND PRESIDENT, INTERNATIONAL BROTHERHOOD OF BOOKBINDERS

Mr. Chairman and members of the committee, the International Allied Printing Trades Association, for whom I speak, is composed of the International Brotherhood of Bookbinders, the International Printing Pressmen and Assistants' Union, the International Photo-Engravers Union, the International Electrotypers and Stereotypers Union, and the International Typographical Union, with a combined membership of almost 200,000 highly skilled workers.

We ask your committee to recommend a substantial increase—100 percent—in the taxes, voted by the House of Representatives, on net time sales of radio broadcasting networks and stations. We believe the rates voted by the House of Representatives are but one-half of those which should be levied, in view of the profits realized on the Government license or franchise, and the ability of the networks and larger radio stations to pay the tax.

$60,000,000 profits on $4,614,694

We favor the imposition of these taxes for several reasons:

1. The annual revenue collectible from this source, estimated at $12,500,000 based on rates voted in the House of Representatives, is needed, as are the taxes sought from numerous other sources, to meet the heavy burdens of national defense. When every available source of revenue must be tapped to meet the requirements of unprecedented public expenditures no fertile source should be neglected, so long as the tax proposed is not discriminatory, and, at the same time would not impose an excessive burden. In these times no tax can properly be opposed merely because it is burdensome. The only question is one of discrimination and of undue burdensomeness. With workers called upon to pay increased taxes of 200 percent to 300 percent and with many workers who never before paid any taxes called upon to deprive themselves of the necessities of life in order to contribute to national defense, surely those who secure yearly net profits in excess of 100 percent, after the payment of present Federal income taxes, should not complain of the so-called burden of taxation. We are opposed to the lowering of the income tax base until such time as those with proven ability to pay are properly taxed.

2. We favor the imposition of a tax on radio broadcasting income, substantially higher—100 percent—than the rates voted by the House of Representatives, because such taxes would not be either excessively burdensome nor discriminatory. We believe your committee should recommend exempting from this tax those radio stations owned and operated by labor, farm, religious, and educational bodies when such stations are not leased to others. We believe

such stations serve a community interest and are not commercial in the usual sense of the word.

The net broadcasting revenues of the radio networks and larger radio stations are and have for a number of years been exceedingly high as measured by the cost of facilities, both when compared with net profits of any industry of similar proportions and when looked at in terms of percentage of profits.

Reports of the Federal Communications Commission show that the net profits of the two major networks, namely, National Broadcasting Co. and the Columbia Broadcasting System, amounted to $59,509,349 for the years 1931–40 inclusive. These figures are taken from the Federal Communications Commission Monopoly Investigating Committees' report, volumes 1 and and 2, and, reports of the Federal Communications Commission for the years 1939 and 1940. These net profits of $59,509,349 for the 10-year period yielded an average annual net profit for these two companies alone of $5,950,934. The total combined investment in these two companies, on which these unusual earnings were made, was $4,614,694. The average annual net profits, after deduction of all operating costs, payment of Federal income and all other taxes, and including depreciation of $10,182,021, were therefore some 129 percent.

They have the profits to pay

It should be added that the net profits for the years of 1936–40, inclusive, were much greater than those for the years of 1931–35, inclusive. National Broadcasting Co. and Columbia combined net profits increased from a total of $19,017,613 in the first half of the 10-year period to $40,491,736 during the second half of the 10-year period, an increase for the years 1936–40 of 213 percent over the profits for the 5-year period 1931–35, inclusive.

Surely, these official figures, as reported by the network companies to the Federal Communications Commission, give every evidence of ability to pay a much higher and more substantial tax than those which were voted by the House of Representatives.

Further evidence of the ability to pay additional taxes is also available from the same official source. In 1939 there were 33 stations of 50,000 watts power operating full time on clear channels. The total broadcast revenues (1939) of these stations were $27,055,000 and their net broadcast revenues were $9,375,000, or an average of $284,000 per station. The declared net worth or current value of the physical property of these stations in the same year was $7,015,000, or an average of $212,000 per station. Thus, their net broadcast income—their net profits before payment of Federal income taxes—was 133.6 percent of their value.

Compare such net profits with an allowance of 8 percent, or even 10 percent, which we believe is considered a high return on investments, and then consider the unusual ability of these radio network and broadcasting stations to contribute substantially to the common burden of national defense.

In 1939 regional unlimited time stations numbered 174. Their total broadcast revenue was $32,814,000. Their net broadcast revenues were $6,393,000, compared with a current value of $10,222,000. Their net broadcast revenue was therefore 63 percent of the current value. This is less than one-half of that enjoyed by the 33 full-time 50,000-watt stations operating on clear channels, but it is many times the liberal rate of 8 percent or 10 percent.

The most profitable radio stations are, of course, located in the larger urban centers of the Nation. Seventy-three stations with time sales of over $25,000 were located in centers of over 2,000,000 people. Without reciting all the supporting figures which are available in the reports of the Federal Communications Commission, calculations show that the net returns of these stations were 76.8 percent of the current value of the stations. Twenty-six stations located in populous centers ranging from one to two million people enjoyed net profits, calculated on the same basis, of over 100 percent, while the net return of the 40 stations with time sales of over $25,000 located in cities with 500,000 to 1,000,000 people was 97.1 percent.

Why exempt profitable broadcasters?

Reports of the Federal Communications Commission reveal that of total net broadcasting revenues of the entire industry, in 1939, not less than 93 percent was received by the 154 stations which had a gross income of more than $150,000.

Many additional statistics could be cited to substantiate the lucrative character of the radio-broadcasting business, but enough has been submitted to demonstrate

conclusively the ability of the radio-broadcasting industry to pay substantially higher taxes than those voted by the House of Representatives without either networks or stations incurring an undue or excessive tax burden.

Much criticism has been leveled at what is alleged to be the possible discrimination of imposing such taxes on radio broadcasters. Before considering the criticism of those who are interested in opposing the levying of these taxes let us consider how fortunate these networks and radio broadcast stations would be in being freed of the payment of these taxes for the year 1941, as provided for all other taxpayers. You might note that these taxes would not become effective before December 31, 1941, instead of sometime during 1941, as do all other new excise taxes.

If we examine the long list of excise taxes already imposed, and bear in mind that a number of these are to be substantially increased under this revenue bill, the question arises, not whether it would be a discrimination to tax radio broadcasters but whether it would not be discriminatory to levy a tax on all of these other industries and services and to single out radio broadcasters for exemption. If all forms of luxury and amusements and a number of necessities are called upon to contribute substantially, yes, even heavily, to meet the costs of national defense, radio broadcasters should not escape paying their share of the common burden.

Radio broadcasting is aimed principally at amusement or what is thought to be amusement and entertainment. That the Federal Government classifies radio programs as entertainment is shown by the form which every broadcaster must file when he applies for a renewal of his license. The space in which he is asked to specify the activities he proposes to engage in is headed "entertainment." No reference is made to advertising in the application filed with the Federal Communications Commission. In the exhaustive report of the Federal Communications Commission, made public May 4, 1941, radio broadcasters are constantly referred to as disseminators of entertainment.

"Broadcasting is entertainment"

In the amusement field radio programs are similarly treated. The organ of the amusement trades, Variety, includes the radio broadcasters as members of the amusement group. In the issue of May 27, 1941, Variety carries a list of the most popular daytime and evening radio programs. Among the 50 listed, only 5 are identified under the names of the sponsors or advertisers. The remainder of the 50 so listed—45—are identified under the names of the popular entertainers. The trade publication Broadcasting likewise identifies radio programs principally by the names of the entertainers. A recent issue of Broadcasting lists the 10 most popular radio programs for the year 1940. In this listing we note the absolute absence of the name of any sponsor or advertiser. Almost all of the leading radio programs are identified only by the names of the entertainers. Much the same is true of the radio schedules appearing in the daily newspapers.

That the National Association of Broadcasters itself regards radio broadcasting as predominantly in the entertainment class is evidenced from their brief filed with the Senate Finance Committee. They claim (p. 18) that "Radio broadcasting is the principal source of entertainment in America today," and that radio broadcasting "enjoys the favor of half again as many people as its closest competitor, the motion picture."

Radio broadcasters secure entry into American homes through their dissemination of entertainment. All other purveyors of amusement are taxed on gross income. Radio broadcasters should not be exempt. Otherwise, one disseminator of entertainment on a national scale would escape the payment of taxes comparable to those collected by others.

3. A third reason why we favor higher taxes than those proposed on radio broadcasting revenue lies in the fact that an outright gift of monopolistic license is made to the radio broadcasting companies by the Federal Government. This free franchise is capitalized by the license holders, as records of the Federal Communications Commission show, and sold for profits sometimes in excess of a million dollars. The licensee pays nothing for this lucrative permit. It is certainly neither unreasonable nor unfair or repressive of freedom to ask the holders of these profitable privileges to take their place alongside other purveyors of amusement and entertainment, and even those of necessities in defraying the costs of arming the country. The opponents of this tax have enjoyed these valuable privileges so long, through the generosity of the Congress,

that they apparently find it disagreeable to be called upon to pay their fair share of the costs of government and of national defense.

Who are the opponents of this proposed tax?

First, of course, are the radio networks and radio broadcast stations which will be called upon to pay the taxes levied. Their desire to escape this taxation may be natural, but the cry of discrimination and excessiveness of the levy are unfounded, as we have shown. All the facts are against these allegations.

On July 21, 1941, the Federal Communications Commission reported the net income, before payment of Federal income taxes, of those 238 radio broadcast stations which would come within the purview of the taxes voted by the House of Representatives. This compilation does not include the network operations. The total net profits of these stations, before Federal income taxes, was $23,533,440. If we allow $5,000,000 for Federal income taxes the balance of net income for these 238 stations would be $18,500,000. Accepting the estimate of the trade publication, Broadcasting, that $4,000,000 of these taxes of $12,500,000 would accrue from the networks, we have $8,500,000 to be paid by these 238 stations which had a net, after payment of Federal income taxes, of $18,500,000, thus a net profit of some $10,000,000.

According to another report of the Federal Communications Commission the current value of the 255 more important stations, which would include these 238, was $20,473,000 in 1939. After payment of the proposed taxes already voted, these 238 stations would therefore have left a net profit in excess of 50 percent on their current value.

As for the two major networks, National and Columbia, calculations based upon reports of the Federal Communications Commission show that after the payment of the proposed low taxes the net profits remaining would be some $3,500,000 on a combined total investment of $4,614,000, or a return of nearly 75 percent.

Considering the vast and unusual profits of this industry their contributions toward eliminating unemployment has been relatively slight. The 84 stations in centers of population of more than 2,000,000, for example, had in 1939 only 3,473 full-time employees, including 314 executives. The total pay roll, exclusive of executives, was also small. The average was $50 per week, including the wages paid to staff musicians and highly skilled electrical operators. Yet these stations showed a net profit of 76.8 percent on the current value of the stations.

Another group that opposes the proposed tax consists of the advertising agencies. These too have a reason for complaint that is not hard to understand. The commission paid by newspapers and magazines for securing advertising is 15 percent. Network broadcasters and many of the larger radio stations can and do pay rebates and discounts as well as agency commissions ranging from 36 percent upward.

Frank K. White, treasurer of the Columbia Broadcasting System, in a recent letter to the Editor and Publisher, a weekly trade magazine, in defense of the bookkeeping practices of radio networks, protested that the maximum commission allowed by his company could only represent 36 percent. These higher rates are arrived at by a combination of rebates, discounts, and commissions. The National Broadcasting Co.—red network—rates published in the 1941 yearbook of Broadcasting, reads as follows:

COMMISSIONS AND DISCOUNTS

[Weekly discounts for 13 or more consecutive weeks network broadcasting]

All network contracts for the same advertiser (advertising agency) may be combined for determining discount rate

Contracted value of network time at gross rates:	*Rate of discount on weekly gross billing, percent*
Less than $2,000 per week	None
$2,000 or more but less than $4,000 per week	2½
$4,000 or more but less than $8,000 per week	5
$8,000 or more but less than $12,000 per week	7½
$12,000 or more but less than $18,000 per week	10
$18,000 or more	12½

"Twenty-five percent annual discount: A discount of 25 percent in lieu of weekly quantity discounts and annual rebates will be allowed currently to advertisers (advertising agencies) whose contracted gross billing equals or exceeds $1,500,000 within a 12-month fiscal-year period.

"Net billings (gross billings less all discounts and rebates) shall be subject to an advertising agency commission of 15 percent."

The blue network of the National, in addition to the above, provides for special blue discounts.

The Columbia has a schedule of weekly and annual discounts, plus an advertising agency commission of 15 percent. There is not much material difference in the systems employed to make it attractive for the advertising agency to divert as much advertising as possible from printed publications to radio broadcasting.

Having in mind that the advertising agencies receive some "36 percent" from radio broadcasting companies, as admitted by the treasurer of the Columbia (which does not advertise special discounts or rebates) as compared with only 15 percent from printed publications for placement of advertising, it might be well for the committee to look over the National Broadcasting Co. billings of those advertising agencies whose billings exceeded $1,500,000 in 1940.

Agency A	$9,564,419	Agency G	$1,956,810
Agency B	4,392,855	Agency H	1,920,143
Agency C	2,972,116	Agency I	1,749,591
Agency D	2,454,059	Agency J	1,604,674
Agency E	2,134,921	Agency K	1,560,537
Agency F	1,950,503		

Much the same could be cited with relation to the advertising agencies and Columbia.

The combined total billings by advertising agencies (1940) amounted to $91,684,000. Of this amount all but $496,641 was placed through advertising agencies. In other words, direct billings was about one-half of 1 percent.

It is estimated that the rebates and discounts, other than advertising agency commissions, divert some $20,000,000 of yearly income which would otherwise be received by the radio networks and broadcasting companies. The proposed tax allows a deduction of not more than 15 percent for commissions free from taxation. The elimination of the rebates and discounts would save the networks and radio stations an estimated total greater than the estimated $12,500,000 which they would pay under the low rates voted by the House of Representatives.

Seek continuance of rebates

The National Association of Broadcasters makes it clear in their brief (p. 2) that "gross amount received or accrued from the sale of time," by the broadcast companies, "cannot logically include discounts or rebates actually allowed." This means that rebates and discounts which are always in addition to the agency commissions, do not show in the gross receipts and so are not deductible. The broadcasting companies will, therefore, look twice before allowing the very generous rebates and discounts which the advertising agencies have become accustomed to.

Little wonder the advertising agencies are concerned about a tax on radio broadcasters!

Radio broadcasters would have you believe that the proposed tax on radio broadcasting stations is a tax on advertising. That they do not believe such themselves is best evidenced in the formal brief of the National Association of Broadcasters. You will find (p. 18) they say: "Radio broadcasting is the principle source of entertainment in America." On the same page they emphasize their insistence that radio broadcasting is an amusement and entertainment enterprise as they contend that radio broadcasting "enjoys the favor of half again as many people as its closest competitor, the motion picture." Surely, no one will contend that "the motion picture," radio broadcastings "closest competitor" in entertainment or amusement, is advertising.

During the Finance Committee hearings, in response to a query as to placing a tax on advertising, Senator Bennett Clark said: "You cannot conceivably tax newspaper advertising under the Supreme Court decision in the *Louisiana* case."

The employees of the broadcasting companies may also be numbered among the opponents of the proposed tax on radio-broadcast companies. In addition to other figures which we have cited it would be well for the committee to have in mind that the 40 stations in centers of population of 500,000 to 1,000,000, in 1939, employed only 1,805 full-time workers. The average wages paid were $42.37. Clerks received an average of $20.59; stenographers, $23.10; accountants, $31.43; writers, $41.60; staff musicians, $43.29; and highly skilled

electrical operators, $42.54. The 87 stations in centers having between 250,000 and 500,000 population employed only 2,561 full-time workers. The average wages received was $34.04. Clerks averaged $20.40; stenographers, $22.93; accountants, $32.06; writers, $28.13; staff musicians, $32.67, and electrical operators, $40.09. The average net broadcast revenue of 80 of these 87 stations was 86 percent of the current value of the stations, after paying commissions and allowing rebates and discounts to billing agencies.

The employees who oppose the levying of the proposed slight taxes obviously have no stake either in the larger profits of the radio-broadcasting companies or the swollen rebates allowed to the advertising agencies.

4. We favor a substantial increase in the proposed taxes on radio broadcasters because of the diversion of advertising from printed publications to radio broadcasting with its resultant loss of thousands of job opportunities to printing trades workers.

Jobs lost—yearly wages decreased

The small number of workers engaged by radio-broadcasting stations, as compared with printing establishments, the broader regional coverage enjoyed by the more powerful radio stations which cover areas wherein are located hundreds of newspapers, magazines, and printing plants, which provide employment for thousands of printing-trades workers; the public gift of a free franchise and finally the great profits of the radio-broadcasting companies together with comparatively small operating expenses have combined to give radio broadcasters an unfair competitive advantage which has resulted in the loss of thousands of job opportunities to printing-trades workers. In addition, we believe, the granting of rebates and discounts, plus agency commissions, has led these advertising agencies to prefer radio business to that of newspaper and magazine contracts from which they receive much lower remuneration.

That the effects of this competition has been serious cannot be doubted. Farm newspapers and magazines have been the greatest sufferers. According to Printer's Ink of March 1, 1940, the advertising revenues of farm papers totaled $35,000,000 in 1929, while in 1939 these receipts had dropepd to $17,000,000, a loss of 50 percent. In 1929 radio advertising amounted to 4.3 percent of total national advertising. In 1939 this percentage had risen to 31.8 percent. Government statistics show a decline of 1,656 in the number of publishing plants compared with 1929. Average annual wages of printing-trades workers during the same period declined $284 or 15 percent. The decline in advertising revenue forced many newspapers and magazines to increase their prices to the consumers as much as 50 percent.

In view of the foregoing it would be difficult to find among the hundreds, yes, thousands of industries, trades, or services in the United States, subject to excise or other taxes, one which might with greater justice and fairness and with less oppressiveness and injury be taxed than the radio-broadcasting stations and networks.

(Subsequently the following telegram was received from Mr. Woodruff Randolph, secretary-treasurer, the International Typographical Union.)

[Telegram]

VANCOUVER, BRITISH COLUMBIA, *August 22, 1941.*

SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.:

The International Typographical Union, in convention assembled, respectfully calls to the attention of the committee that the printing-trades unions are unanimous in their support of the International Allied Printing Trades Association's request for adequate amusement tax to be levied on net time sales of radio broadcasting networks and stations as presented to your committee by John B. Haggerty, chairman of the board of governors of the association. The International Typographical Union further states that the American Federation of Labor does not represent the association in this matter, and that a resolution adopted by the executive council of the American Federation of Labor opposing such a tax does not represent the desires of the five international printing-trades unions involved. The names of such other American Federation of Labor unions as may be desirous of such an action by the executive council of the American

Federation of Labor have not been made known to our organization. Four of the five printing-trades unions forming the International Allied Printing Trades Association are members of the American Federation of Labor but do not depend upon that organization for guidance on this particular question. These four printing-trades unions even though affiliated with the American Federation of Labor are unqualifiedly in support of the presentation of President Haggerty, as is also the International Typographical Union.

WOODRUFF RANDOLPH, *Secretary-Treasurer.*

The CHAIRMAN. Mr. Casey.

STATEMENT OF WILLIAM J. CASEY, NEW YORK, N. Y., REPRESENTING THE FEDERAL TAX FORUM

Mr. CASEY. Gentlemen, I am William J. Casey, an attorney associated with the Research Institute of America, and I am here on behalf of the Federal Tax Forum of New York City. It is a forum of tax men in the tax departments of corporations and attorneys and accountants who practice tax law in New York. This organization of over 100 tax men meets together 2 nights a month for the purpose of studying and discussing taxes and pooling experiences with both taxpayers and tax collectors.

In appearing for the forum, I am presenting not my own ideas and recommendations but those of the organization as a whole. I agree with most of these recommendations; with some of them I disagree. They were arrived at after submitting to the group over 30 different and distinct suggestions for amending the tax law in the interest of greater equity and expediency in raising revenue. These suggestions were boiled down; some of them discarded; some were amended. I am submitting to you the recommendations which the group, as an organization, has approved and thinks deserving of serious study and action by you gentlemen who are charged with drafting revenue legislation.

At the outset, let me say that the Federal Tax Forum as a body recognizes the urgent need for more revenue. We are not speaking in behalf of any taxpayer, class of taxpayers, or even in behalf of all taxpayers as a group. We appear as plain citizens for the purpose of contributing our experience to the task of raising the greatest amount of revenue with the least amount of hardship and inequity. We submit that our own experiences in dealing with both taxpayers and with tax collectors gives us a particularly advantageous perspective from which to consider this problem of raising a maximum of revenue with a minimum of hardship, irritation, and injustice with which you are so seriously concerned. Before proceeding to our specific recommendations, let me urge one general principle. It is this: It is just as important in drafting tax legislation that you consider taxpayer morale, as it is in drafting military legislation to consider the morale of the men in Army camps. Without good taxpayer morale, the new and higher tax rates, which are necessary this year and for some years to come, will not produce their maximum in revenue. Most of our recommendations are directed at clearing up inequities and hardships which generate resentment among taxpayers. In some cases, these steps which we are asking you to take—for example, restoring the tax on investment income to a net income instead of a gross income basis—may cost something in revenue. We submit, however, this cost will be offset—perhaps even more than

offset—by the reduced difficulty and expense in collection, and the general increase in revenue which will result from the more cheerful cooperation by taxpayers in reporting income, keeping records, cooperating on audits, and in general cooperation with the Bureau of Internal Revenue.

Removal of these sources of irritation will pay dividends in revenue. If they do not, it is within your power to make whatever rate increases are necessary to make up the loss in revenue which results from following these recommendations.

Investment expenses.—It is strongly urged that section 23 (a) of the Internal Revenue Code be amended to specify clearly and unmistakably that any expenses incurred in connection with the production of any income which would be taxable shall be deductible. The Supreme Court, in *Higgins* v. *Commissioner* (61 S. Ct. 475), has upheld the Commissioner in disallowing clerical salaries, office rent, and similar expenses incident to supervising extensive investments.

The CHAIRMAN. It will not be the purpose of the committee, according to its tentative decision at least—I think we will have to follow it—to go into what you might call the administrative or technical, or miscellaneous provisions of the tax bill at this time. The Treasury is making a study and will be ready to submit a bill that will cover such matters as the correction of the rule in the *Higgins case* sometime this winter.

Mr. CASEY. I would like to lay these recommendations on the record anyway. Some of the things I have to speak on concern technical and administrative changes; others concern provisions of this bill.

The CHAIRMAN. You can file the brief in the record; it will be more helpful for us a little later.

Mr. CASEY. This *Higgins decision*, perhaps primarily aimed at inactive investors, has been applied against persons actively engaged in carrying on an investment business. This discriminates gravely against the taxpayer who invests his money in securities and bonds and who has to spend money in investment research, keeping records, making reports, etc. Frequently he would be much better off putting his money in an annuity or some other form of investment where he received only a net return. Under the current Treasury practice, he must pay tax on his gross return without the benefit of any deduction for incidental business expenses. Thus, taxpayers who happen to receive the income on which they are taxed from investments are taxed on their gross returns. Other taxpayers are taxed on their net return. This glaring, and now very common discrimination can be readily eliminated by providing for deduction of all expenses incurred in earning taxable income.

It is particularly important that inequities and injustices be eliminated now. As tax rates increase, taxpayer resentment is apt to increase correspondingly. By eliminating technical discriminations of this kind, that resentment can be at least kept at a minimum.

In 1938 a subcommittee of the House Ways and Means Committee made a recommendation on this point which received Treasury approval. This recommendation was to this effect:

> It is recommended that a deduction be permitted under section 23 of the Revenue Act of 1936 for expenses not attributable to the taxpayer's trade or business, but immediately and directly incurred in the collection or production of amounts included in gross income, limited to 50 percent of the amount collected or produced.

This recommendation was not written into the law at that time because the Bureau was as a general thing allowing deductions of expenses incurred in producing income. The need now is acute. It might be noted that a provision in the New York income-tax law similar to the recommendation of the House Ways and Means subcommittee is operating satisfactorily.

It is recommended that the relief be made retroactive to all cases now open. For many years it was the regular practice of the Bureau of Internal Revenue field men and auditors to allow deductions of bookkeeping and stenographic expenses, office and safe-deposit-vault rent, auditing and legal fees, the cost of investment advisory services, etc. Disallowance of these expenses on a really large scale began with the Supreme Court's decision on February 3, of this year in the *Higgins* v. *Commissioner case*. Now it is not fair to levy assessments for the disallowance of their investment expenses on taxpayers whose returns for prior years have been kept open by waiver or otherwise. To avoid discrimination in favor of those taxpayers whose returns happened to be closed when the *Higgins case* came down, the amendment authorizing deduction of any expense incurred in producing taxable income should be retroactive. This change will put the Treasury back on the basis on which it operated for many years.

Basis for graduation of excess-profits-tax rates.—It is strongly recommended that the excess-profits-tax rates be graduated on a percentage basis instead of a dollar basis. The present scale of rates and the proposed rates operate arbitrarily with respect to many corporations. The present graduation of the rates of tax according to brackets measured by dollar amounts is entirely out of accord with the principles and the logic of excess-profits taxation. As the law stands, some corporations can increase their earnings four or five times and earn over 100 percent on their capital without hitting the top rates. On the other hand, other corporations might hit the top rates though earning only 10 percent on capital or earning slightly in excess of their average earnings during the base-period year. This is illustrated in the following examples:

Corporation A has an invested capital of $10,000,000 and average base-period earnings of $800,000 so that under either credit method it has an $800,000 credit. In 1942 its earnings amount to $1,350,000—an increase of slightly more than 50 percent over the base-period earnings. Corporation A will pay excess-profits taxes at rates running from 35 to 60 percent on its adjusted excess-profits net income. Corporation B has an invested capital of $100,000 and average base-period earnings of $8,000 so that its credit under either method is $8,000. Corporation B earns $42,000 in 1942—a 200-percent increase over base-period earnings, but pays excess-profits tax at no more than the 35-percent rate. Because of the fact that the excess-profits-tax rates are at present tied to brackets graduating according to fixed money amounts, a corporation which increases its earnings by only 50 percent may be required to pay at the very highest rate while a corporation increasing its earnings threefold can pay at the very lowest excess-profits-tax rate.

The philosophy behind the option to take a credit based on prior earnings record or capital is that a corporation is entitled to a reasonable return on capital and to earnings equal to its earnings for a

representative predefense period before it should be required to pay excess-profits tax. Since the rates are to be graduated it is logical that they should be graduated according to the proportion by which current earnings are in excess of predefense earnings or the allowable rate of return on capital.

Consider that a stockholder in a corporation with a high level of earnings in dollars may now have his return depleted by excess-profits tax at top rate even though his return on his investment is much lower than that of stock in a close corporation which earns more on its capital, more in relation to its predefense earnings and yet keeps within the low-rate bracket.

We therefore urge that the excess-profits tax be placed on an equitable basis by graduating the rate schedule according to a percentage of the excess-profits credit. The rates can be adjusted to produce the amount of revenue sought from the excess-profits tax. All we ask is that the arbitrary dollar basis of a graduating rate be replaced by a fair and reasonable percentage basis. The Treasury in the testimony of Mr. Sullivan recognized that the proper basis for graduating excess-profits-tax rates is the ratio between excess profits and the credit and not the dollar amount of excess profits.

Amortization allowance.—The forum recommends that the revenue act be amended to require the Treasury Department or the National Defense Advisory Commission to issue certificates of nonreimbursement permitting 5-year amortization in all cases where the contract contains no specific treatment of or reference to reimbursement for the amortization of capital costs. There is a serious log jam in the issuance of certificates of nonreimbursement. The Defense Commission is requiring taxpayers who expanded their facilities to carry out defense work to establish that they will not recover any part of the cost of the expansion in the price they charge for the defense items they contracted to produce. This is causing a great deal of anxiety among taxpayers. It is understood that the Defense Commission has gone so far as to break down the corporation's profit on the contract, consider that it is entitled to earn only what it considers a reasonable profit, and so consider the balance as reimbursement of the costs of expansion. Where the Defense Commission is able to find what it considers to be reimbursement, it withholds certificates of nonreimbursement and doubt is thrown on the taxpayer's right to the 5-year amortization privilege which Congress granted last year. It does not seem to have been the intent of Congress to authorize anybody to determine what is a legitimate profit on a Government contract and to treat the amount in excess of what that party considers a reasonable profit as reimbursement for the cost of expansion. This dispute and litigation can be cleared up now by making it mandatory to issue a nonreimbursement certificate unless the Government contract specifically provides for reimbursement of expansion costs. Of course, where the latter is the case, clearly 5-year amortization is not allowable.

It was not the intent of Congress in enacting section 124 of the Second Revenue Act of 1940 that a taxpayer's right to amortize the cost of expansion certified as necessary should be contingent upon the taxpayer's being able to break down the cost elements and the profit anticipated in taking a Government contract to show that he did

not figure on a return of his expansion cost in the contract price. It was the apparent intent of Congress and the almost universal opinion among taxpayers that nonreimbursement certificates would be issued unless reimburstment for expansion costs was specifically agreed upon as such and appeared on the face of the contract. There was no suggestion that ordinary supply contracts might involve a hidden reimbursement that would require protection of the Government's interest.

Taxpayers have relied on the assurance given by the entire history of section 124 that 5-year amortization would be available if expansion was certified as necessary and reimbursement was not specifically contracted for. Those contemplating additional expansion can't be sure as to their tax position. This situation can only be cleared up by amending section 124 to require issuance of nonreimbursement certificates in all cases when necessity certificates have been issued unless the contract on its face provides for specific reimbursement of expansion costs, as in the case of emergency-plant-facilities contracts.

Extension of the "growth corporation" formula.—In March 1941, the excess-profits-tax law was amended to permit a computation of base-period earnings which gave special weight to the last 2 years of the 1936 to 1939 base period. The purpose was to relieve a young corporation which had grown rapidly during the base period. It was felt here that in the case of these rapidly growing corporations the last 2 years of the base period were more representative of their average predefense earnings than were the first 2 years. The law as it stands today does not seem to permit the use of income of predecessors. It does not seem fair or reasonable that a business which carried on through the entire base period should, merely because of that fact, receive better treatment than a business which underwent reorganization, changed corporate form, or was perhaps transformed from an individual proprietorship or partnership form to the corporate form during the base period. Frequently, a corporation which had new capital pumped into it or which changed managership during the base period will have undergone some change in corporate form. This is precisely the type of corporation which the growth corporation formula intended to assist. It is recommended that the law be amended or clarified to afford the benefits of the growth corporation formula to all corporations, including the one which used the data or earnings record of a predecessor corporation or individual proprietorship or partnership in computing its average earnings credit.

Extension of section 3801.—The forum recommends extending the provisions of section 3801 of the Internal Revenue Code to lift the bar of the statute of limitations where the Treasury Department disallows a loss on the ground that it should have been taken in an earlier year. This revision would permit the taxpayer to take his loss in the earlier year even though ordinarily that year would be closed by the statute of limitations. The House Ways and Means Committee, in its report on the 1938 Revenue Act, stated:

> The sole purpose of the statute of limitations is to prevent the litigation of stale claims. Its use to obtain a twofold advantage, whether by double deduction or by double taxation, is not in keeping with its fundamental purpose.

Pursuant to this philosophy, section 820 of the Revenue Act of 1938, now section 3801 of the Internal Revenue Code, was enacted. This

section effectively closed up the possibility of a taxpayer taking a double deduction. It protects the Government from claims by taxpayers that income sought to be taxed in a current year should have been taxed in a year outlawed by the statute of limitations. It protects taxpayers against efforts by the Government to impose tax on an item of income which was reported and taxed in a year barred by the statute of limitations. However, there is one glaring and obvious omission. The Commissioner is still entirely free to disallow a deduction on the theory that it should have been taken in a year outlawed by the statute of limitations. Suppose in 1939 the taxpayer claimed a worthless stock deduction. The Commissioner erroneously disallows it on the ground that the stock is not yet worthless. In 1941, after a refund for 1937 is barred, the taxpayer again claims his worthless-stock deduction and again the Commissioner disallows it. This time the disallowance is on the ground that the stock had become worthless in 1937. Although the taxpayer has suffered a valid loss, the Commissioner, by changing his position, has prevented him from using that loss to reduce tax liability. The Government is protected from double allowance of all losses, but the taxpayer is not protected from double disallowance of a loss which he actually suffered, whether in one year or in another. This inequity can be remedied by adding to subsection (b) of section 3801 a further circumstance for adjustment.

Income from partially completed contracts.—It is recommended that taxpayers performing work on Government contracts or subcontracts be given the option of taking into taxable income of the current year the income arising from goods completed within the year but not delivered until after the close of such year.

This proposal would afford relief in situations where a contractor has completed a large amount of goods on Government contract, income from which cannot be taken into taxable income because of the failure of the Government to inspect and/or accept the goods for various reasons. It would also afford relief where completion of the entire contract is delayed because of inability to obtain parts or certain essential materials. The taxpayer's object in exercising such an option, of course, would be to avoid being taxed on such profits in the following year, when tax rates might be higher and/or other deductible expenses lower. Such a relief provision would operate generally to advance the date of collection of taxes.

Accounting principles.—The experience of a good many of the tax men in the Federal Tax Forum indicates that many troublesome situations met in their practice had an obvious solution from an accounting viewpoint, although not covered by any specific provision of the tax statutes. The forum therefore recommends that the bill contain a provision substantially as follows:

> Generally recognized principles of accounting are to be followed in determining what is gross and net income and the year of its realization, and what constitutes paid-in capital and earned surplus except to the extent, if any, that such determination be clearly contrary to specific provisions of the code.

Note that this provision would not operate to permit dispute and litigation over what is the recognized accounting principle or the best recognized accounting principle. If the taxpayer follows any recognized accounting principle or practice, the Bureau would be required to compute income and capital on that basis in the absence of any conflicting statutory provision.

Extension of limitation period.—The forum recommends that the law or regulations be amended so that the statutory waiver form used by the Commissioner to keep open the statute of limitations on assessment automatically operate also to keep open the right to file refund claim for the same year. Frequently, the Bureau has insisted upon obtaining a waiver to keep open a number of tax years. Although the taxpayer cooperates by giving such a waiver, this waiver does not operate to keep open the period within which he can file refund claims for the same year or years. Frequently, further audits and examinations, discussions, and negotiation on a return for an outlawed year will reveal that the taxpayer failed to take a deduction to which he was entitled or that he reported an item of income which he did not have to report. If the statute of limitations has run on the filing of a claim for refund, he is helpless. On the other hand, the waiver, if it is signed by the taxpayer, permits the Commissioner to knock out exemptions erroneously claimed, or add an income item which the taxpayer failed to report, even though the statute of limitations has run. In the interest of tax justice, this should work both ways. This is another point at which placing the Commissioner of Internal Revenue and taxpayers on an even and equal footing would result in more cheerful or, at least, less resentful payment of taxes, keeping of records, filing of returns and other cooperation with the tax-collecting authorities. Here it is quite clear that is difficult for a taxpayer and a Bureau representative to sit down and work in a fair, cooperative, and truthful manner to determine the taxpayer's exact tax liability when the atmosphere is clouded by the knowledge that if the Bureau representative finds some way to add to the taxpayer's liability he is free to do so, but if the taxpayer finds some point on which he paid more tax than he should have, he gets no refund.

The forum recommends a basic provision in the statute that any agreement extending the period within which the Commissioner may make an assessment will automatically grant the taxpayer a similar extension of time within which he may file a claim for refund. It has been held (*Tucker* v. *Alexander*, 275 U. S. 228) that the Commissioner does not have the power to extend the period for filing refund claims. Therefore, there is a clear necessity for legislative relief to produce equal operation of the statute of limitations.

Bad debts.—The forum recommends that section 23 (k), permitting deducation of bad debts, be amended so that no charge-off is deemed necessary. A similar amendment eliminating the need for ascertainment within the taxable year should be enacted. Both of these recommendations could perhaps be best accomplished by creating a statutory presumption in favor of the year in which a bad debt is taken off or deducted on the tax return. The thought behind these recommendations is that a bad debt should be deductible when it actually becomes worthless. The technical requirement that the taxpayer go through the mechanical process of ascertaining that the debt is worthless within the year in which it becomes worthless, and charging it off within that year, appears to be superfluous to the main objective of permitting a taxpayer to use bad debts to offset taxable income. The requirement for charge-off and ascertainment is a pure matter of form. It has no effect upon the substance of when a debt

actually is worthless, and thus when it can be deducted. Large mercantile and manufacturing organizations can avoid these technical requirements by using the reserve method of deducting bad debts.

A statutory change, such as the one proposed, would help the small taxpayer who does not use extensive accounting set-ups or, in many cases, even keep books. Here the requirement that he must ascertain that a debt is worthless within the year in which he wants to deduct it and charge it off in that year is particularly harsh. Too often the Bureau of Internal Revenue had disallowed the bad debt deduction purely on the ground that it was not charged off or not ascertained to be worthless within the taxable year, even though the taxpayer is able to prove that the debt actually became worthless in the year for which the deduction is claimed. Taxpayers are in the best position to know when they have exhausted efforts to collect a debt and when the debt becomes uncollectible. The Commissioner should be required to overcome a presumption that the taxpayer has claimed the debt in the proper year. It might be noted that the courts and the Board of Tax Appeals are trending to correct inequities worked by failure to observe these technical requirements. Thus it has been held that a taxpayer who keeps no books makes an effective charge-off when he takes a bad debt on his return. However, this judicial assistance has not extended to the point of overlooking the technical requirement that the taxpayer ascertain the debt to be worthless within the taxable year. Judicial assisance on a question of this kind is slow and uncertain. It does not operate with complete uniformity. The taxpayer should not be required to carry his case to the Board of Tax Appeals in the attempt to avoid inequities of this type. Too frequently the amount involved does not justify appeal. The clear, certain, and reasonable remedy for inequities caused by this vestigal technicality in the tax law lies in the statutory amendment.

Impose excise taxes as near point of manufacture as possible.—The forum recommends that Federal excise taxes or sales taxes, if they are enacted, be imposed on manufacturers instead of on retailers. The forum opposed a general Federal sales tax. The grounds for opposing a general sales tax and for recommending that existing and new excise taxes be imposed at the point of manufacture bear some resemblance. The basis for both is the administrative convenience of collecting the tax more readily from manufacturers than from a much greater number of retailers. A general Federal sales tax would require a new army of auditors, examiners, and all the other incidentals involved in collecting a sales tax. If excise taxes are collected from manufacturers, the Government will be required to deal with a much smaller number of firms, and the job can be handled by a much smaller number of persons on the Federal pay roll. By adjusting the rates to manufacturers' selling price rather than the retail selling price, the required amount of revenue and substantially the same economic and business effects can be produced.

Merger of gift and estate taxes.—The forum recommends that the gift and estate taxes be combined to provide only one exemption and, in effect, one tax on gifts in trust and the general estate payable at different times. Lifetime gifts would first absorb the single exemption. Then the value of lifetime gifts in trust over and above the exemption

would be taxed at gift-tax rates, which would be as they are at present, about three-fourths of the estate tax.

Thus, the discount for paying the tax on a lifetime gift would be retained. But when the donor dies, estate taxes would begin operating against the property held at the time of his death at the level of the value of all gifts in trust over and above the exemption. Thus, if there were a $40,000 exemption, and a donor gave to trusts during his life property valued at $240,000, he would pay gift tax on $200,000 at about three-fourths the estate-tax rate. If at his death he held property worth $500,000, this property would not be taxed at the estate-tax rates from zero to $500,000, but would be taxed at the estate-tax rates in effect between $200,000 and $700,000.

No retroactive excise taxes.—Final recommendation calls for elimination of the retroactive provision of section 2405 which would impose the new and increased excise-tax rates on conditional or installment sales made since July 1, 1941. While sympathizing with the desire to begin the collection of new excise-tax revenue at the earliest possible date, we do not feel that it is fair to discriminate against sales made on an installment basis. As the bill stands today, there will be no excise tax on cash- or charge-account sales made before the effective date of this 1941 Revenue Act. This discriminates against the small income taxpayer who does most of his buying on articles subject to excise taxes on an installment basis. This favors the taxpayer who can afford to pay cash or who enjoys the luxury of a charge account.

We particularly protest against the retroactive application of this provision, which penalizes the buyer or seller of jewelry, furs, musical instruments, and other articles affected by these new excise tax rates. There was no warning that penalty of this kind was contemplated at the time the sale was made. Many business lines face the requirement to pay excise tax and adjust their selling prices accordingly for the first time this year. Certainly for the period between July 1 and the date the House Ways and Means Committee bill was made public, most businesses sold without collecting excise tax or adjusting their selling price to cover a new or increased excise tax rate. If the bill goes through as it stands today, they will be faced with the necessity of absorbing as much as 10-percent excise tax or jeopardizing customer relations by attempting to collect from buyers a tax which was not contemplated by either party at the time the sale was made.

We, therefore, recommend that the new and increased excise tax rates be made applicable only to sales made after this tax bill becomes law.

In conclusion, I want to say that some of the recommendations we have made here may cause a little loss in revenue to the Government. We thought and talked about this, however, and concluded that there was a good possibility that the decreased cost of collection and better taxpayer cooperation, resulting from taking out some of these more irritating taxing provisions, might more than compensate for the loss in revenue, particularly in connection with such items as bad debts. In any event, we feel that if that doesn't prove to be the experience, you gentlemen can raise the rates to recover the required revenue with the full assurance that you will then be doing it on a more equitable tax structure.

The CHAIRMAN. Mr. Guiney. For whom are you appearing?

Mr. GUINEY. The National Tavern Association.
The CHAIRMAN. New York City?
Mr. GUINEY. Yes; 8 East Forty-first Street, New York City.
The CHAIRMAN. All right; you may proceed.

STATEMENT OF TIMOTHY P. GUINEY, NEW YORK, N. Y., REPRESENTING NATIONAL TAVERN ASSOCIATION

Mr. GUINEY. Gentlemen, as the president of the National Tavern Association, I am presenting the views of my fellow tavern men on the tax measure now before this committee, insofar as it concerns a proposed tax on alcoholic beverages, which my members, the owners of the Nation's bars and grills, taverns and restaurants, sell. Officially we are designated as on-premise licensees and there are more than 250,000 of us throughout the country. We sell liquor "by the drink" for on-premise consumption in our establishments, and in this manner account for better than 70 percent of the alcoholic beverage sales volume in this country. Which means that out of the 50,000,000 cases of so-called hard liquor sold nationally, more than 35,000,000 cases are sold by these on-premise licensees, by the drink.

The facts and figures you will hear today from other factors in this industry will convince you that there is a grave danger lurking in any added tax at this time. An increased tax opens the way to illicit liquor sales, refilling of bottles, the use of lower-proof whiskies and the general increase of unlicensed sales of alcoholic beverages, all of which must result in a greatly curtailed consumption of tax-paid liquor. I could talk about the law of diminishing returns, or stress again that the point of tax-satiety has been reached on this commodity. But I believe that, if you will permit me, a practical tavernman, to show you exactly what happens to the tax dollar in this industry, and what the result, practically, of an added tax would be in actual revenue to the Government, you may agree with me, that the proposed $1 per gallon tax, will not only result in a falling off of consumption, but will cause a definite loss in tax revenue from this industry of over $27,000,000 in the coming year.

First, for the purposes of computation, permit me to discuss this tax on the basis of a case of whisky—12 quart bottles at 100 proof, 3 gallons to the case. Now, let me take you step by step with this tax from the distiller to the consumer. The placing of a $1 per gallon tax on distilled spirits, would mean that the Government should get for each case sold $3. The distiller then adds to his price this $3 plus a mark-up for handling, overhead, and interest of about 50 cents, making the additional price to his distributor $3.50. The distributor in turn adds to this price his mark-up of about 13 percent, bringing the price to the tavernman to about $4 per case. The tavernman should now add to his cost his usual mark-up and pass it on to the consumer, the public—but he cannot do so. For he now breaks up the case into individual drinks—and thanks to the last two tax increases his price per drink is as high as he can make it, and still obtain customers to buy it. The next price increase would have to add 5 cents to the price, and he cannot get that price from his customer, or can only get it at the cost of a great loss in trade. As proof positive that he cannot get an additional nickel is the fact that in

States where a State tax in 1940 has boosted this price, the sales have decreased as in the State of Virginia, where a State tax resulted in an exceptionally noticeable decline in tax-paid revenue, and a relatively high increase in captured stills, and other illicit outlets. In the State of Louisiana, too, a State tax increasing the cost per drink, resulted in a definite and marked decline in State tax revenues, directly attributable to this tax.

This leaves but one alternative to the tavernman. He must absorb the tax himself or find other means of passing it on to his customer—other means than a price increase, if he is to maintain his sales volume, and correspondingly the tax-revenue possible through such sale.

Where you cannot get more for a commodity, and the cost to the seller is increased, there is but one thing to do—stretch that commodity, so that you give less for the same price, and thus maintain your same percentage of profit. In the case of meats for example, the price of the dinner might not be increased because the cost of steak has been increased, but the size of the steak served is noticeably reduced, although the price of the dinner is the same. By the same token, the tavernman must stretch the whisky in the bottle he buys, so that he can continue to derive the same volume of profit at the same price. In other words where he formerly sold 20 drinks out of each quart of liquor, he now must get 30 drinks to overcome the added taxes and costs with which he is burdened. If the $1 per gallon ($3 per case) tax is made a fact, it will be inevitable and the duty of this association to advise its members to cut their drinks, by serving them in 1-ounce glasses instead of in the 1½-ounce glasses in which they are now sold. Only in this way can the tax be passed on to the public as it was originally intended to be. Only in this way can the tavernman avoid again absorbing a tax, which he cannot afford to pay.

What does such cutting down of the size of the glass mean to the Government in revenue. As pointed out, of the 50,000,000 cases sold annually, over 35,000,000 were sold, by the drink, through the taverns. On these 35,000,000 cases of liquor, the taxernman paid a tax amounting to some $315,000,000. Should he reduce the drink sold to 1 ounce from 1½ ounces he would need exactly one-third less liquor to serve the same number of drinks as he sold the previous year. In other words he would only have to purchase some 24,000,000 cases, instead of 35,000,000 cases of tax-paid liquor to do the same volume of business. The number of drinks he sells would be the same, but the volume of liquor sold in each drink would be reduced exactly one-third. So that even if there was a tax increase of $3 per case as is proposed—it would only be paid on 24,000,000 cases. Figured at the new tax total, including the new tax proposed, the tax would be $12 per case, which would only bring in $288,000,000 of tax revenue. In other words, at the present $9-per-case tax the revenue would continue to reach at least $315,000,000 annually. At the proposed $12 rate, the total revenue would only be $288,000,000, or a loss of revenue of $27,000,000 without taking into consideration the very evident loss through the sale of illicit liquor, bootlegging, and other subterfuges made possible by the inviting margin between legal and illegal liquor, not to mention the loss of revenue to the States who now average $3-per-case-tax revenue

from the present taxes in force. This association is not anxious to suggest any changes to the tavernman which in these times would adversely affect the national tax revenue. No one knows better than America's No. 1 taxpayer how vital such funds are to national defense. We therefore have a suggestion to make which has been endorsed and approved by our members throughout the country. Despite the burden of the present taxes, we feel that if we must we can stand a tax rise of not more than $0.25 per gallon—$0.75 per case. By the time this tax reaches the tavernman it will be $1 per case—getting out of each case 240 drinks (using the 1½-ounce glass as at present); it would mean that each drink would cost us a little less than one-half cent additional to serve—we are willing to absorb this cost ourselves, just as we have absorbed most of the past tax rises, in the interest of national defense and the great need for funds, despite the present heavy tax load we are now called upon to pay. As a practical matter, you can see that where the tax increase involves a cost to the tavernman of only one-half cent per drink, it would not pay him to change over to the other size of glassware, at the risk of offending the customer, the public. Only dire economic necessity would make such a move mandatory. We feel that this is the only way to keep up this industry's present tax-paying capacity—and while this tax would not add the $100,000,000 the $1 new tax proposal contemplated—it will definitely assure the Government of the same tax as last year, plus an added $30,000,000 from the $0.75 per case suggested here, plus the normal increase added national earning power should bring. Against which you have the almost certain loss of $27,000,000 which must result if the $3-per-case tax proposal now recommended should pass. A net difference in national tax revenue of $57,000,000 less than you can have under the plan we have submitted here.

This association sincerely hopes that this committee will take into consideration the figures and facts stated here, and act upon the suggestion of this association. And, lest the cry of "unpatriotic" be raised by anyone against this industry, let me point out that over 75 percent of the licensed tavern owners in this country are ex-service men like myself who proved their patriotism in the last war. In fact, we feel that we would be definitely unpatriotic were we to fail to point out and protest a proposed tax which cannot possibly raise the revenue intended, because it is economically impractical. Two hundred and fifty thousand tavernmen are anxious to cooperate—with a just tax they can do so.

The CHAIRMAN. Thank you very much, sir.

Mr. GUINEY. Mr. Chairman, I am submitting to the committee a brief requesting an exemption on floor stock on hand to the extent of 100 gallons as previously granted in past tax measures, and would appreciate permission to file a final brief on the matter with the committee in the next few days.

The CHAIRMAN. You may do it up to Monday.

Mr. GUINEY. Thank you, Mr. Chairman; I do appreciate the privilege granted me here today, in expressing the views of the tavernmen of this country.

The CHAIRMAN. It will be included.

(The memorandum referred to follows:)

NATIONAL TAVERN ASSOCIATION FINAL BRIEF

REQUEST FOR EXEMPTION FOR FLOOR STOCKS ON HAND IN PROPOSED 1941 REVENUE BILL FOR ALCOHOLIC BEVERAGES IN TAVERNS

COMMITTEE ON FINANCE, UNITED STATES SENATE.

GENTLEMEN: The brief attached hereto clearly shows that the tavern men whom this association represents, under the present economic conditions in the industry, have little hope of passing on to the public any part of the tax now proposed on alcoholic beverages. The tavern men of this country suggested to the Congress, on behalf of this industry that the tax be limited to 25 cents per gallon of distilled spirits, and have offered to absorb this tax so that the tax revenue resulting would not be diminished and could in fact be increased. But that is not the purpose of this brief.

We are requesting that the committee incorporate in the proposed tax bill an exemption such as was included in the last tax bill passed on July 1, 1940, for stocks on hand in retail outlets to the extent of 100 gallons.

As in 1940, we base this figure of 100 gallons on the normal stocks on hand in the average business establishment throughout the country. We do not believe that any stock in excess of this figure should be tax exempt if a new tax is to be levied. But we do believe that the tavern man, the small businessman of this industry, is entitled to every consideration unsofar as it is economically possible for the taxing agencies to extend such consideration. Stocks in excess of this figure should be taxed. All we want is a 30-day supply exempt from tax—35 cases, 100 gallons of alcoholic beverages is sufficient for normal business. The average tavernman would, if given a floor-tax exemption on this quantity of merchandise, be given an opportunity to adjust himself to the next tax and would feel that the Government is cooperating with him, rather than burdening him with taxes without any consideration for his normal business activities, and would reciprocate by lending his every effort to continue to be America's No. 1 tax collector and taxpayer. Sufficient precedent exists for the inclusion of such floor-stock exemption clause, not only in the tax bill of July 1, 1940, was exemption granted, but in the present tax bill of 1938 a 250-gallon exemption was granted. Such excessive exemption is not needed or expected by the taverns. But we do feel that an exemption of 100 gallons, especially inasmuch as the tavern-we do feel that an exemption of 100 gallons, especially inasmuch as the tavernman must absorb this tax himself, would be of the utmost economic, moral, and financial aid to the small tavernowner who has never protected any levy that was for the general welfare of the country. A small businessman who needs the little lift, the saving of this seemingly small amount of money which nevertheless means much to him. This exemption would have a tonic effect on the man upon whom the burden of collecting America's heaviest industrial tax ulptimately falls. We respectfully request your inclusion of the exemption clause in any tax which may be levied, either at the level suggested by this association of $0.25 per gallon or at the tax rate finally determined by the Congress.

The CHAIRMAN. Mr. John P. Crane.

STATEMENT OF JOHN P. CRANE, PHILADELPHIA, PA., REPRESENTING THE PHILADELPHIA RETAIL LIQUOR DEALERS ASSOCIATION

Mr. CRANE. Mr. Chairman and members of the committee, I do represent 14,000 retail liquor licensees in Pennsylvania, employing some 50,000 people. I appreciate this privilege of appearing before your committee today and wish only to point out that we think this is a dangerous tax. It is a tax that would deprive the working man whom we cater to mostly of the drink he has been used to getting, or increase the price of that drink to just double the amount he has paid for it in the past. I therefore appeal to you not to remove that drink from the market so that this workingman will be deprived of the pleasure given to people in the higher wage brackets. I

sincerely hope you will give this consideration. This provision will increase the number of bootlegging outlets in this country; they are in every township, city, and borough. We are infested with bootleggers and the authorities, Federal and State, agree that it is a condition they cannot meet. They do not have a number of men sufficient to stamp this thing out. I believe to make the price of any drink prohibitive to the one who enjoys it will only add to the enforcement problem which we are confronted with today. We are interested in the enforcement and control of the liquor laws and try to cooperate always with the agencies charged with that enforcement; therefore, I hope an exemption will be allowed, as it has been in the past.

I want to thank you very much for the privilege of permitting me to address you on this subject.

The CHAIRMAN. I believe that exhausts the witnesses for today, so we will recess until 10 o'clock tomorrow morning.

(The following letters and statements were ordered incorporated in the record:)

STATEMENT SUBMITTED BY THE NATIONAL ASSOCIATION OF CREDIT MEN, NEW YORK CITY

The National Association of Credit Men, an organization representing the credit interests of approximately 20,000 American manufacturers, wholesalers, and financial institutions, respectfully submits the following statement on taxation. In submitting our statement we are doing so with two points in mind:

1. A full recognition of the fact that in the present emergency now confronting our Nation all must make sacrifices. Our organization approves the efforts being made to meet as much as possible of the expense of the defense program out of current income. As a vital essential to full defense effort, we strongly urge that every nondefense item possible be eliminated from Government operation.

2. The maintenance of the business activity necessary to the securing of maximum revenue by the Government is greatly dependent upon the credit operations of business. On the other hand, credit is greatly affected by the fiscal policy of the Government.

Our statement is made in the hope that such an expression of views may be of assistance to Congress in coping with its gigantic task of financing during such an emergency period.

With these thoughts in mind we submit the following suggestions for consideration:

I. We believe in the principle of a widened income-tax base, both from a fiscal viewpoint and because of the creation of citizenship interest in all governmental problems. We favor placing the greater emphasis upon the extension of direct taxes rather than indirect taxes.

II. We recognize the necessity of increased taxes for all groups and classes. In such increase of taxes, however, there is always the danger that the added burden may fall disproportionately upon those in one particular income group. That group is usually the so-called middle class. Most of those within this group are professional men, men of moderate salary and small businessmen. Aside from the fact that it is obviously unfair to discriminate against one group in any way which might tend to conflict with the ability-to-pay principle of taxation, it is likely that much of the market for the sale of defense bonds will be found among those in this middle income group. A disproportionate increase in taxes for this group would, therefore, serve as a hindrance rather than a help to the Government in its financial aims.

III. Consideration might well be given to establishing a principle for taxation for individuals similar to that now in existence for corporations. In corporation taxes the principle of making the greater increases on profits beyond the normal corporate profit has been accepted. In formulating a tax program for individuals this same general principle might well be used so that the heavier increases will fall upon abnormal earnings rather than upon normal earnings.

IV. In the coming years the tax factor will become of increasing importance in the cash position both of individuals and of companies. This fact will have a marked bearing both upon any analysis of credit and upon business in general. We heartily commend the plan for the issuance of tax anticipation warrants. In addition to this, we believe that provisions should be adopted, permitting the payment of taxes on a monthly installment basis. Such provisions will, if adopted, facilitate tax collections and serve as a benefit both to individual taxpayers and to business organizations.

AUGUST 6, 1941.

NATIONAL ASSOCIATION OF CREDIT MEN,
New York, N. Y., August 25, 1491.

RECOMMENDATIONS OF A GROUP OF TEXTILE CREDIT EXECUTIVES WITH RESPECT TO INVENTORY MATTERS IN THE PROPOSED NEW TAXATION LAW

It is the suggestion of this group that the new revenue bill embody a provision permitting businesses when computing their income for 1941 and subsequent years to deduct a reserve for future inventory depreciation. As will hereafter be shown, this provision will not benefit concerns enjoying actual excess profits but will only tend to the preservation of business houses that in reality will never enjoy such excess income.

Assume that for the year 1941 a concern has had an extraordinary volume of sales the proceeds of which it has used in part, as it is desirable, in acquiring merchandise to be sold. But because of the present extraordinary conditions this merchandise has been purchased at greatly advanced prices at which it cannot be profitably sold when the inevitable recession comes. The result will be, if the law does not make a suitable provision to meet this situation, that such businesses must destroy their cash position by paying out cash for taxes on net income they will never realize. And of course these businesses will collapse to the detriment not only of the investors therein but more particularly to that of the employees who will be thrown out of employment.

To accomplish what is herein advocated, the suggestion is made that taxpayers be permitted to deduct annually in determining their taxable income for 1941, and subsequent years, an amount found by subtracting from the value of their inventories, determined on the basis of 1941 and subsequent year prices, the value of their inventories for 1941 and subsequent years, determined on the basis of September 1939 market prices. Such an amount should be set up as a reserve on their books and maintained until the need therefor arrives. Such a need will arise when prices equal or fall below September 1939 prices. At that time inventories will be taken at the prices prevailing, and the total of the amounts previously deducted and carried in the reserve will be credited to cost of sales as a reduction of the opening inventory, and taxable income for the year determined on the basis of this adjustment.

In the case of those who have truly enjoyed excess profits this will not happen. These persons will not have reinvested in inventories; their unusual profits will be represented in cash or its equivalent, and they will accordingly receive no benefits from this provision. They have truly realized their excess profits and will be taxed thereon. On the other hand, the average business which has invested its profits into goods, which business should not be destroyed in order to reach those persons who should be taxed on their extraordinary gains, will alone be benefited by the present proposal.

The present income-tax law (sec. 22 (d) of the Internal Revenue Code) recognizes to some extent the necessity for maintaining inventory stability in determining taxable income by permitting the use of the so-called last-in and first-out method of valuation. But this method is inadequate under present conditions because when it is adopted it is only permissible to go back to prices at the beginning of the year of change instead of to the sound prices prevailing in September 1939. This, of course, does not permit adequate provision for further inventory depreciation.

In addition, section 22 (d) is faulty because the special method therein provided requires the actual valuing of inventories at the special prices allowed rather than permitting the deduction of reserves to cover the situation. Such valuing

of inventories at other than market conditions is in various businesses unsuitable for merchandising purposes and cannot be adopted. Moreover, when the last-in-first-out basis is employed, the prices at the beginning of the year of adoption to the extent of quantities then on hand is perpetuated regardless of future market conditions. Should the last-in-first-out method be adopted for 1941, for example, thereafter the prices at the beginning of the year—and they are not the representative prices of ordinary times—must be maintained to the extent of the quantity of merchandise for which the method is employed at the beginning of the year, regardless of the fact that market may subsequently fall far below such prices. Many business houses do not dare to adopt the last-in and first-out method because of these conditions. Also certain types of businesses—for example, the retail business using the retail selling system—cannot employ it, as it does not fit in with their methods of operation.

The textile group submits that if the method herein advocated is adopted, a most constructive step will be taken to stabilize business and benefit credit conditions. Should a provision allowing what is herein suggested be incorporated in the new bill, to a great extent the cloud of uncertainty that now overhangs business will be removed. Then, when merchandise is sold on the basis of balance sheets showing a large inventory as an asset, the businessman will know that the possible depreciation of that asset is covered by proper reserve reflected in that balance sheet in arriving at the net worth shown thereby, which net worth is the basis of credit extended. And so far as the business is concerned which has that inventory as an asset, the investors therein and its employees are protected because its cash is not being improperly depleted; and it is in a position to meet the depression that will come, and carry on.

HENRY H. HEIMAN,
Executive Manager.

STATEMENT OF A. LOWENHAUPT, ST. LOUIS, MO.

Presently, the law contains two alternative bases for the determination of normal corporate income which is exempt from the excess-profits tax. That is, the tax is applied to the excess income over the normal income.

The two bases are (1) a percentage of invested capital deemed a fair return, or (2) the corporate income during the base period. A corporation may choose which of the two bases it will use. A proposal has been made that the use of the base period income as a measure of normal corporate income shall be eliminated, and I desire to point out to you that this will result in many cases in a capricious and unjust tax for the following reason. The other basis, so-called invested capital a percentage of which is exempt is in the case of many corporations not true or real invested capital at all. It is merely a name for a formulary result and not anything real or true.

Under the invested capital method, property transferred to a corporation for its stock is entered into the calculation at what is called the unadjusted basis. These words refer to the basis for determining gain or loss defined in section 113 of the Revenue Act. In most cases where a corporation received property from a predecessor corporation in what is classified as a reorganization under section 112, the basis for the allowance of invested capital is not the cost of the property to the existing corporation but the cost of its predecessor or the prior owner.

When the property was acquired in this manner by the existing corporation it was done with notice that it—the existing corporation—in the event it sold the property, must account for gain or loss calculated on its predecessor's cost, but that was the limit of the liability which it accepted at that time. Now, under the present statute, it is subjected to a new liability, that is, it is not allowed to earn a fair return of income on what it paid for the property.

For instance, if A and B form a corporation, and A invests $100,000 and receives half the stock, and B transfers a patent to the corporation for half the stock, B being the inventor and having paid substantially nothing for the patent, the present statute says that the patent cost the corporation nothing, and its invested capital is determined without any allowance of any value for the patent. Plainly, the patent was valued when received at $100,000.

The same thing is true as to reorganizations which occurred after January 1, 1936, in which gain or loss was not recognized to the transferors, but it is not true as to identically the same kind of reorganizations occurring prior to January 1, 1936, unless 50 percent control remains in the transferors.

The use of the statutory formula, unadjusted basis, is purely capricious. In many cases it results in excessive invested capital, sometimes grossly excessive, and in other cases it results in a grossly insufficient allowance. In hardly any case does the unadjusted basis reflect actual invested capital; that is, the amount embarked by the adventurers in the business.

An illustration of the excessive invested capital allowance is the case of a bondholders' foreclosure. For instance, under the generally accepted rule, suppose in years past stockholders invested $1,000,000 in the stock of a corporation which acquired land and built a building thereon, and the corporation borrowed $500,000, secured by a mortgage on the land and building. Assume further that the corporation paid off $150,000 of the bonds secured by the mortgage before 1932, at which time it defaulted and the bondholders foreclosed, bought in the property at foreclosure sale, using their bonds to pay the purchase price, and then organized another company to which they transferred the property and which issued its stock to the former bondholders. The Commissioner of Internal Revenue has contended both ways as to the result of this transaction. The Board of Tax Appeals and the courts of appeals, with one or two exceptions, have ruled that this was a reorganization and that the unadjusted basis for the property owned by the corporation formed by the bondholders was the cost to the mortgagor corporation, that is, in the case illustrated, approximately $1,500,000, or about $1,150,000 more than the bondholders who now own the property of the corporation formed by them embarked on the business. The capricious results from the formulary definition of invested capital in the present statute necessitate, if justice and equality are the ideal of the statute, that the base-period income as the alternative measure of normal income exempt from tax be retained in the statute.

CALIFORNIA STATE CHAMBER OF COMMERCE,
San Francisco, Calif., August 18, 1941.

Senator WALTER F. GEORGE,
Chairman, Finance Committee of the Senate,
Washington, D. C.

MY DEAR SENATOR GEORGE: Attached hereto is a statement briefly outlining my views and recommendations with respect to the proposed Federal Revenue Act of 1941, which is now under consideration by the Senate Finance Committee.

I believe this represents a fair cross section of business opinion in the State of California, and I hope it will receive your considered attention.

Yours very respectfully,

SIDNEY M. EHRMAN,
Chairman, State-wide Tax Committee.

STATEMENT BY SIDNEY M. EHRMAN, CHAIRMAN, STATE-WIDE TAX COMMITTEE, CALIFORNIA STATE CHAMBER OF COMMERCE

Although the responsibility for determining the Nation's fiscal policies rests with Congress, the question of Federal revenues and expenditures is of such broad public interest as to invite expressions from taxpayers and citizens generally. Accordingly I am taking this means of directing the attention of your committee to certain observations and conclusions on the proposed Federal Revenue Act of 1941, which I believe are representative of business opinion in the State of California.

RETRENCHMENT IN NONDEFENSE SPENDING

While the Federal Budget for the fiscal year 1941–42 has already been approved and the appropriations provided therefor are now operative, we feel that this body should insist upon drastic economy in current spending by the nonmilitary departments and agencies of the Federal Government. Moreover, future appropriations for these agencies should likewise be restricted to the utmost. By diverting revenues from civil to military purposes, the same objective can be achieved as that sought through new taxes.

The Federal Government has called upon all citizens to bear an unprecedented tax burden as their patriotic duty toward the national defense effort, and I am of the opinion that Congress and the administration should set the equally patriotic example of drastically reducing the expenditures of all agencies not absolutely essential to defense and of eliminating functions now made obsolete with the passing of the depression emergency.

An examination of the nonmilitary expenditures of the Federal Government over recent years indicates an increase of more than twofold. Yet the internal emergency brought about by the great economic depression, which called for an expansion of civil expenditures, is past. Now the Nation is faced with an external emergency that calls for a tremendous expansion of defense expenditures. While the citizenry is being required to bear billions in additional taxation, the nonmilitary functions of Government should likewise tighten their belts in the interests of national solvency.

NEW FEDERAL TAXES

Few, if any, citizens question the need for additional taxation to finance national defense. There are doubtless differences of opinion as to amounts and methods, but I believe that it is commonly agreed that these new imposts should be made on the basis of equality and with due regard for the possible effect, both present and future, on the Nation's economic structure. It would appear wise, therefore, to make the new tax program as equitable as is humanly possible.

Perhaps the first factor of equality is to give proper consideration to keeping the tax base as broad as possible. While the tax burden should be graduated according to ability to pay, every citizen should be expected to make his pro rata sacrifice in the interests of financing the cost of preserving the Nation's safety. Therefore I commend to your committee the desirability of maintaining a broad tax base in the interest of unifying the defense effort.

At this point I wish to stress the importance of applying the excess-profits tax to true excess profits and not to income that is not out of line with normal earnings. In fairness, the normal income tax should apply to normal earnings and the excess-profits tax should apply to earnings in excess of normal.

In administering the excess-profits tax it is desirable to lend enough flexibility to avoid hardships on businesses that find their operations governed by exceptions to the rule. I commend, therefore, the retention in the law of the alternate methods of computing excess profits—that is, the invested-capital method and the average-earnings method. While the latter is being attacked by those who would substitute a rigid rule for a flexible one, it surely is not the desire or intention of Congress to penalize certain businesses in an attempt to squeeze the last drop of blood out of the tax base.

Your attention is directed to the desirability of computing excess profits in terms of percentages of such excess over normal, rather than in dollar amounts. The dollar-amount method does not result in uniform application of the theory of excess-profits taxation. It would be more equitable to apply a scale of rates graduated according to the degree that profits exceed normal earnings, rather than to graduate the rates according to the dollar amounts of such excess earnings.

It is further suggested that there be a greater degree of uniformity in allowing deductions for operating expenses in computing net taxable income of taxpayers. If the objective is to tax net income whether it be normal or in excess of normal, all necessary business expenses incurred in making such profits should be deductible. Under the present law the tendency is to restrict more and more the deductions that are allowable as business expenses, with the result that hardships are placed on certain businesses and the income tax deviates from its true purpose.

While the capital-stock tax is not considered in this bill, I desire to state that it would be in the interests of fairness to allow corporations to make annual declaration of value. At the present time, these declarations can be made only once in 3 years and this does not take into proper account the rapidly changing conditions under which businesses are now compelled to operate.

As the bill now stands, the provision to require husbands and wives to file joint income-tax returns is absent. I strongly recommend that your committee reject any proposal to reinsert this provision into the bill. It is not a question of revenue alone, but it strikes at the individual status of married women to the exclusion of other individuals and is an infringement upon private-property rights now governed by the States.

MACK MANUFACTURING CORPORATION,
Long Island City, N. Y., August 14, 1941.

HON. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate,
Washington, D. C.

DEAR SENATOR: We urge an amendment to section 1202 of the Internal Revenue Code by adding a new paragraph at the end thereof to permit any year not otherwise a declaration year for capital stock tax purposes, to be a declaration year if with respect to such additional declaration year the value declared by the taxpayer is in excess of the adjusted declared value computed under paragraph (1) of subsection (b).

We suggest for your consideration the following proposed amendment to be added as a new paragraph at the end of section 1202 of the Internal Revenue Code:

"*Additional declaration years.*—In the case of any domestic corporation, any year not otherwise a declaration year, shall constitute an additional declaration year if with respect to such year (1) the taxpayer so elects (which election cannot be changed) in its return filed before the expiration of the statutory filing period or any authorized extension thereof, and (2) the value declared by the taxpayer is in excess of the adjusted declared value computed under paragraph (1) of subsection (b)."

Taxpayers are under the necessity this year to redeclare a new capital stock value which will be based upon estimates of net income for the years 1941, 1942, and 1943. It is practically impossible to make an intelligent guess as to what the net income of a corporation will be even for the year 1941, while an estimate for 1942 and 1943 can be nothing more than a vague conjecture. It seems that (1) the reasons which were sufficiently impelling to justify enactment of the amendment, which became effective in the Revenue Act of 1939, and permitted an upward redeclaration of value for each year 1939 and 1940, are even more persuasive under the current emergency conditions of priorities, price control, defense requirements, etc. and (2) corporate taxpayers should not be penalized by the fact that it is humanly impossible, under present conditions, to intelligently forecast their financial situation for the future.

In addition, since we now have an excess-profits tax, there appears to be no purpose served by the declared value excess-profits tax except to make it mandatory upon the taxpayer to declare a high enough capital stock value to enable it to void the declared value excess-profits tax.

Respectfully submitted.

MACK MANUFACTURING CORPORATION,
J. E. SAVACOOL,
Vice President and Comptroller.

MACK MANUFACTURING CORPORATION,
Long Island City, N. Y., August 14, 1941.

HON. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate, Washington, D. C.

DEAR SENATOR: We urge your committee to substitute for section 549 of H. R. 5417 the policy adopted in section 210 of the Revenue Act of 1940, with regard to the application of the increased taxes imposed by this bill with respect to leases, installment and conditional sales, in which delivery occurs prior to the effective date of the increased taxes.

Section 210 of the Revenue Act of 1940 specifically provided that the increased rates should only apply to payments made under leases, installment, and conditional sales, in which the delivery occurred after the effective date on which the increased rates became effective. Section 549 of the pending bill proposes to change this policy and make the increased rates applicable to such leases and sales, when delivery is made subsequent to July 1, 1941, and prior to the effective date of the act.

While our leases, installment and conditional-sales contracts provide for the addition of any Federal tax that may be later imposed, because of the

nature of our business if section 549 is enacted in its present form it will be necessary for our company to absorb most, if not all, of the additional taxes imposed under section 549 with respect to sales made during the period from July 1, 1941, to the date of effectiveness of the act. In the case of such leases and sales it is impossible for us to include the additional taxes to be imposed in the selling price agreed to because the rate is not definitely known and because of the penalty provision of section 3325 of the Internal Revenue Code. Section 549 discriminates against a company such as ours which sells directly to its customers and handles its own paper as compared with the competitor which sells its paper to a finance company.

In fairness to all concerned, we urge that the policy adopted in section 210 of the Revenue Act of 1940 shall be substituted for the policy set forth in section 549 of the pending bill, and the increased rates made applicable only to leases, installment, and conditional sales in which the delivery occurs after the date of the effectiveness of the act.

Respectfully submitted.

MACK MANUFACTURING CORPORATION,
J. E. SAVACOOL,
Vice President and Comptroller.

STATEMENT SUBMITTED BY JESSE T. PALMER, ARLINGTON, VA.

PART V. NEW EXCISE TAXES

Add sections 5551/4 and 5551/2 to H. R. 5417, Seventy-seventh Congress, First session.

SEC. 5551/4. *Parimutuel Wagering on Horse and Dog Races.*—A tax of 2½ percent of the total of all moneys wagered each day of a horse or dog racing meeting is imposed upon every person, association, corporation, or trust licensed by any State racing commission, board, or authority to conduct a horse or dog racing meeting. Each day's tax shall be paid to the Secretary of the Treasury within 24 hours after the close of the racing day upon which the same is assessed. Every purchaser of a parimutuel ticket shall make written application for said ticket, giving his or her name and address on a form approved by the Secretary of the Treasury. Said application for the purchase of a parimutuel ticket and the parimutuel ticket sold by any person, association, corporation or trust licensed under any State racing act shall be stamped with the same serial number and the purchase price of the ticket. Every parimutuel ticket shall be endorsed in ink or indelible pencil by the person purchasing same giving his or her address, before same shall be cashed by any person, association, corporation, or trust licensed under any State racing act. Every application for a parimutuel ticket and every parimutuel ticket cashed by any person, association, corporation, or trust licensed under any State racing act shall be kept and preserved, subject to examination by the Secretary of the Treasury and the respective State racing commission, board, or authority. The use of a fraudulent or fictitious name on any parimutuel ticket shall constitute a misdemeanor.

SEC. 5551/2. *Bookmaking on Horse and Dog Races.*—A tax of $500 for each day's operation is imposed upon every person, association, corporation, or trust engaged in the business of bookmaking in respect to any horse and dog race and/or accepting wagers on the outcome of any horse and/or dog races. Each day's tax shall be paid to the Secretary of the Treasury within 24 hours after the close of the racing day upon which the same is assessed. Every bookmaker shall keep a permanent record of the name and address of every person wagering money on horse and dog races as well as the amount of money wagered and such record shall be subject to examination by the Secretary of the Treasury and the respective State racing commission, Board, or authority.

JESSE T. PALMER.

PROPOSED FEDERAL MUTUELS TAX

BASIC CONSIDERATION

A. *Revenue.*—1. A tax of 2½ percent will, based on 1940 wagerings ($408,500,000) at horse races, yield a revenue of $10,000,000 for national defense. Reports indicate that wagerings at horse races may exceed $500,000,000 this year.

2. This is a luxury amusement tax—only the winning bettor pays it—it is not a burden to the taxpayer.

3. There is no indication that a small Federal mutuels tax will appreciably reduce betting at race tracks. Betting in 1941 appears to be far ahead of betting in 1940, in spite of increased take-out by the States.

4. There is no indication that such a tax will appreciably increase betting at bookies located off the tracks. Bookies, with all of their attractions, do not take the place of the race track.

5. There is no reason to believe that the administration of this tax will be any more difficult than the administration of any other Federal tax, and the yield per administrative dollar is likely to be much higher. Our excise taxes, especially these on tobacco and liquor, are difficult and expensive to administer. A Federal agent must be maintained in every distillery. The minutest details, to the weighing and testing of the ingredients, are carefully watched.

6. There is no question of State rights, as horse racing is most interstate in character. Furthermore, no attempt is made to restrict the taxing of mutuels by States. Race horses race in many States in a single racing season, and are continually crossing State lines. Not only are race horses continually moving in interstate commerce, but in international trade as well, as race horses are imported for racing from Europe, South America, and Austrial, and are shipped abroad for racing. This summer already, Whirlaway has raced in Florida, Kentucky, Maryland, New York, Illinois, and New England.

(*B*) *Regulations.*—7. The scheme of requiring an application when purchasing a parimutuel ticket is simple and not objectionably time consuming, and cannot be objectionable to honest people. Bettors simply pick a blank application card from any number of receptacles near the mutuel ticket windows, sign their name and address and hand it to the ticket seller, who stamps it with a serial number at the time he sells the ticket. All of this will take only a fraction of a minute's time. Honest people will not hesitate to sign their correct name and address. People do not hesitate to buy stock certificates in their correct names, yet speculation in the stock market is the greatest gamble of all.

8. The purpose of this check on betting is to protect the betting public. As a result of association jockey rings, it is doubtful if more than 50 percent of the money wagered ever finds its way back to the bettors. If the race-going public ever wakes up to this wholesale exploitation, horse racing will permanently collapse to the utter detriment of a vast horse-breeding industry in the United States. This legislation should be passed to put one of our important industries on a sound, permanent basis. Here again it should be pointed out that even betting on horse races is interstate commerce. The bettors follow the races from State to State—go South in the winter—North, East, and West in the summer. The race tracks wire their own money away to the bookies, and the bookies wire their money to the tracks.

9. This tax will aid in the enforcement of our banking laws. For example, a bank clerk absconds with bank funds. He is caught and claims that he lost the missing funds at the horse races, thereby giving racing an unjust reputation. Under this tax proposal the truth can be quickly learned, and the search continued for the hidden funds.

10. This tax proposal will block evasions of our Federal income-tax laws. Thus it will be possible to check deductions as losses at race tracks.

11. Racing holds a high stake in national defense. Racing on the level provides a wholesome form of amusement needed by defense workers—i. e., the opportunity to get out in the fresh air and sunshine, and to relax from the heavy grind. Annual importations of thoroughbred race horses and breeding stock reaches into the hundreds of thousands of dollars. Millions of dollars are invested in breeding farms and racing establishments in this country. Similar investments in France suffered irreparable losses when that country was conquered by Hitler. The horse-racing industry in this country cannot afford to take a chance on similar confiscation.

JESSE T. PALMER.

AUGUST 21, 1941.

STATEMENT SUBMITTED BY JOHN R. KEEFE, CALDWELL, N. J.

PLAN TO LIQUIDATE ALL GOVERNMENTAL DEBT BY REDUCING ALL TAXES

It is estimated that aggregate debts of local governments (State, county, and municipal) is $90,000,000,000. The New York City debt alone is about $3,500,000,000.

This plan is based on two facts that have been proved many thousand times. (1) That the Federal Government can borrow at a much lower interest rate than any local government can. (2) That local governments get gyped right and left in selling their securities by "all or none" flimflams, collusive syndicate biddings, private sales, fixing serial bond maturities and the amounts thereof so that short-term notes pay long-term interest rates, omissions of call clauses which will unnecessarily cost local taxpayers throughout the Nation $36,000,000,000 more for interest than it should (New York State has 5-percent bond issues maturing as late as 1964), and other acts of omission and commission that indicate gross incompetency and neglect by local officials.

Plan.—The United States Government to sell its own long-term bonds (50 years), bearing 1½ percent interest rate, and loaning this money to local governments to refund maturing loans and for new improvements, charging local governments 2½ percent interest. This rate will be 1½ percent less than these same local units now pay. The Federal Government will not have to actually sell its own securities and loan the money to local governments for refunding purposes; an exchange of bonds will suffice. The collective governmental debt is not increased one dollar.

The Federal Government profit ($98,250,000,000) and local government savings ($90,000,000,000) will amount to $188,250,000,000 in 80 years; the due date of the last maturity included in these calculations. However, the profits and savings will continue just as long as local governments borrow for betterments, which means forever. Thus a new and permanent source of Federal income is assured.

The Federal Government underwrites its own and all local government debts without investing a dollar of new capital under this plan, which is self-liquidating in fact. Local governments will eventually arrive at a point when the only requirement in order to carry and discharge a Federal debt will be to pay 2½ percent interest on the loan. As it now is, they pay up to 5 percent without decreasing the debt.

In order to show concisely how the plan works the figures involved on a $1,000,000,000 loan unit follow.

On the sum of $1,000,000,000 the Federal Government will make a direct profit of 1 percent, amounting to $10,000,000 a year. This latter sum will also be loaned and, as it does not represent an investment, will earn 2½ percent interest, amounting to $250,000 a year on each such $10,000,000 annual direct-interest profit. This sum ($250,000) will be multiplied 1,275 times during the life of a 50-year bond. Local governments will pay 1½ percent less interest to the Federal Government than they now pay to private parties and will save $15,000,000 a year.

Federal Government profit	$10,000,000×	50=	$500,000,000
Federal Government profit	250,000×1,275=		318,750,000
			818,750,000
Local government savings	15,000,000×	50=	750,000,000
Total profit and savings			1,568,750,000

Based on $90,000,000,000 being loaned to local governments to refund existing debts and $1,000,000,000 to be loaned annually for the next 30 years for new improvements, the profits and savings on a $1,000,000,000 unit will be multiplied 120 times thus $1,568,750,000×120=$188,250,000,000.

There are numerous instances where local governments pay less than 2½ percent interest on a part of its debt. In no such case is the debt paid off at maturity as is done under this plan which also provides for promptly lessening (next paragraph below) Federal taxes throughout the Nation thus further reducing the tax burden all over the country.

In order to more quickly and better implement this plan and at the same time actually conscript wealth, the Federal Government should call all local government outstanding bonds and give in exchange therefor United States 50-year bonds bearing 1½ percent interest. Otherwise numerous large local government debts paying an average 4 percent interest rate cannot be refunded for many years thus delaying full benefits though the plan is not dependent on such action for success.

NOTE FOR SENATE FINANCE COMMITTEE

The foregoing is one feature lifted from a financial plan that also provides for reducing post-war unemployment by 6,000,000 and paying $50 monthly to dependents over 50. The entire plan is available to the Senate Finance Committee if so desired.

JOHN R. KEEFE.

LETTER AND MEMORANDUM SUBMITTED BY BRADLEY H. WALTZ, BALTIMORE, MD.

AUGUST 18, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: The attached memorandum, disclosing the need and desirability of deficit financing, the error of considering Federal taxation as a means of acquiring revenue instead of solely as a means of regulating production, and the fallaciousness of commodity price fixing, is submitted for your consideration in passing on pending tax legislation.

Very respectfully,

BRADLEY H. WALTZ.

THE MECHANICS OF MONEY

Since the worker's activity in a modern society is so highly specialized that he can neither produce any appreciable portion of what he utilizes nor utilize any appreciable portion of what he can directly produce, he produces only when he can exchange the product of his effort for the product of another's effort. Hence the opportunity to exchange is essential to production. But the wealth accumulated through generations is eloquent evidence that man will produce when he has this opportunity, so the opportunity to exchange is also provocative of production.

Since Nature, the source of all wealth, receives no money for the wealth she affords man, all money men pay each other is for service. Or all money paid to man is wages.

If each of a number of workers has a dollar which he exchanges at the end of the day for what some other worker has done in the day, the daily wage of each worker is $1. If the dollars change hands twice a day, the wage is doubled. Or, a change in the number of workers can be accommodated by an inversely proportionate change in the wage, or a proportionate change in either the frequency of the wage payment or the circulating quantity of money. And where regulation of the average wage and its payment frequency is tabooed by governmental philosophy, unless the requisite adjustment of these factors be automatically attained an increase in the circulating quantity of money will be required for the employment of an increased number of workers. And, conversely, an increase in the circulating quantity of money will be reflected in employment when the average wage and its payment frequency are constant, for it will constiue an increase in the opportunities for exchange.

So because of its influence for constancy on wage and its payment frequency, the regularity in payment and quantity in normal times, of the average man's monetary disbursements should be encouraged whilst efforts to stabilize commodity prices should be discouraged, for since Nature's and man's vagaries will vary the output of wealth per unit of time for different periods, such stabilization is mere variation of the average wage.

When one of the afore-mentioned workers pockets his dollar at the end of the day, rather than exchange it for some other worker's output, the latter is disemployed and so remains as long as the dollar is hoarded and not circulating, if the change in the circulating quantity of money be not compensated by change in

the average wage and/or its payment frequency. Thus the tendency in a society where men must build reserves against sudden needs and do prefer the accumulation of money to that of property is toward unemployment.

When private reserves are depleted by the Government in correcting unemployment private enterprise is discouraged, but will be stimulated and reserves enlarged when the correction is accomplished with new money, and it can then be repressed in favor of public enterprise and reserves reduced by attaching private expenditures. The manufacture of silk shirts, for instance, can be depressed by taxing their purchase, so that their creators may be released for the production of parachutes.

BRADLEY H. WALTZ.

(Thereupon, at 4 p. m., the committee recessed until 10 a. m., Friday, August 22, 1941.)

REVENUE ACT OF 1941

AUGUST 22, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Congressman Dewey, if you will be good enough, we will be very glad to hear you this morning.

STATEMENT OF HON. CHARLES S. DEWEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. DEWEY. Thank you very much, Mr. Chairman. I wish to thank you and the members of the committee for the privilege of appearing before you. I do so in behalf of the small business and the small industries of this country.

Back in, I think it was, 1931, President Roosevelt wrote a book called Looking Forward, and in that book he particularly recommended that there should be a decentralization of industry, and a retirement to the smaller localities of the country. In other words, that industry should go back to where the population was and not all amass in the great metropolitan districts. I rather think that his advice has been forgotten, particularly recently, for the simple reason that these little industries that have located there have, to my way of thinking, been extremely burdened by the taxes placed on them, and particularly in the form of the Federal estates tax.

I have been sitting for the past 3 weeks in the Banking and Currency Committee, listening to the testimony of Mr. Leon Henderson on the price-control bill.

Now, these little industries are just not going to exist; they are not going to continue to exist, and they are certainly not going to produce any revenue unless something is done to protect them.

Priorities naturally have to be made for national defense, but any industries, and there are many of them, that are not engaged in national defense are in danger of being forced out of business. They are having to lay off men constantly; they cannot get material with which to make their products, and it is, to me, the promise of a terrible situation.

I am taking the liberty of putting into the record the number of companies that have already been called down here to Washington

to be told that their production will be reduced by anywhere up to 50 percent. That list of companies runs about 36.

Senator LA FOLLETTE. Are you reading from the hearings in the House committee?

Mr. DEWEY. This is from the hearings in the House committee. I will not bother you to read all of the industries affected, but I will indicate them and will ask to have the list introduced in the hearings at this time, if you please.

The CHAIRMAN. Yes, sir.

Mr. DEWEY. They cover every line of industry.

Senator VANDENBERG. You mean 36 categories, not companies?

Mr. DEWEY. Thirty-six industries, categories. I am glad you corrected me, Senator. They cover many endeavors.

(The table referred to is as follows:)

TABLE 1.—*List of industries for which meetings have been held or are contemplated; proposed level of operation in comparison with last year*

[NOTE.—(1) Indicates "Full capacity." (2) Indicates "No definite curtailment program has been formulated"]

Meetings held:	*Percent*
Rayon	(1)
Domestic laundry equipment	73
Refrigerators	52.2
Vacuum cleaners	92
Farm-equipment manufacturers	120
Gasoline (east coast distribution)	90
Automobiles	50
Thermostat bimetals	60
Commercial refrigerators	(2)
Tapioca	(2)
Burlap	(2)
Air conditioning and refrigeration	(2)
Domestic heating equipment	(2)
Cooking stoves	(2)
Metal office furniture	(2)
Domestic electrical equipment	(2)
Chlorine (Freon refrigerants)	(2)
Cotton linters	(2)
Formaldehyde and derivatives	(2)
Oil burners	(2)
Petroleum products and refining	(2)
Chinaware and pottery	(2)
Battery-can manufacturing	(2)
Die casting	(2)
Domestic ranges	(2)
Electric-light bulbs	(2)
Electric-switch and circuit control	(2)
Eyeglass frames	(2)
Fruit-jar tops	(2)
Galvanized ware	(2)
Grain-bin manufacturing	(2)
Home canning	(2)
Hospital apparatus and equipment and surgical instruments and supplies	(2)
Hot-dip galvanizing	(2)
Jewelry manufacturing	(2)
Milk-bottle crates	(2)
Oil filters	(2)
Pen and pencil	(2)
Pressure cookers	(2)

Meetings held—Continued.	Percent
Radio receivers	(2)
Resistance welding electrode manufacturing	(2)
Slide fasteners	(2)
Thermostats for domestic appliances	(2)
Wire screen	(2)

Meetings contemplated:
Household metal furniture.
Hardware.
Domestic ice refrigerators.
Cooking utensils metalware.
Commercial counter appliances.
Vending machines.
Bones (glue, gelatin, buttons, fertilizers).
Tar acids—cresol and phenol.
Toluol.
Ammonia (all nitrogen products).
Methanol.
Ethyl alcohol.
Ethylactate.
Enameled-ware manufacturers.

Mr. DEWEY. Now, having to support that sort of thing, and the various other difficulties that will come, to have a heavy Federal estates tax placed upon the smaller industries, as is proposed under the House bill, will just close them up, those that are still alive at the time of the death of their owner. Those little industries are generally—and you are familiar with them all—all types.

I have taken a list from the census of 1937, the manufacturers census of 1937, which is the most recent. There are 163,000 of those little companies in the United States, which employ 250 men or less. They employed at that time 3,817,000 out of the total of 8,569,000 of factory workers, which is 44½ percent of all people employed in factories in this country. They not only did that, but out of the manufactured products of 1937, which were totaled at $60,712,000,000 for all manufactured products in the United States in the year 1937, these little companies manufactured $27,385,000,000 of that $60,000,000,000.

I wish to impress upon the committee that these small companies are the backbone of the Nation's business. They are the little newspapers, they are the little knitting mills, machine shops. Every one of us, as he travels through this country, has seen them in every one of these little towns. They not only are the backbone of the business, but, as I have shown, they employ 44 percent of all factory workers in this country, and they give a livelihood and a means of livelihood to the people in those small locations.

I am going to read to you one letter, if you please, that came in to me when I presented this matter before the Ways and Means Committee from a man in Pella, Iowa, who makes window casings. He states:

> I have been very much interested in reading newspaper comment on relief for estate tax applying to small businessmen, which you are sponsoring. We have one of those businesses here, which, as nearly as I can determine, will be completely wrecked in case of my death. We have a business employing about 250 people. It was built up from nothing in this small town of about 3,500 people, and you can well realize that this business means a lot to this little city—in fact, so much, that we have had no unemployment problem among Pella citizens during the last several years.
>
> I have built up this business by reinvesting all of the profits. No profits have ever been taken out of this business.

I thought that I had taken fairly good precautions for an emergency by taking out about $100,000 worth of life insurance but under the proposed schedules of the estate taxes, this insurance will be considerably less than half of the total amount of the estate taxes with which this business would be hit. My wife would not only have to dig up an additional $150,000 to pay estate taxes, but the business would be further jeopardized by my not being here to help direct the affairs.

I took out my life insurance originally to have emergency cash on hand for carrying on the business, but this emergency cash will not now be available, to say nothing about having to pay perhaps $250,000 in estate taxes.

I can see no way of financing a thing like that. The business is such that I doubt whether anyone would be interested in putting any money into it, due to all of the uncertainties and right now I can foresee nothing but the wrecking of this business due to the injustice of estate taxes.

Unfortunately I am now at such an age that buying additional life insurance is prohibitive--especially when it has to be paid for out of profits that will be subject to a 30-percent corporation tax and then perhaps a 25-percent or 30-percent individual income tax, plus a 5-percent State income tax.

I am just another one of those small businessmen that feels completely frustrated and helpless, and I surely hope that you can do something for us.

That is one of many letters of that nature that I have received, Mr. Chairman.

Now, without wishing to bother your committee longer in this discussion, I wish to present what I propose.

With these points in mind that I have mentioned, I respectfully propose that Congress include in the tax bill under consideration the following new provisions in regard to the Federal estates tax:

(1) The Secretary of the Treasury to be empowered to accept prepayments of estimated Federal estates tax in 10 equal installments.

(2) The Secretary of the Treasury to be empowered to issue in acknowledgment of any such payment, and the amount paid, a Federal estates tax anticipation receipt.

(3) These receipts shall bear no interest, but shall be redeemable at face value, by the Treasury Department, upon presentation by original holder.

(4) Upon death of original holder or if a corporation, upon the death of that person, the integrity of whose estate was being protected by prepayment of Federal estates tax, the Treasury Department shall accept said Federal estates tax anticipation receipts in payment and settlement of said tax, providing said receipts show a face payment equal to the tax involved, and further providing that any excess payment shall be considered as taxable cash in the estate involved.

(5) No installment of anticipated tax payment, whether by an individual or a corporation, may exceed the sum of $25,000 in any calendar year.

(6) No individual or corporation may make payment in anticipation of the Federal estates tax on a net estate greater than $500,000.

The purpose of all this being, Mr. Chairman, to determine the exact amount of the estate tax and to permit preparation in advance of death for its payment. A man with an estate of $500,000, under the proposed rate, we will say, takes out a life insurance policy sufficient to pay his Federal estates tax, which would be $131,000. But that does not pay his estates tax, because his estate then becomes $631,000 instead of the $500,000, naturally, less any amount that you might exempt on the insurance, which I think is $25,000. So he has to take out another life insurance policy on the amount of the insurance policy that he has taken out, which would amount, in this case, to $42,000. Well, that adds to his estate, and on that $42,000 he has to take out an additional $13,486, and on this $13,486 an additional $4,300, and so forth, and so forth. So his tax liability, instead of being $131,000, will be

$193,000, because the more insurance he takes out the bigger his estate becomes, and there is no end to it.

My theory is, that in these small estates a man should be permitted during his life, to figure out what may be the value of his business for Federal estate tax purposes and start prepayments. Those prepayments should not become a part of his estate, nor should they be taxable. As an offset the Treasury will have the use of those prepayments, which will be made in installments, without paying interest on the funds received, during the period that they are being paid. I think that this prepayment feature, during this period of heavy Federal expenditures, is of real value to the Treasury.

It is also of value to the Treasury to have an immediate payment of their cash claim without waiting 18 months for the settlement of an estate, and who can tell what the future may bring forward and what will be the value of estates? I think these points are something that should be considered, sir, at this time.

When we finish this emergency we hope at least to have our little businesses alive and going, so that the boys that are now going into the Army can come back to their little communities and find a job waiting for them.

I respectfully ask you to give consideration to this matter.

The CHAIRMAN. Thank you, Congressman.

Senator DANAHER. Mr. Chairman, before the Congressman goes, may it be indicated in the record from what issue of the testimony and from what page he read?

Mr. DEWEY. I am referring to part 10 of the hearings before the Banking and Currency Committee, upon the price-control bill, H. R. 5479, page 566, table 1.

Senator DANAHER. Thank you very much.

Senator VANDENBERG. You would reach the same general net result, Mr. Congressman, would you not, if you exempted from the estates tax any insurance taken out with the Government as a beneficiary?

Mr. DEWEY. It would be the same plan, sir.

Senator VANDENBERG. Would not that be even simpler?

Mr. DEWEY. It would be just as simple. That has been considered. I would like to make it a part of my plan. The only thing, however, is that there may be a time when a man may be able to pay over $10,000 a year for 10 years but he could not take out a life-insurance policy, owing to ill health or age, or questions of that kind, and he ought not to be put in the position where he would not have the same opportunity as those that had life insurance or who can obtain a life-insurance policy.

I agree with you on that theory and am in perfect harmony with the use of life insurance, but I would like to see this used with it, too, to give an equal benefit to all.

Senator DANAHER. That is a very excellent suggestion.

Mr. DEWEY. Thank you very much.

The CHAIRMAN. Thank you very much.

Mr. Long.

STATEMENT OF HENRY F. LONG, BOSTON, MASS., COMMISSIONER OF CORPORATIONS AND TAXATION, STATE OF MASSACHUSETTS; CHAIRMAN OF COMMITTEE, NATIONAL STATE TAX ADMINISTRATORS; CHAIRMAN OF THE COMMITTEE OF THE AMERICAN BAR ASSOCIATION ON THE COORDINATION OF FEDERAL, STATE, AND LOCAL TAXES; CHAIRMAN OF THE COMMITTEE, NATIONAL TAX ASSOCIATION, ON THE COORDINATION OF FEDERAL, STATE, AND LOCAL TAXES

Mr. LONG. My name is Henry F. Long, and I am the commissioner of corporations and taxation of Massachusetts, and have served in that capacity since 1920.

I am here representing a group of State tax administrators who have gathered here in Washington, undertaking to discover what effect the proposed Federal revenue bill may have on the taxes of the States.

The CHAIRMAN. Would you like to finish your general statement before questions, or would you object to questions?

Mr. LONG. I would be very glad to have questions at any time.

The CHAIRMAN. All right.

Mr. LONG. I would wish the committee, if it please, to consider that the States have different forms of tax structures, and have also different requirements, and also the taxes can be reported in different ways. Insofar as Massachusetts is concerned, our government is so interlocked that, speaking as a State tax administrator, I am consciously thinking of the total tax burden on the people of the State of Massachusetts, the local taxes, as well as the State taxes.

We wish to present to this committee two or three things which we think are quite vital: First, I would like to call to the attention of the committee the fact that the States must continue to exist; that there should not be any encroachment upon their revenue sources which they have enjoyed through the years, unless it becomes of paramount necessity under any proposal of revenue production by the Federal Government.

It seems to us that there can be consideration given to the States on these general principles.

We have, all of us, inheritance taxes, and we believe that there should be in the minds of the Congress, in passing a Federal revenue bill, constantly in mind that the States are entitled to a proportionate share of the accumulated wealth of decedents in that State.

The progress of the Federal Government's taxation in regard to estate taxes during a number of years has been very seriously tended to deplete the amount of revenue which the States have under their inheritance taxes. It, in substance, comes in the form of taxation which the Federal Government has resorted to as a tax on estates that is, by indirection, a very similar situation as has developed in respect to the income tax schedules.

Every estate that has an income tax, or something comparable to it, finds that its revenue source is very substantially reduced by the high rate which the Federal Government employed in their income-tax proposals.

That means that there is depleted, where the estates are allowed credit for taxes paid the Federal Government, the amount which the State can receive for their own particular activities.

In this proposal, which I will leave with you, I think there is very well outlined the thoughts that I have just briefly called to your attention, which perhaps might be summed up, first, by saying that we hope, in considering this Federal revenue bill, you will not overlook the fact that the States do have revenue sources such as I have called to your attention, gasoline taxes, taxes on tobacco products, taxes on liquor, taxes on incomes, taxes on property, taxes on various privileges, and a good many of them have sales taxes which have also been implemented by usage taxes, all of which they have come to rely upon, and every excursion that the Federal Government makes into those fields, is going to be very detrimental to the States in financing the kind of governmental activities which they are obligated to perform.

This group that has gathered here in Washington has made up a memorandum which will be submitted to you, of some of the suggestions that we have in mind, together with an appendix in the form of tables, that call to your attention the impact of this proposal upon the States' particular revenue.

The second thing that I want particularly to emphasize is this: In addition to being the commissioner of corporations and taxation in Massachusetts, I am also chairman of the committee of the American Bar Association on the coordination of the Federal, State, and local taxes, and equally I am chairman of a similar committee of coordination of Federal, State, and local taxes of the National Tax Association; and, thirdly, I am chairman of the committee of the National State Tax Administrators on the coordination of Federal, State, and local taxes.

Now, all of the tax administrators through the years, particularly beginning at the time of the depression, have been very greatly concerned at the enormous assessments which, by indirection, have been made in the various Federal revenue bills on the States, and the groups that I am chairman of their committees, of the American Bar and the National Tax Association, and the Association of State Tax Administrators, have concerned themselves with the thought of how we could work out some plan that we could present to the Congress to indicate how the Federal Government may be able to raise their revenue without any particular attempt to tax by indirection the States' revenue.

Those committees have not as yet been able to get sufficient data to present to you, although we are struggling with the problem.

This group has called to your attention House bill 5196, which is another bill pending before the Congress, which seeks to set up by Federal enactment a committee which will think in terms of the coordination of the Federal, State, and local tax sources.

We suggest that the committee, in approaching this, begin to think very seriously in terms of—in respect to any future revenue bills—of considering, through the Treasury Department—if it is on that source that the committee relies for its information—the proposals of all representatives of the States.

In the particular proposal, H. R. 5196, there is only one representative of the State.

While the Federal expenditures are very heavy, it is respectfully submitted that the States, through their political subdivisions particularly, are much closer to the economy of our people and much closer to their lives than is true of the contact which the Federal Government has, and that the States should be permitted a larger representation on this coordinating committee.

We would ask, in a general way, that there be no provisions in this particular proposal which is now before you, which looks to the future in the matter of revenue, that you keep as a primary thought in the development of this present Federal revenue measure, the immediate return of revenue, and not, as in the bill, for example, in respect to your estate tax, project something that may develop revenue in the future. It is respecfully submitted that the Congress is going to be in session at another period, and that this bill might necessarily be only a forerunner to what might be thought of as a well-worked-out plan, as ultimately we must reach, as our cost of government increases, so that the Federal Government can exist, and the States and the local subdivisions are able to exist.

Senator LA FOLLETTE. I am not too optimistic about that. I have been waiting 15 years for that sort of thing.

Mr. LONG. Your State of Wisconsin, Senator, has been very reluctant to come in with us on any plan to work out coordination of the States and the Federal Government. We think it can be done, and we believe there is opportunity of doing it.

Senator LA FOLLETTE. I do not want you to think I am not in favor of it. When you talk about getting a sound Federal structure, it has always been said when we had a Federal bill before us, that the next time we are going to do a thorough job, and take into consideration all these questions, but I have never seen them do it.

Mr. LONG. I think it is largely due to the fact that human nature does not change, and one of the strongest emotions in human nature is the acquisitive sense. People do not wish to give up anything. Ultimately we may reach some sort of scheme, and the first step will be to have at least the Congress feel that there is some place in this picture for the States and the political subdivisions, and at least let us have some provision inaugurated in Congress that will permit us to sit down around the table and talk it over.

Senator LA FOLLETTE. I am very enthusiastic about that being done.

Mr. LONG. If we have of the States, who are rather constantly in contact with this problem, might sit down at the beginning of the drafting of the Federal revenue bill——

Senator LA FOLLETTE (interposing). Instead of at the end?

Mr. LONG. Instead of at the end, I think we might at least be able to show where the States were rather badly injured, and possibly we might make some suggestions which might be of value, at least to the committee in reaching their conclusions.

I can see no other way we can attempt it. In the last analysis, we have got to raise revenue. We should do it in the best way possible, and we should have it under consideration at the beginning rather than at the tail end.

It is clear that this particular group I represent have not had any time, nor are we implemented to bring the sort of report to you that we would like.

Forty-eight States in the Union are not very easily brought together. We can do the best we can. We do believe if the Congress will think in terms of what the States can do, we would be very glad, indeed, of that opportunity.

Senator LA FOLLETTE. It is true, is it not, that the greater the tax revenue raised by the Federal Government, the more imperative becomes the necessity of some coordination or cooperation between the States and the Federal Government in this field of taxation, because as you increase the impact of the Federal taxes you intensify the problems with which the States are confronted?

Mr. LONG. Yes, Senator, I think that is very intelligently put. In Massachusetts, for example, since the Federal Government has used the estates tax in large rates, we have averaged a drop in our normal revenue of about $3,500,000 a year, by virtue of the fact that we are giving credit because of the Federal estates tax paid.

Now, if you should say, in answer to that, that the States might very well discontinue giving credits because of the Federal estate tax paid, then you counsel destruction of all accumulation of wealth and the movement of that wealth down to those that the decedent wants to be the beneficiaries of his accumulation. That, of course, will lead us into another picture, it will mean the hiding of the accumulated wealth of people, so that neither the Federal Government nor the State can obtain it.

It can be done by scattering the fortunes into small hands, which again destroys our economy, which we have, particularly in Massachusetts, benefited fr through the years, of the ability of accumulated wealth to create w h upon which we must depend for the continuation of our Government.,

We think that when the States are, as now, largely dependent upon what might be called the people in the lower brackets of the income group, and lower brackets of the estates, that the field, even though the States may not immediately avail themselves of it, should be left open to the States, and not the theory adopted that where the States have not seized these sources, or because the States have not taken them, the Federal Government will go in and take them.

I submit there are some things which the Federal Government can well do, which the States are almost prohibited from doing. The obvious ones, of course, are the taxes on interstate commerce, which is only to a certain extent employed by the Federal Government. The States are very definitely prohibited from obtaining very much revenue from interstate commerce. The devices of corporations engaged exclusively in interstate commerce, are manifold in the ways in which the taxes can be avoided.

That is true also in respect to sales taxes. We are prohibited in the States from employing the manufacturers' sales taxes, that is, in regard to anything which has a Nation-wide spread, and which again is in relation to interstate commerce, which, it seems to me, might very well be modified by the Federal Government to supplement the other sources.

In other words, what I am pleading for is for the Federal Government to be constantly watchful that they do not gather revenue in those fields which are, in the first instance, close to the States, that when they enter the fields in which the States are also in part occupied, that they will do it in such a way that there will be a return for the Federal Government of $100,000,000 at the expense of $85,000,000 which the States have to give up, which is a net gain to the Government or the people of the United States of only $15,000,000. That, of course, is a major problem for a committee, which again is probably like the State tax administration, it is not given the opportunity to consider the Federal revenue bill until it is pretty well cooked and it is pretty difficult to break up the batch of dough and start all over again. At least we can try, and we are now presenting to you the suggestions as to what we would like. We would like the opportunity of coming in as States and sitting down with you and seeing if we can work this out. Perhaps we can.

I think the very fact that the Congress looks with favor on considering the States and subdivisions in the picture of financing the Government of the United States, which, after all, is not exclusively Federal and not exclusively State, but a combination of State and Federal and local, I think that is a good sign that we can get together.

The views of this particular group that is here, of the State tax administrators, and we have had communications with perhaps 35 of the 48 States, that will be presented to you in the form of a memorandum and tables. That is in detail what we would like to have you consider, but I would like to make these specific recommendations, if I may, and it will not take but a moment.

There are six in number.

1. We would like to recommend that there should be no increase in Federal estates taxes at this time. If, however, they are considered an indispensable source of additional revenue, provision should be made for an augmented share to be made available to the States by adjustment of the credit for death duties paid to the States.

You will recall that the 1926 revenue act gave the States 80 percent credit. You will recall the subsequent estate taxes have been superimposed upon that 1926 enactment, but that there have been no credits given in respect to the subsequent acts, and that therefore, when a person dies, coming within the sweep of the Federal estates tax, he is first taxed under the 1926 revenue act and the States there have the opportunity of taking the 80 percent credit, and then what there is over and above that is taxed without giving any credit to the States whatever.

Senator BROWN. What do you think of the proposal to reduce the exemption from $45,000 to $25,000?

Mr. LONG. You mean on the insurance?

Senator BROWN. On both, as I understand.

Mr. LONG. I am in favor of the abolition of exemptions. I think exemptions are the real burden in any tax structure.

Senator BROWN. What exemption do you have in Massachusetts?

Mr. LONG. We have a complete exemption on insurance.

Senator BROWN. On the estate, what exemption do you have?

Mr. LONG. We have no estate tax except to take up the 80 percent credit allowed by the Federal Government. The Massachusetts courts

ruled a great many years ago that in an insurance policy, where the main beneficiary was found in the policy that there was a completed transaction, and therefore upon the death of the decedent, there was not anything which came by way of succession to the beneficiary. Our courts have ruled they cannot tax insurance. Unquestionably our legislature could overcome that by making a tax. We have a tax where the insurance is made payable to the estate. Where the insurance is made payable to the estate or the beneficiary dies, and because there is no other beneficiary, the money is paid to the estate and then we have no exemptions whatever, the entire amount of the policy is included in the estate of the decedent.

Senator BROWN. Do you approve of the Treasury's recommendation to make that exemption $25,000 instead of $45,000?

Mr. LONG. Yes. But it is my opinion the States should have these lower amounts for taxation to themselves.

Senator BROWN. That would be a very material method and means of broadening the base of taxation.

Mr. LONG. Well, it would be a means of what we think is a method now permitted, to avoid a tax.

In Massachusetts, for example, a person can avoid our inheritance tax merely by taking out insurance.

Now, if the Federal Government taxes that in a large estate, we can pick up some of it under our 80-percent credit.

If you give us 80 percent credit under the 1941 Revenue Act we would, all of us, be highly pleased.

Senator BROWN. I am pleased to note your second recommendation there, about the allowance of the creation of a tax-free reserve by which to meet the Federal death duties. We tried to cover that here, I think, about 3 or 4 years ago, in part.

Mr. LONG. I recall it.

Senator BROWN. By providing for an 8-year period payment in the case of capital levies—that is what it amounts to—and by lowering the interest rate from 6 to 4, as I recall it. But I think there is merit in what you suggest. Often it amounts to a capital levy, and it should be spread over a number of years, or a reserve should be set up to repay it.

Mr. LONG. It is equally true that there is an accumulation, it is a circle and you never catch up. I think the rule, if it is good in this instance, and I think it is, should be generally applied. Ultimately, if taxes are going to develop, as I think they are, we will of necessity and fairness permit the accumulation of pools of money which are completely free from any assessment, just for the purpose of paying taxes in cash.

2. The second recommendation was that provision should be made to allow the creation of tax-free reserves with which to meet Federal death duties.

Such a provision would help both Federal and State Governments by retarding the exhaustion of capital holdings, and preserving the taxable base for future revenues.

3. The third suggestion is that large increases in income taxes, especially those applicable to individuals, should not be made retroactively. Since the revenue bill is so long delayed, provision for payment of taxes for the ensuing year will be difficult for many individuals who will be liable to State Governments upon income and other taxes.

4. The fourth point is that because the impact of Federal taxes upon the State tax yield is so great, there should be provision for prior consultation by Treasury representatives with State authorities before Treasury recommendations as to types and amounts of new taxes are made.

5. The fifth point is that attention should be given to the increasing number of commodities upon which duplicating or conflicting excises are being imposed.

6. The sixth point is that in any Federal legislation providing for a Commission to consider and report upon the interrelationship of Federal and State taxation systems, that there should be provision for adequate representation of State taxation officials.

In closing, gentlemen, I would like again to repeat what I said at the beginning:

We are anxious to do what we can to protect our States. We are not unmindful of the fact that the Government must be the first in concern in regard to the Nation. We do, however, want to ask that the Federal Government, having the greater power, having the first bite and being allowed to take too large a bite, that it be a little modest, and nibble instead of bite at these sources which they are seeking.

Senator GERRY. Mr. Long, you have a peculiar situation, haven't you, in Massachusetts, according to your testimony, in regard to the insurance policies?

Mr. LONG. In regard to inheritance taxes, that is correct.

Senator GERRY. That does not apply to other States, does it? I never heard of it, that is why I ask.

Mr. LONG. I think that the doctrine is rather to be found in the other States, namely, that when an insurance policy is taken out for the main beneficiary that there is not anything that goes to the living at the time of death. Now, if the State has an estate tax, you have an entirely different problem, and it may be that by legislation that the State can arrange that insurance policies will go into the estate. I think most of the States in the Union, in probating, where there is a main beneficiary in an insurance policy, do not run them through the probate court; nor does the fiduciary in the estate have any control in the insurance policy which is going to the main beneficiary.

Senator GERRY. My State has both the estate and inheritance taxes.

Mr. LONG. As I remember, your State merely passed the estate tax, as many other States did; I think you passed it in 1927.

Senator GERRY. No; we were the initial State, I think, that passed the estate tax, way back. The Treasury copied ours.

Senator TAFT. You do not have the catch-all 80-percent tax?

Mr. LONG. Yes; we do, Senator.

Senator TAFT. Does not that catch the insurance?

Mr. LONG. It catches the insurance, if it is sufficiently large, as far as the Federal is concerned. If the estate is under $2,000,000, our inheritance tax in Massachusetts is more than the 80-percent credit under the 1926 Revenue Act; therefore, we would not get any insurance because our inheritance tax would take it all. If it is a $5,000,000 estate, then we would pick up some of the insurance, under the 80-percent credit, to the extent that the 1926 Revenue Act made any contribution to the State. That is relatively small. I have in mind a recent

estate in which we were interested of approximately $40,000,000. Under the 1926 Revenue Act the Federal Government had a tax only of about $8,000,000, a little less than that, $7,000,000, of which we received 80 percent, but the ultimate amount which the Federal Government received was $23,000,000 out of the $40,000,000 estate. If we had 80 percent of the $23,000,000, we would be very happy.

Senator TAFT. The Federal Government would not have gotten it.

Mr. LONG. No.

The CHAIRMAN. I want to call your attention to the fact that exemptions from the Federal estate taxes have been put in partly, at least, on the theory that we were leaving the small estates—that is, estates that fell under that exemption—to the State, in which the small estate was generally accumulated.

Mr. LONG. I think, Senator, that is entirely to be commended, and I think that is correct because ultimately the Federal Government has got to think in terms of the higher things—the bigger things—those corporations which are Nation-wide.

The CHAIRMAN. That accounts, in part at least, for the exemption that we have always put in an estate tax. Of course it has been gradually reduced. The Treasury has made the suggestion this year that it be further reduced on the basis of $40,000 straight exemption. So far as the Federal tax is concerned, it leaves the estate of $40,000 or under for the State to deal with as it sees fit.

Mr. LONG. That is a statement of principle which we are asking on that, and we appreciate what you have done with respect to the estate tax.

The CHAIRMAN. Thank you very much.

Senator VANDENBERG. May I ask you for the explanation of one figure on table 3 of your compilation? Do I understand that the second item directed to fuel means that the States are collecting $845,000,000 from fuel taxes, representing 25 percent of the total State revenues?

Mr. LONG. Yes; I think that is correct. Now, the difficulty there is that again we have related these figures to just the State revenue itself, and have not thought in terms of the political subdivisions' revenues.

Senator TAFT. Yes.

Mr. LONG. The gasoline tax so far as the State budget itself is concerned, bulks very large in every single State in the Union. In my State it represents, or has represented in the past, about $22,000,000 which, out of our income in the State—because the bulk of taxes we collected were distributed to the cities and towns—is more than 25 percent of the actual State revenue. That is all earmarked and goes back to the cities and towns.

Senator VANDENBERG. Speaking generally, the State government is supported to the extent of about 25 percent by gas taxes?

Mr. LONG. That is correct. If you will permit me to add this to it: All of that money is earmarked for highways, and to the extent that the highways are brought into the picture of the cost of State government, then that suggestion is correct.

There is no opportunity to use any of this money for the normal activities of our State government. For example, we could not, in Massachusetts, take any of that and pay the $11,000,000 it cost us to take care of our mentally ill.

Senator TAFT. We do that in Ohio.

Mr. LONG. A great deal to the dissatisfaction of a great many people.

Senator TAFT. I mean you cannot make a general statement that it is all used for highways, because it is not.

The CHAIRMAN. The contrary is true in my State. Part of it is used for the educational activities.

Mr. LONG. In a great many States they have used it by device. I think the Federal Government has frowned on those kind of distributions from the Federal sources, yet there has been what they call diversion of the gasoline money for other than road purposes.

Senator LA FOLLETTE. And that diversion has been growing.

Mr. LONG. In the States with which I am most familiar there has not been any diversion. In some of the States of necessity, because their sources of revenue were incomplete, they have been obligated, by devices of various forms, to use the gasoline money for education and various other things.

Senator VANDENBERG. I was wondering if you were giving any attention to what would seem to me to be a tremendously serious problem, hanging over State functions. If 25 percent of your revenues come from gas taxation, the sharp curtailment in the use of gas will be a proportionate curtailment of State revenues, will it not?

Mr. LONG. That is true, but, if the Senator pleases, that would, I think, ultimately result only in diminution of highway expenditures. If in any of your States really you have used it for other purposes, I think as between the closing of the schools in Ohio and delaying of the construction of a new boulevard in Cincinnati, that the construction of the boulevard will be delayed. I think the revenue we are going to lose by curtailment of fuel consumption will be expressed by lack of expenditures rather than by any other difficulty.

Senator TAFT. Let me ask you about table 1. You have there "Total State expenditures." Of course that does not include local expenditures?

Mr. LONG. That is correct.

Senator TAFT. "Federal grants-in-aid, $645,000,000." Does that include both State and local grants?

Mr. LONG. That includes only State grants.

Senator TAFT. That includes only State grants?

Mr. LONG. Yes. Some of those are distributed to the local political subdivisions.

For example, you have "Old-age assistance." The old-age assistance starts locally, feeds in through the Government with the distribution back through the States.

Senator TAFT. The State and local relief is supposed to cover all relief except the W. P. A.?

Mr. LONG. That is true. It would come into this. As far as the relief end of it is concerned, it is included here, but there are certain grants made to local communities which are scattered, which are not general in character, which are not included in these figures.

Senator DANAHER. One question, please. I think this is one of the most significant exhibits which has been filed here. I wish the witness could supplement it by an itemized reference to the sources from which he has drawn these figures, if it is feasibly possible.

I would like to ask permission, Mr. Chairman, that such supplementary reference be given and included at an appropriate point, of this witness' testimony, in the record.

Mr. LONG. I would be very happy to do that.

The CHAIRMAN. We will be glad to have you do so and furnish it for the record.

Mr. LONG. Thank you.

(The memorandum submitted by Mr. Long is as follows:)

MEMORANDUM SUBMITTED BY HENRY F. LONG, CHAIRMAN OF THE COMMITTEE ON COORDINATION OF FEDERAL, STATE, AND LOCAL TAXATION OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS AND COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS

A group of State tax commissioners and other State fiscal officers who have met here in Washington to discuss, and have by correspondence and otherwise exchanged information, data, and opinions relative to their common problems in State taxation and finance. The result of their discussions has been a general concern about the effect of Federal revenue taxation upon State finances during the present emergency.

OBJECTIVES

The purpose of submitting this memorandum is not to intrude into the committee's deliberations upon the revenue bill (H. R. 5417) at this late date, nor to oppose or criticize your efforts to provide the revenues with which to finance the national defense. We want to emphasize the resulting problems in finance which will face the State governments in this crisis and request that these problems be given adequate consideration through consultation with State officials, be they tax commissioners or finance officers of State governments, in order that full cooperation may be rendered and the States' revenues protected insofar as possible in the adoption of Federal tax schedules in a way which will create the least financial disturbance to our existing forms.

LIMITATIONS OF PRESENTATION

It is the desire of the group for whom I speak to indicate the relationships of this Federal taxation, the effects of H. R. 5417, in general on all States and in particular upon certain States:

(*a*) Upon State taxation by resulting decreases, and (*b*) upon State expenditures by resulting increases, and (*c*) cite the effects of price inflation on purchasing power, and (*d*) suggest the implications of taxable capacities of the States and the classification of their tax systems as elements for consideration bearing upon any proper solution of this problem.

One incidental objective of this presentation is to call your attention to another bill, H. R. 5106, which proposes to create a commission to study taxation in this country. The proposal provides for one representative of State government on this commission. There are 48 States and 180,000 municipalities that levy taxes in this country in addition to the Federal Government. These taxing authorities are to be represented by one consultant. The States and municipalities collect 63.54 percent of all taxes collected in this country. We submit that one representative in a commission of 10 scarcely provides proper representation to State government, nor can any single individual possess the ability to solve the complexities and unravel the confusion of the taxes which are levied by the States, let alone the municipalities who exist as creatures of these States. It is not our purpose in calling these facts to your attention at this time to inject this subject into your present deliberations, but, as I have said, we are concerned with the probable decrease in State revenue and the probable increases in State expenditures which may be expected during this crisis.

RATIONING AND PRIORITIES

The effects of rationing and priorities have been weighed but the necessity for these controls in the defense economy transcends in importance that of State revenues, although we urge that in the adoption of rationing and priority schedules an eye might be kept upon State revenues which will be directly affected and often in serious degree by these necessary defense controls. Our objective may be summed up briefly by stating that it seems advisable to give consideration to State revenue through consultation with State representatives when measures affecting it, such as the revenue measure now before you and related economic legislation, is being given consideration.

STATE EXPENDITURE INCREASES

The costs of defense are believed by many to be entirely the subject to payment out of Federal revenues. Despite this fact it begins to appear definitely that the States have been, and will be, increasingly called upon to bear many of the costs incidental to defense. These costs begin to be felt in those activities entailing the maintenance of vocational education and training for firemen, police, etc., and those involving the preparations by councils of national defense which have been created in the States. With their national guards in Federal service, the upkeep of home guards will place additional defense costs upon the States. Those States represented in this group fully realize and are in sympathy with the importance of economical State budgeting, to make free the taxable capacity of the citizen to the Federal Government in this crisis, but they also believe the Federal Government should practice strict economy in its nondefense spending. This type of spending parallels and conforms closely to the normal regular expenditures of States in many ways. Legislation in recent years has more and more shown the tendency to intermingle the functions originally allocated to Federal and State Governments at the expense of the States' budgets by grants-in-aid, and the expansion of those functions whose performance had come to be considered a matter of national emergency some time before the present crisis arose. Attention is merely being directed to the fact that State expenditures will increase during this emergency. The extent of the increase is speculative, but nonetheless real and sizeable.

TAXABLE CAPACITY AND STATE SYSTEMS CLASSIFIED

The principal objective of this presentation, as we have said, is to survey with you the factors and to measure, as well, the possible effects of revenue legislation upon the State tax systems. In order to properly survey and estimate these effects in dollars and cents, consideration must be given to the taxable capacity of the various States which differs as the wealth and income of the population and the taxable resources located within each State differs one from the other. In addition to the factor of taxable capacity, it seems appropriate to classify the various State tax systems in a general way to show groups which will be affected more adversely by certain types of taxation than certain other types.

A perusal of the data on taxable capacities will disclose the receipts from the various States set opposite to the expenditures by the various States from Federal sources. It will call your attention to the degree of reliance placed upon certain forms of taxation by the several States and furnish you with some indication of the willingness of the States to tax themselves.

Factors which affect and are of significance in the taxable capacity are indicated by the flow of income payments, the types of productive activity, the nature of the tax systems adopted, and the willingness of the State legislatures to impose taxes to support a program adequate to the States' needs. There is no desire to accentuate State differences in these statements, but rather to indicate the part taxable capacity should play in plans for existence of State government in a dual taxing system, such as that relied upon in this country. Tax techniques are closely associated with taxable capacity in any criterion of willing and effective efforts by State to support enlightened programs. Without further analysis of taxable capacity at this time, permit me to summarize the type and nature of the various tax systems.

Thirty-seven States employ the income tax as a revenue-raising measure, 33 in its individual form, and 32 employ the corporate form. Of the 33 individual income-tax States, 20 allow the deduction of Federal taxes paid; 18 of the corporate income-tax States allow the deduction of Federal corporation taxes paid.

Sales and use taxes are employed in 22 States, 5 of which do not take advantage of the use tax features, but it seems significant, also, that only 4 of these 22 States do not employ the income-tax method—Illinois, Michigan, Ohio, and Washington. Of the 37 income-tax States 20 do not resort to the sales and use method. All States employ a tax on gasoline to provide revenues. Certain inequities have resulted from the full employment of this tax as a State revenue measure through the limitations of the Hayden-Cartwright Act which will be discussed in a moment. All States but one employ the inheritance, estate, and gift tax in some form as a revenue-producing measure; 6 of these have adopted methods similar to the Federal estate tax, while 7 employ a tax on inheritances only and the remaining 35 have both inheritance and estate tax forms, the latter primarily to take advantage of the crediting device allowed under the 1926 Federal estate tax law; 8 States have gift tax laws in effect to supplement the death taxes. Appended to this presentation is a table classifying the State systems as nearly as possible for your guidance and assistance and including the most relevant data from which to determine in a general way the taxable capacities of the various States.

ANTICIPATED REVENUE LOSSES

The over-all picture

H. R. 5417 proposes to levy new taxes, or increase those now levied to the amount of $3,300,000,000. Of this $3,300,000,000, $1,300,000,000, or 40.87 percent, will be derived from the income tax on corporations, chiefly excess profits taxes: $864,800,000, or 26.75 percent, from the income tax on individuals; $151,900,000, or 4.69 percent, from the tax on estates and gifts; $127,300,000, or 3.93 percent, from the tax on alcoholic liquors. Smaller amounts and percentages will be raised by levies on other taxable objects.

The proposed levies are to a large extent on the same persons and objects now taxed by the various States. The principal reliance of the States for their revenues is placed upon gasoline and motor-vehicle taxes, representing 37 percent of the total collections, or $1,233,000. Gasoline tax, a form of sales tax, varying in rates in the several States, represents 25 percent of the total collections of State taxes, and other taxes on motor vehicles for registration and operation, 12 percent. Gasoline tax, on the other hand, furnishes 5.75 percent of all Federal internal revenues, and motor-vehicle taxes, 2.66 percent. Pay-roll taxes have been omitted from these computations, although this form is employed in all 48 of the States. Next in importance as a form of taxation come sales and use taxes providing 14.73 percent of the States' revenues and only 4.1 percent of all Federal internal revenues. Income taxes in the individual and corporate forms provide approximately 10 percent of the States' revenues and 46 percent of Federal revenue, although this percentage is bound to increase proportionately under the new schedules. Taxes on alcoholic beverages provide 7.16 percent of States' revenues and 13.02 percent of Federal revenues, being fourth in importance in the States' schedules. Next in importance, primarily to the local governments, is property taxation, providing only 7.95 percent of State revenues, but 53.7 percent of all revenues collected in this country. Death taxes range next in importance in the State systems providing 3.5 percent of State revenues and 8 percent of Federal revenues. Rather than continue to cite figures of relative importance of taxes below the levels which we have referred to and which provide the principal sources of conflict or impact from the States' anticipated losses as a result of Federal legislation, an additional table has been attached to this presentation to furnish the elements for survey which seem important to the group for whom I speak.

Perhaps a discussion of each of the proposed taxes mentioned above will throw light upon this conflict between the State and Federal tax systems, even though it does not measure the competition for each source of taxable capacity.

CORPORATION INCOME TAXES

The Federal Government now levies excess-profit taxes, corporation-income taxes, and capital-stock taxes, and H. R. 5417 proposes to increase the corporation-income tax above to increase the yield by $1,300,000,000. This tax will conflict directly with the corporation-income tax of 33 States which levy taxes on corporate incomes, and indirectly with 34 States which levy on individual incomes. In 1940 the States raised 4.15 percent of their total taxable income exclusive of pay-roll taxes from this source. Even in 1940 the Federal Govern-

ment collected $3.27 from the tax on corporate incomes for every $1 the State collected. The States directly competing with the Federal Government in the taxation of corporations can be seen by examining table 3A.

INDIVIDUAL-INCOME TAXES

H. R. 5417 proposes to increase the yield by $864,800,000 the tax on individuals. This tax competes directly with individual-income taxes levied by 34 States, but most directly with the 20 States in which Federal income-tax payments are an allowable deduction. In 1940 the States collected 0.13 percent of their total income from taxes, exclusive of pay-roll taxes, from this source. In that year the Federal Government collected $4.66 from this source for every $1 the States separately reporting income taxes raised from this source. The States in which the Federal Government and the States compete for this taxable revenue may be seen by examining table 3B.

ESTATE AND GIFT TAXES

H. R. 5417 proposes to increase by $151,900,000 the tax on estate and gifts. All but one State in 1940 levied inheritance, estate, and/or gift taxes, collecting $118,000,000 from these taxes. This was 3.54 percent of their total tax receipts, exclusive of pay-roll taxes. During this same year the Federal Government collected $358,000,000 or $3.03 for every $1 the States collected. The trend in this direction is more fully evidenced by the fact that in 1926 total death taxes were divided 30 percent Federal and 70 percent State, while in 1939 the ratio is completely reversed. The States affected by this competition and the importance of that competition can be seen by examining tables 3C and 5.

TAX ON ALCOHOLIC LIQUORS

H. R. 5417 proposed to increase by $127,300,000 by further taxing alcoholic liquors. In 1940 all the States levied on this source, collecting 7.16 percent of all their taxes, exclusive of pay-roll taxes, from this source. This revenue amounted to $238,000,000, which was $1 for every $2.62 collected by the Federal Government. The relative importance of this tax to the various States can be seen by examining table 3D

SALES TAXES

H. R. 5417 proposes to levy taxes on certain manufactured articles. Twenty-three States now have general sales taxes. The total yield of this tax to the States amounted to $490,000,000. The proposed tax will not cover all the same taxable objects that are carried by the States, but there will be certain areas of conflict. The revenue derived from this source and its relative importance may be learned from table 3E.

OTHER MEANS IN WHICH THE FEDERAL AND STATE REVENUE SYSTEMS MAY CONFLICT

We are told on every hand that the defense expenditures of the Federal Government will bring at least a temporary prosperity which will of itself offset the decreases in State revenues, a generalization which will bear examination.

Prosperity means profits. If there are profits, the income-tax States allowing a deduction of Federal taxes paid will not benefit to the extent they otherwise would. The machinery for their capture are the (1) excess-profits tax, (2) corporation-income tax, (3) individual-income tax. There remains for the States the taxing of leavings of the anticipated prosperity. (Pay-roll taxes will not relieve the situation for they are earmarked.) This will leave only the States which levy general sales taxes to reap the benefits of general prosperity. The amounts collected from general sales taxes and their relative importance may be learned from table 3E.

If we have inflation, there will be a marked lag between the higher price level and increased State revenues from increased spending except in the case of the sales-tax States. There will be, however, no lag between increased State expenses and increased prices.

We also hear on every side that priorities will be invoked. It is now too early to discuss the impact of priorities on specific objects, except upon automo-

biles and gasoline; 25.41 percent of the tax revenues of the States came from a tax on motor fuel and 11.65 percent from the tax on auto licenses. If these proposals of priorities and rationing are effectuated, the States' revenues will be further reduced. The importance of levies on motorists in the States' fiscal system are shown in table 3F.

PURCHASING POWER

It seems necessary, however, for you to bear in mind any reduction in purchasing power resulting from the forces presently at work requires consideration in determining the effect on the fiscal problems of the States. Decline in the value of the dollar will be felt seriously in carrying on the programs of roads, highways, schools, welfare, and general government which have been identified since the beginnings of our form of government as functions of the State. Local responsibility and local obligation must be exercised for their support. It seems to be generally admitted by those in close touch with the situation that purchasing power will decline and, as it declines, to that extent will the difficulties of State finances increase.

The estimated tax yield or the yields for each State in 1939, be they unaffected in any other respect by Federal-tax legislation, would feel the impact of declining purchasing power in the reduced value of the tax dollar. The States furnish complete living costs to many of their unfortunates and governmental services of some types to all citizens. Your attention is invited to this factor of purchasing power as applied to State revenues and State expenditures to show the trend which may be expected and the embarrassment to either the revenue or the expenditure side of State budgets as this purchasing power declines during a period of price inflation.

CONCLUSION

The national income, no matter who be the recipients and in what proportion and in what manner it is divided between the several States, is the source from which the Federal Government has the authority to reach first; to cut the first slice of taxation, so to speak, before the remainder becomes available to the States. We would remind you of this primacy in the hope that no undue advantage is taken of it.

Attesting the interest which has manifested itself throughout the country in this subject, and which has prompted the group which I represent to call this situation to your attention, we have attached as appendix 6, quotations from letters endorsing the idea and measuring the seriousness of the situation in the opinion of the tax commissioners contacted throughout the country. Your attention is respectfully called to this exhibit for assurance that this presentation is prompted by concern for State revenues and should be implemented in the future by consultation before revenue legislation is adopted.

The States cannot afford to lost millions of dollars through the impacts of Federal legislation and continue to operate. We do urge upon you that State fiscal conditions involving taxation and expenditures can be foreseen more readily by those actively interested and immediately engaged in fiscal fields within the several States with a more intimate grasp than anyone else.

A group of State tax commissioners therefore, has sought this opportunity to be heard to offer assistance in measuring the effects of Federal legislation upon subsequent revenue policy.

APPENDIX

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TABLE 1.—*State expenditures and Federal grants-in-aid, 1938*

[000's omitted]

	Total State	Federal grants-in-aid	State and local relief	Percent relief	
				State	Local
Alabama	$57,217	$8,915	$250	48.9	51.1
Arizona	20,384	5,449	459	100.0	.....
Arkansas	33,976	8,290	220	100.0	.....
California	300,399	50,602	47,552	79.8	20.2
Colorado	54,019	13,758	2,347	63.1	36.9
Connecticut	53,491	8,618	6,878	24.1	75.9
Delaware	12,641	2,074	444	50.0	50.0
Florida	52,473	8,163	709	.....	100.0
Georgia	61,145	9,423	426	.....	100.0
Idaho	19,261	4,745	371	52.3	47.7
Illinois	185,405	36,071	48,433	74.8	25.2
Indiana	91,295	19,159	8,325	.....	100.0
Iowa	86,872	12,970	6,207	29.8	70.2
Kansas	41,441	8,825	3,415	30.0	70.0
Kentucky	51,130	9,036	541	.....	100.0
Louisiana	82,806	9,919	1,286	98.6	1.4
Maine	31,564	5,504	2,760	29.0	71.0
Maryland	54,950	8,233	2,527	11.1	88.9
Massachusetts	139,112	27,326	22,085	20.0	80.0
Michigan	169,645	24,086	17,836	55.3	44.7
Minnesota	118,865	17,438	12,656	24.1	75.9
Mississippi	47,493	7,309	51	.....	100.0
Missouri	85,808	19,493	4,358	95.8	4.2
Montana	20,194	6,209	966	47.1	52.9
Nebraska	29,148	8,035	1,105	.....	100.0
Nevada	7,438	2,523	99	3.4	96.5
New Hampshire	18,117	3,024	2,350	.....	100.0
New Jersey	114,435	16,235	18,319	71.7	28.3
New Mexico	26,898	3,788	157	89.9	10.1
New York	498,959	53,216	122,661	41.3	58.7
North Carolina	86,086	12,519	433	.....	100.0
North Dakota	20,018	3,344	955	49.9	50.1
Ohio	180,869	34,540	20,711	56.1	43.9
Oklahoma	82,658	15,645	708	53.2	46.8
Oregon	42,089	8,281	1,913	52.7	47.3
Pennsylvania	366,422	43,010	93,316	100.0	.....
Rhode Island	20,782	4,307	2,970	45.5	54.5
South Carolina	43,552	6,025	279	53.9	46.1
South Dakota	22,060	4,456	838	.....	100.0
Tennessee	55,522	11,676	321	.....	100.0
Texas	164,363	28,480	1,384	.....	100.0
Utah	25,821	5,459	1,363	84.7	15.3
Vermont	13,296	2,287	779	.....	100.0
Virginia	59,818	7,950	984	45.0	55.0
Washington	74,780	12,667	3,355	69.1	30.9
West Virginia	64,952	6,975	1,619	76.7	23.3
Wisconsin	92,604	16,539	12,537	10.5	89.5
Wyoming	12,571	3,308	431	65.1	34.9
Total	4,000,844	645,904	481,019	.....	.....

Source: Book of the States, Council of State Governments, 1941.

TABLE 2A.—*Determinants of taxable capacity of States, wealth basis*

[000's omitted]

Land area (square miles)	Population	Assessed value [1]	State	Bonded debt	
				State and local	Per capita
51	2,830	$936	Alabama	$213,066	$75.21
113	497	386	Arizona	76,555	153.42
52	1,918	447	Arkansas	214,187	109.89
155	6,873	7,004	California	1,538,597	222.76
103	1,118	1,102	Colorado	159,960	142.44
4	1,710	3,072	Connecticut	201,943	118.16
1	264	306	Delaware	27,282	102.18
54	1,877	533	Florida	433,092	223.03
58	3,119	961	Georgia	151,166	48.39
83	523	389	Idaho	67,714	128.98
56	7,874	5,159	Illinois	985,845	124.96
36	3,416	3,851	Indiana	167,561	48.88
55	2,535	3,218	Iowa	194,562	76.66
81	1,799	2,795	Kansas	116,649	64.77
40	2,839	2,757	Kentucky	130,059	47.81
45	2,355	1,341	Louisiana	394,275	166.78
29	845	672	Maine	68,385	80.74
9	1,811	2,890	Maryland	339,183	186.26
8	4,312	6,243	Massachusetts	648,787	150.29
57	5,245	6,391	Michigan	714,530	135.95
80	2,785	215	Minnesota	347,556	124.48
46	2,181	551	Mississippi	185,782	85.07
68	3,775	3,845	Missouri	333,772	88.18
146	554	1,030	Montana	62,917	112.55
76	1,313	2,033	Nebraska	125,781	95.58
109	110	192	Nevada	10,576	96.15
9	489	553	New Hampshire	39,309	79.89
7	4,148	5,514	New Jersey	1,216,264	292.37
122	528	312	New Mexico	69,313	130.29
47	13,379	5,623	New York	5,282,500	391.91
48	3,563	22,348	North Carolina	460,426	128.90
70	639	930	North Dakota	51,069	79.55
40	6,889	9,159	Ohio	761,071	110.17
69	2,329	1,224	Oklahoma	197,396	84.50
95	1,087	900	Oregon	187,893	172.38
44	9,891	2,205	Pennsylvania	1,611,952	162.82
1	711	11,543	Rhode Island	179,620	251.92
30	1,905	365	South Carolina	160,983	84.73
76	641	990	South Dakota	79,579	123.76
41	2,910	1,489	Tennessee	417,001	143.00
262	6,418	3,497	Texas	734,434	114.49
82	548	569	Utah	41,776	75.96
9	357	276	Vermont	24,142	67.25
40	2,664	2,104	Virginia	203,187	75.87
66	1,721	1,080	Washington	264,380	152.29
24	1,900	1,834	West Virginia	134,648	70.79
55	3,125	4,467	Wisconsin	151,328	48.22
97	246	328	Wyoming	37,910	151.04

[1] In millions only.

Source: Social Security Board Book of the States.

TABLE 2AA.—*Determinants of taxable capacity of States, income basis*

State	State revenue		State and local tax collections, percent of total income payments	State	State revenue		State and local tax collections, percent of total income payments
	Per capita	Percent of total income payments			Per capita	Percent of total income payments	
Alabama	$17.72	7.5	8.6	Nebraska	18.45	4.6	12.2
Arizona	25.00	5.5	13.0	Nevada	35.19	4.8	10.0
Arkansas	14.94	6.4	8.1	New Hampshire	27.40	5.4	10.9
California	39.19	5.4	10.9	New Jersey	26.96	4.4	14.0
Colorado	29.33	5.9	11.5	New Mexico	37.33	11.8	11.7
Connecticut	33.88	4.8	8.5	New York	29.00	3.6	12.2
Delaware	42.91	5.5	7.2	North Carolina	23.46	8.1	9.2
Florida	26.12	6.1	11.8	North Dakota	21.19	6.5	12.7
Georgia	14.87	5.3	8.3	Ohio	27.29	4.9	9.2
Idaho	26.97	6.2	12.0	Oklahoma	27.28	8.1	14.5
Illinois	24.47	4.1	10.7	Oregon	27.28	5.3	11.2
Indiana	24.49	5.3	9.6	Pennsylvania	(1)	(1)	8.6
Iowa	26.51	6.2	14.4	Rhode Island	29.65	3.3	9.4
Kansas	23.42	5.7	13.4	South Carolina	16.35	6.6	9.7
Kentucky	16.81	5.7	9.4	South Dakota	26.41	7.6	16.0
Louisiana	29.01	8.6	14.9	Tennessee	14.66	5.1	8.8
Maine	28.49	6.2	12.7	Texas	19.94	4.7	9.6
Maryland	24.61	4.4	8.9	Utah	35.12	7.9	13.6
Massachusetts	30.92	4.6	10.9	Vermont	31.20	6.8	10.2
Michigan	33.01	6.0	11.1	Virginia	21.42	5.0	7.2
Minnesota	35.53	7.3	12.3	Washington	37.04	6.6	9.3
Mississippi	12.84	6.6	13.7	West Virginia	27.67	7.6	9.1
Missouri	19.14	4.2	10.1	Wisconsin	31.98	6.5	12.4
Montana	26.51	5.2	13.2	Wyoming	30.78	6.3	11.9

[1] Not available.

Source: Social Security Board.

TABLE 2AA.—*Determinants of taxable capacity of States, income basis*

INCOME PAYMENTS, 1939

State	Amount (000,000)	Percent of United States total	Per capita	Percent of United States average	Percent wages and salaries of total income payments, 1939
Alabama	$686	1.0	$243	45	58.6
Arizona	225	.3	456	85	59.6
Arkansas	472	.7	244	46	44.1
California	5,122	7.3	753	140	57.9
Colorado	581	.8	522	97	54.7
Connecticut	1,310	1.9	768	143	63.9
Delaware	222	.3	843	158	46.4
Florida	843	1.2	457	85	54.4
Georgia	905	1.3	292	54	58.1
Idaho	234	.3	453	85	53.0
Illinois	5,027	7.2	640	119	63.6
Indiana	1,684	2.4	494	92	63.6
Iowa	1,128	1.6	446	83	48.1
Kansas	739	1.1	411	77	53.6
Kentucky	847	1.2	300	56	55.4
Louisiana	820	1.2	350	65	57.4
Maine	404	.6	481	90	60.4
Maryland	1,070	1.5	505	111	63.3
Massachusetts	3,035	4.3	705	132	61.9
Michigan	3,125	4.5	604	113	69.2
Minnesota	1,398	2.0	505	94	56.7
Mississippi	441	.6	203	38	43.8
Missouri	1,782	2.5	472	88	60.0
Montana	304	.4	552	103	58.2
Nebraska	552	.8	421	79	52.4
Nevada	88	.1	806	150	65.9

TABLE 2AA.—*Determinants of taxable capacity of States, income basis*—Continued

State	Amount (000,000)	Percent of United States total	Per capita	Percent of United States average	Percent wages and salaries of total income payments, 1939
New Hampshire	254	0.4	519	97	61.4
New Jersey	2,674	3.8	(1)	(1)	64.0
New Mexico	170	.2	323	60	51.8
New York	10,991	15.7	825	154	59.9
North Carolina	1,068	1.5	302	56	57.8
North Dakota	231	.3	362	68	43.3
Ohio	4,181	6.0	608	113	64.6
Oklahoma	797	1.1	343	64	49.7
Oregon	591	.8	545	102	62.8
Pennsylvania	5,678	8.1	575	107	64.0
Rhode Island	473	.7	666	124	64.1
South Carolina	508	.7	268	50	58.1
South Dakota	239	.3	373	70	46.0
Tennessee	856	1.2	296	55	60.4
Texas	2,558	3.7	401	75	53.2
Utah	245	.4	449	84	61.2
Vermont	174	.2	486	91	57.5
Virginia	1,019	1.5	385	72	63.2
Washington	1,041	1.5	606	113	63.6
West Virginia	712	1.0	378	71	68.1
Wisconsin	1,555	2.2	501	93	61.4
Wyoming	152	.2	623	116	55.9

[1] Not available.

Source: Social Security Board.

TABLE 2B.—*Classification of State tax systems*

States employing:
- Income, sales, and inheritance forms:
  - With State property tax:
    - Alabama
    - Arkansas
    - California
    - Iowa
    - Kansas
    - Mississippi
    - Missouri
    - New Mexico
    - Oklahoma
    - South Dakota
    - West Virginia
  - Without State property tax:
    - Arizona
    - Colorado
    - North Dakota
    - North Carolina
- Death tax forms only:
  - With property tax only:
    - Florida
    - Maine
    - Nebraska
    - New Jersey
    - Rhode Island
    - Texas

States employing:
- Income and inheritance forms (no sales):
  - With State property tax:
    - Georgia
    - Indiana
    - Kentucky
    - Louisiana
    - Maryland
    - Minnesota
    - Montana
    - Tennessee
    - Vermont
    - Virginia
  - Without State property tax:
    - Connecticut
    - Delaware
    - Indiana
    - Massachusetts
    - New Hampshire
    - New York
    - Oregon
    - Pennsylvania
    - South Carolina
    - Wisconsin
- Property tax only:
  - Nevada

Source: Prentice-Hall, Inc., Tax Diary and Manual, 1941, and reports of State tax commissioners.

TABLE 3.—*Amount of tax collected and relative importance of receipts from selected taxes, State and Federal Governments, 1940 (social-security taxes excluded)*

[000's omitted]

Kind of tax	Federal collections[1]		State collections[2]		Local collections[3]	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Motor	$119,402	2.66	....	....	....	....
Fuel	257,149	5.75	$845,421	25.42	$4,351	0.10
Auto license	....	....	387,747	11.65	1,788	.04
Sales	183,669	4.11	490,187	14.73	68,004	1.53
Property	....	....	261,653	7.95	4,175,416	93.81
Income:						
Corporations	1,114,424	24.91	138,076	4.15	....	....
Individual	950,834	21.25	203,984	6.13	....	....
Death	357,630	7.99	117,903	3.54	431	....
Liquor	622,991	13.92	238,149	7.16	3,315	.07
Tobacco	608,070	13.59	97,052	2.92	5,158	.12
All others	259,980	5.82	544,055	16.35	192,277	4.33
Total	4,474,149	100.00	3,327,227	100.00	4,450,743	100.00

[1] Report of the Commissioners of Internal Revenue, 1940, table 1.
[2] Special Report No. 10, Bureau of the Census, Department of Commerce.
[3] State Tax Yields, 1939, Tax Policy League.

TABLE 3A.—*Relationship between corporation income taxes collected by States, and corporation income taxes collected in those States by the U. S. Government, 1940*[1]

[In thousands of dollars]

	Percent of total State taxes collected	Corporation income taxes collected—		For every $1 States collect, U. S. Government collects—
		By States	By U. S. Government	
Total, 30 States	....	$138,076	$159,295	$3.27
Total 46 States	4.15	....	1,114,424	8.07
Alabama[2 3]	3.36	1,536	4,402	2.87
Arizona[2 3]	3.01	511	908	1.83
Arkansas[4]	1.12	344	1,955	5.68
California	8.10	20,597	60,680	2.95
Colorado[3 4]	.82	286	8,270	2.89
Connecticut	8.28	3,651	19,170	5.25
Delaware	....	....	41,185	....
Florida	....	....	6,377	....
Georgia[3 4]	6.01	2,700	8,696	3.22
Idaho[2]	12.73	1,540	1,613	1.05
Illinois	....	....	95,931	....
Indiana	....	....	16,606	....
Iowa[3]	1.41	915	7,728	8.45
Kansas[3]	2.00	767	4,630	6.04
Kentucky[4]	4.55	1,945	9.887	5.08
Louisiana	3.80	2,722	8,147	2.99
Maine	....	....	3,272	....
Maryland	2.93	1,298	14,859	11.45
Massachusetts	.62	752	36,353	48.34
Michigan	....	....	83,905	....
Minnesota[2 3]	3.75	2,842	17,341	6.10
Mississippi[4]	2.61	852	1,641	1.93
Missouri[5]	....	....	35,145	....
Montana[3]	5.61	688	1,754	2.55
Nebraska	....	....	4,648	....
Nevada	....	....	1,128	....
New Hampshire	....	....	1,686	....
New Jersey	....	....	38,589	....
New Mexico[3 4]	1.72	279	560	2.01
New York	8.68	39,529	282,417	7.12
North Carolina	11.55	8,657	16,463	1.90
North Dakota[2 3]	1.49	196	376	1.92
Ohio	....	....	73,841	....
Oklahoma[3]	7.07	3,918	10,620	2.71
Oregon[2 3]	7.04	1,844	3,882	2.11
Pennsylvania	9.32	23,777	87,516	3.68

[1] Exclusive of social-security taxes. [2] 1938 data. [3] Federal income tax deductible as an expense. [4] 1939 data. [5] Not reported separately.

TABLE 3A.—*Relationship between corporation income taxes collected by States, and corporation income taxes collected in those States by the U. S. Government, 1940* [1]—Continued

[In thousands of dollars]

	Percent of total State taxes collected	Corporation income taxes collected—		For every $1 States collect, U. S. Government collects—
		By States	By U. S. Government	
Rhode Island			5,487	
South Carolina [4]	5.10	1,571	3,512	2.26
South Dakota [3] [5]			512	
Tennessee	3.61	1,562	7,663	4.91
Texas			31,574	
Utah [3]	1.51	769	2,077	2.70
Vermont [2] [3]	1.74	179	1,227	6.80
Virginia	5.74	2,690	17,131	6.37
Washington			7,817	
West Virginia			6,883	
Wisconsin [3]	10.81	9,126	17,694	1.94
Wyoming			543	

[1] Exclusive of social-security taxes.
[2] 1938 data.
[3] Federal income tax deductible as an expense.
[4] 1939 data.
[5] Not reported separately.

Source: Same as table 3.

TABLE 3B.—*Relationship between individual income taxes collected by the States and individual income taxes collected in those States by the U. S. Government, 1940* [1]

[In thousands of dollars]

	Percent of total State taxes collected	Individual income taxes collected—		For every $1 States collect, United States Government collects—
		By States	By Federal Government	
Total, 31 States		203,084	520,098	$2.59
Total, 46 States	6.15		950,834	4.66
Alabama [2] [3]	2.39	1,091	4,293	.39
Arizona [3] [4]	3.24	586	1,492	.25
Arkansas [3] [4]	1.11	342	2,001	5.85
California	7.70	19,572	70,719	3.61
Colorado [3] [4]	3.02	1,056	7,676	7.27
Connecticut			20,579	
Delaware	15.48	1,662	24,727	14.88
Florida			18,765	
Georgia [4]	5.08	2,283	8,258	3.62
Idaho [2]	5.06	699	823	1.18
Illinois			84,083	
Indiana [5]			14,641	
Iowa [3]	0.11	3,973	4,817	1.21
Kansas [3]	3.51	1,349	3,291	2.44
Kentucky [3]	5.50	2,351	5,499	2.34
Louisiana [3]	3.34	2,401	8,280	3.45
Maine			6,152	
Maryland	14.25	6,338	21,175	3.34
Massachusetts [4]	16.85	20,292	41,139	2.03
Michigan			42,623	
Minnesota [2]	4.07	3,079	13,874	4.51
Mississippi [4]	2.62	855	1,491	1.74
Missouri [3] [6]			21,510	
Montana [3]	4.43	543	1,360	2.51
Nebraska			2,856	
Nevada			2,039	
New Hampshire	4.52	587	2,401	4.09
New Jersey			40,733	
New Mexico [3] [6]	1.66	268	1,030	3.84
New York	23.87	108,734	246,026	2.26
North Carolina	4.37	3,278	10,245	3.13
North Dakota [2] [3]	3.22	293	394	1.35
Ohio			48,506	

[1] Exclusive of social-security taxes.
[2] 1938 data.
[3] Federal income tax payments are deductible as an expense.
[4] 1939 data.
[5] Federal income tax payments are deductible as an expense in special cases.
[6] Not reported separately.

TABLE 3B.—*Relationship between individual income taxes collected by the States and individual income taxes collected in those States by the United States Government, 1940*[1]—Continued

	Percent of total State taxes collected	Individual income taxes collected—		For every $1 States collect, United States Government collects—
		By States	By Federal Government	
Oklahoma [3]	4.37	2,424	6,184	2.55
Oregon [2]	13.81	3,616	3,624	1.00
Pennsylvania	.....	.....	84,050	.....
Rhode Island	.....	.....	7,037	.....
South Carolina [4]	3.84	1,186	1,858	1.57
South Dakota [3 6]	.....	.....	471	.....
Tennessee	3.86	1,670	7,929	4.75
Texas	.....	.....	30,073	.....
Utah [3]	4.71	803	1,286	1.60
Vermont [2 5]	5.62	580	1,239	2.14
Virginia	4.15	1,943	10,060	5.18
Washington	.....	.....	6,537	.....
West Virginia [3]	3.47	1,598	4,083	2.55
Wisconsin [3]	10.11	8,532	11,824	1.39
Wyoming	.....	.....	1,062	.....

[1] Exclusive of social-security taxes.
[2] 1938 data.
[3] Federal income tax payments are deductible as an expense.
[4] 1939 data.
[5] Federal income tax payments are deductible as an expense in special cases.
[6] Not reported separately.

Source: Same as table 3.

TABLE 3C.—*Relationship between Federal and State death taxes collected, 1940*

[In thousands of dollars]

State	Inheritance, estate, and gift taxes collected—			For every $1 State collects, United States Government collects—
	By States		By Federal Government, amount	
	Amount	Percent [1]		
47 States	$117,903	3.54	$357,630	$3.03
Alabama	262	.57	2,002	7.64
Arizona	167	.92	910	5.45
Arkansas	235	.76	309	1.31
California	10,530	4.64	28,351	2.69
Colorado	1,207	3.45	2,800	2.32
Connecticut	3,590	8.14	8,821	2.46
Delaware	472	4.39	4,512	9.56
Florida	923	1.70	7,077	7.67
Georgia	472	1.05	3,735	7.91
Idaho	80	.66	154	1.93
Illinois	4,384	2.19	18,063	4.12
Indiana	1,230	1.67	4,082	3.07
Iowa	1,021	1.57	1,932	1.89
Kansas	375	.97	1,335	3.56
Kentucky	1,200	2.81	1,842	1.54
Louisiana	638	.89	4,002	6.27
Maine	661	3.22	1,685	2.55
Maryland	1,721	3.87	5,130	2.98
Massachusetts	9,373	7.78	21,077	2.34
Michigan	2,736	1.86	12,959	4.74
Minnesota	1,355	1.79	3,364	2.48
Mississippi	49	.15	487	9.94
Missouri	1,962	2.68	7,298	3.72
Montana	187	1.52	301	1.61
Nebraska	155	.62	1,518	9.79
Nevada	.....	.....	330	.....
New Hampshire	1,103	8.50	2,218	2.01
New Jersey	5,621	5.27	16,985	3.02
New Mexico	44	.27	1,319	29.98
New York	28,956	6.36	102,483	3.54

[1] Exclusive of social-security taxes.

TABLE 3C.—*Relationship between Federal and State death taxes collected, 1940*—Continued

[In thousands of dollars]

State	Inheritance, estate, and gift taxes collected—			For every $1 State collects, United States Government collects—
	By States		By Federal Government, amount	
	Amount	Percent [1]		
North Carolina	1,009	1.35	1,833	1.82
North Dakota	41	.31	151	3.68
Ohio	4,561	2.21	20,812	4.57
Oklahoma	1,635	2.95	3,085	1.89
Oregon	652	2.49	636	.98
Pennsylvania	19,575	7.68	37,787	1.93
Rhode Island	1,206	7.16	5,016	4.16
South Carolina	141	1.45	803	5.70
South Dakota	52	.32	61	1.17
Tennessee	854	1.97	2,948	3.45
Texas	713	.58	4,663	6.54
Utah	164	.96	467	2.85
Vermont	250	2.42	541	2.16
Virginia	722	1.54	3,419	4.74
Washington	1,445	2.39	1,648	1.14
West Virginia	521	1.13	1,267	2.43
Wisconsin	3,508	4.16	4,267	1.22
Wyoming	46	.66	215	4.67

[1] Exclusive of social-security taxes.

Source: Same as table 3.

TABLE 3D.—*Relationship between taxes on alcoholic beverages collected by the States and taxes on alcoholic beverages collected by the United States Government in those States, 1940*

[In thousands of dollars]

	Percent of total State taxes collected [1]	Taxes on alcoholic beverages		For every $1 the States collected, the U. S. Government collects—
		Collected by the States	Collected by the U. S. Government	
48 States	7.16	238,149	322,991	$2.62
Alabama	1.05	478	102	.21
Arizona	7.73	1,398	256	.18
Arkansas	8.84	2,715	153	.06
California	6.29	15,994	36,034	2.25
Colorado	7.20	2,515	1,723	.69
Connecticut	10.33	4,558	3,484	.76
Delaware	7.01	752	263	.35
Florida	10.23	5,548	1,708	.31
Georgia	7.70	3,459	613	.18
Idaho	1.99	241	230	.95
Illinois	5.93	11,900	83,842	7.05
Indiana	9.25	7,359	67,459	9.17
Iowa	1.82	1,183	800	.68
Kansas	1.39	534	136	.25
Kentucky	15.75	6,729	68,933	10.24
Louisiana	4.42	3,171	7,410	2.34
Maine	7.25	1,487	53	.04
Maryland	10.03	4,473	39,107	8.74
Massachusetts	7.35	8,852	14,835	1.68
Michigan	4.96	7,280	16,230	2.23
Minnesota	7.00	5,302	14,341	2.70
Mississippi	2.22	723	71	.10
Missouri	7.89	5,769	23,846	4.13
Montana	11.05	1,356	990	.73
Nebraska	7.41	1,865	1,802	.97
Nevada	5.68	212	117	.55
New Hampshire	5.65	734	215	.29
New Jersey	9.25	9,859	26,530	2.69
New Mexico	4.54	734	37	.05
New York	9.23	42,043	61,663	1.47
North Carolina	3.02	2,262	682	.30
North Dakota	5.85	768	62	.08

[1] Exclusive of social-security taxes.

TABLE 3D.—*Relationship between taxes on alcoholic beverages collected by the States and taxes on alcoholic beverages collected by the United States Government in those States, 1940*—Continued

	Percent of total State taxes collected [1]	Taxes on alcoholic beverages		For every $1 the States collected, the U. S. Government collects—
		Collected by the States	Collected by the U. S. Government	
Ohio	15.52	32,091	32,679	1.02
Oklahoma	.62	346	498	1.44
Oregon	3.02	792	883	1.11
Pennsylvania	8.36	21,312	70,125	3.29
Rhode Island	3.41	1,245	3,239	2.60
South Carolina	.51	159	215	1.35
South Dakota	9.23	1,506	67	.04
Tennessee	2.70	1,167	846	.72
Texas	5.66	6,949	4,949	.71
Utah	.70	119	612	5.14
Vermont	10.04	1,036	37	.04
Virginia	3.96	1,854	1,333	.72
Washington	5.17	3,118	4,652	1.49
West Virginia	2.48	1,110	260	.23
Wisconsin	3.22	2,722	28,553	10.49
Wyoming	4.94	310	316	.93

[1] Exclusive of social-security taxes.

Source: Same as table 3.

TABLE 3E.—*Amount of State taxes collected from the general property and general sales and percent of total taxes collected, by States, 1940*

[In thousands of dollars]

	General property taxes	Percent of total State tax collections	General sales taxes	Percent total State taxes
48 States	264,653	7.95	490,187	14.73
Alabama	5,103	11.17	7,756	16.98
Arizona	4,739	26.20	4,010	22.17
Arkansas	3,282	10.69	5,514	17.96
California	13,265	5.22	93,780	36.89
Colorado	5,008	14.34	8,810	25.22
Connecticut	4,410	10.00		
Delaware				
Florida	2,677	4.94		
Georgia	4,828	10.75		
Idaho	2,684	22.19		
Illinois	282	.14	90,818	45.29
Indiana	6,850	8.61	23,538	29.58
Iowa	7,103	10.93	16,858	25.94
Kansas	6,027	15.66	10,080	26.23
Kentucky	5,192	12.15		
Louisiana	7,723	10.77	[1] 7,473	10.43
Maine	5,044	24.58		
Maryland	5,781	13.00		
Massachusetts	16,030	13.31		
Michigan	9,772	6.65	60,374	41.14
Minnesota	13,520	17.86		
Mississippi	2,450	7.51	6,713	20.68
Missouri	5,233	7.15	23,019	31.47
Montana	1,785	14.55		
Nebraska	5,337	21.22		
Nevada	1,166	31.22		
New Hampshire	1,401	10.82		
New Jersey	26,580	24.93		
New Mexico	2,280	14.09	4,198	25.94
New York	2,977	.65		
North Carolina	2,690	3.59	12,208	16.29
North Dakota	3,438	26.06	3,099	23.49
Ohio	6,775	3.28	50,985	24.66
Oklahoma	53	.09	10,952	19.76
Oregon				
Pennsylvania	22,007	8.63		
Rhode Island				
South Carolina	946	3.07		

[1] Repealed.

TABLE 3E.—*Amount of State taxes collected from the general property and general sales and percent of total taxes collected, by States, 1940*—Continued

[In thousands of dollars]

	General property taxes	Percent of total State tax collections	General sales taxes	Percent total State taxes
South Dakota	963	5.90	4,504	27.61
Tennessee	1,286	2.97		
Texas	22,276	18.13		
Utah	4,243	21.88	4,109	21.62
Vermont	471	4.57		
Virginia	2,650	5.65		
Washington	3,199	5.30	20,689	34.28
West Virginia	783	1.70	18,608	40.10
Wisconsin	13,829	16.38		
Wyoming	510	7.32	1,961	28.14

Source: Same as table 3.

TABLE 3F.—*Amount of taxes collected from motorists and of percent of total taxes States, 1940*

[In thousands of dollars]

	Fuel taxes collected	Percent of total	Auto licenses	Percent of total
48 States	845,421	25.41	387,747	11.65
Alabama	15,301	33.49	3,600	7.88
Arizona	4,610	25.49	1,163	6.43
Arkansas	11,013	35.88	3,438	11.20
California	51,144	20.12	14,654	5.76
Colorado	9,252	26.48	2,343	6.71
Connecticut	10,568	23.96	7,140	16.19
Delaware	2,205	20.54	1,131	10.54
Florida	25,511	47.05	7,328	13.52
Georgia	21,614	48.11	2,895	6.44
Idaho	5,281	43.66	328	2.71
Illinois	43,688	21.79	24,187	12.06
Indiana	24,565	30.87	11,798	14.82
Iowa	16,771	25.81	11,650	17.93
Kansas	10,054	26.16	4,204	10.94
Kentucky	13,458	31.50	3,471	8.12
Louisiana	18,251	25.46	5,401	7.53
Maine	6,133	29.89	4,090	19.93
Maryland	11,232	25.26	4,525	10.17
Massachusetts	21,134	17.55	7,379	6.13
Michigan	31,243	21.29	22,125	15.08
Minnesota	18,646	24.63	9,512	12.57
Mississippi	12,101	37.10	2,567	7.87
Missouri	13,904	19.01	10,741	14.69
Montana	5,030	41.01	1,084	8.84
Nebraska	11,800	47.15	2,834	11.27
Nevada	1,510	40.43	291	7.79
New Hampshire	3,716	28.86	2,966	22.85
New Jersey	23,271	21.83	20,119	18.87
New Mexico	4,975	30.74	2,004	12.38
New York	70,931	15.57	50,950	11.19
North Carolina	25,916	31.62	8,655	11.55
North Dakota	2,292	17.37	1,622	12.29
Ohio	51,428	24.87	28,318	13.70
Oklahoma	14,495	26.15	6,161	11.12
Oregon	12,381	47.28	3,603	13.76
Pennsylvania	57,007	22.16	37,464	14.69
Rhode Island	3,847	22.91	3,457	20.59
South Carolina	12,838	41.64	1,915	6.21
South Dakota	5,412	33.18	937	5.74
Tennessee	19,664	45.42	4,903	11.32
Texas	45,918	37.39	8,889	7.23
Utah	3,871	22.71	1,218	7.14
Vermont	2,703	26.21	2,599	25.20
Virginia	18,236	39.90	7,071	15.09
Washington	16,234	26.90	5,909	9.79
West Virginia	10,690	23.21	5,304	11.52
Wisconsin	20,670	24.48	13,196	15.63
Wyoming	2,756	39.54	604	8.67

Source: Same as table 3.

TABLE 5.—*Trend in death-tax collections, 1926–39, by States*

[Money figures in thousands of dollars]

	Collections		Percentage collections	
	Federal [1]	State [2]	Federal	State
Alabama:				
1926	305	.....	100.00	.....
1930	251	.....	100.00	.....
1936	591	103	85.16	14.84
1939	1,097	198	84.71	15.29
Arkansas:				
1926	24	291	7.61	92.39
1930	31	282	9.90	90.10
1936	216	96	69.23	30.77
1939	281	174	61.75	38.25
California:				
1926	4,212	7,420	36.21	63.79
1930	1,748	11,647	13.05	86.95
1936	20,599	6,561	75.84	24.16
1939	22,228	8,372	72.64	27.36
Colorado:				
1926	56	876	6.01	93.99
1930	49	900	5.16	94.84
1936	1,568	717	68.62	31.38
1939	1,587	944	62.70	37.30
Connecticut:				
1926	842	2,407	25.44	74.56
1930	1,475	3,606	29.02	70.98
1936	9,411	2,486	79.10	20.90
1939	10,445	3,684	73.92	26.08
Delaware:				
1926	129	140	47.95	52.05
1930	640	1,852	25.68	74.32
1936	619	459	57.42	42.58
1939	1,807	258	87.50	12.50
Florida:				
1926	1,816	.....	100.00	.....
1930	4,104	.....	100.00	.....
1936	1,807	3,391	34.76	65.24
1939	14,987	4,535	76.77	23.23
Georgia:				
1926	87	160	35.22	64.78
1930	71	359	16.51	83.49
1936	2,065	86	95.38	4.62
1939	2,001	236	89.45	10.55
Idaho:				
1926	1	22	4.34	95.66
1930	1	35	2.77	97.23
1936	55	79	41.04	58.96
1939	174	108	61.70	38.30
Illinois:				
1926	1,643	6,805	19.44	80.56
1930	1,707	16,091	9.59	90.41
1936	26,130	3,868	87.10	12.90
1939	22,076	5,636	79.66	20.34
Indiana:				
1926	146	1,047	12.23	87.77
1930	505	1,450	25.83	74.17
1936	3,156	1,081	74.48	25.52
1939	2,395	1,071	69.09	30.91
Iowa:				
1926	137	1,110	10.98	89.02
1930	34	1,233	2.68	97.32
1936	740	1,139	39.38	60.62
1939	1,669	1,616	52.40	47.60
Kansas:				
1926	80	511	13.53	86.47
1930	56	684	7.56	92.44
1936	693	436	61.38	38.62
1939	992	500	66.48	33.52
Kentucky:				
1926	99	639	13.41	86.59
1930	218	1,024	17.55	82.45
1936	1,439	334	81.16	18.84
1939	2,726	1,867	59.35	40.65

[1] Reports of the Commissioner of Internal Revenue.

[2] Financial Statistics of States, Department of Commerce, and Tax Policy League. Includes gift-tax collections for those States employing such tax.

TABLE 5.—*Trend in death-tax collections, 1926–39, by States*—Continued

[Many figures in thousands of dollars]

	Collections		Percentage collections	
	Federal	State	Federal	State
Louisiana:				
1926	499	606	45.15	54.85
1930	100	688	12.69	87.31
1936	790	532	59.75	40.25
1939	1,577	677	69.96	30.04
Maine:				
1926	124	667	15.67	84.33
1930	270	1,010	21.09	78.91
1936	1,416	672	67.81	32.19
1939	1,677	578	74.36	25.64
Maryland:				
1926	1,079	800	57.42	42.58
1930	641	1,415	31.17	68.83
1936	3,810	1,419	72.86	27.14
1939	10,565	2,005	84.04	15.96
Massachusetts:				
1926	2,950	6,495	31.23	68.77
1930	1,846	14,337	11.40	88.60
1936	19,015	6,221	75.35	24.65
1939	19,037	11,082	63.20	36.80
Michigan:				
1926	739	2,100	26.03	73.97
1930	1,189	5,420	17.99	82.01
1936	8,192	2,107	79.54	20.46
1939	11,230	4,964	69.35	30.65
Minnesota:				
1926	372	924	28.71	71.29
1930	1,097	1,529	41.77	58.23
1936	1,732	1,235	58.37	41.63
1939	4,662	1,980	70.18	29.82
Mississippi:				
1926	16	269	5.62	94.38
1930	25	41	37.87	62.13
1936	285	36	88.78	11.22
1939	481	100	82.78	17.22
Missouri:				
1926	856	1,901	31.04	68.96
1930	270	3,841	6.56	93.44
1936	3,936	1,522	72.11	27.89
1939	11,735	1,625	87.83	12.17
Montana:				
1926	3	514	.59	99.41
1930	110	212	34.16	65.84
1936	148	97	60.40	39.60
1939	159	232	40.66	59.34
Nebraska:				
1926	123	----------	100	----------
1930	30	19	61.22	38.78
1936	618	37	94.35	5.65
1939	1,360	87	93.98	6.02
Nevada:				
1926	----------	1	----------	100
1930	6	6	100	----------
1936	218	----------	100	----------
1939	134	----------	100	----------
New Hampshire:				
1926	77	339	18.51	81.49
1930	150	480	23.81	76.19
1936	2,214	490	81.87	18.13
1939	641	743	46.31	53.69
New Jersey:				
1926	2,236	7,104	23.94	76.06
1930	6,292	15,766	28.52	71.48
1936	16,301	21,748	42.84	57.16
1939	16,488	6,916	70.44	29.56
New Mexico:				
1926	----------	23	----------	100.00
1930	5	65	7.14	92.86
1936	116	188	38.15	61.85
1939	47	51	47.95	52.05
New York:				
1926	10,035	22,295	31.03	68.97
1930	14,350	50,487	22.13	77.87
1936	105,896	26,420	80.03	19.97
1939	91,482	35,582	71.99	28.01

TABLE 5.—*Trend in death-tax collections, 1926–39, by States*—Continued

[Many figures in thousands of dollars]

	Collections		Percentage collections	
	Federal	State	Federal	State
North Carolina:				
1926	218	828	20.84	79.16
1930	53	1,195	4.24	95.76
1936	4,871	530	90.18	9.82
1939	2,194	881	71.34	28.66
North Dakota:				
1926	6	36	14.28	85.72
1930	1	31	3.12	96.88
1936	63	68	48.09	51.91
1939	76	32	70.37	29.63
Ohio:				
1926	2,246	2,099	51.69	48.31
1930	754	2,999	20.09	79.91
1936	12,770	3,401	78.96	21.04
1939	14,362	5,446	72.50	27.50
Oklahoma:				
1926	23	293	7.27	92.73
1930	201	187	51.80	48.20
1936	382	451	45.85	54.15
1939	1,008	565	64.08	35.92
Oregon:				
1926	26	528	4.69	95.31
1930	84	1,230	6.39	93.61
1936	1,200	323	78.79	21.21
1939	792	498	61.39	38.61
Pennsylvania:				
1926	5,036	14,070	29.67	70.33
1930	2,554	26,844	8.68	91.32
1936	26,582	18,724	58.67	41.33
1939	32,395	21,077	60.58	39.42
Rhode Island:				
1926	267	404	39.79	60.21
1930	252	6,155	3.93	96.07
1936	3,854	893	81.18	18.82
1939	5,681	1,318	81.16	18.84
South Carolina:				
1926	54	256	17.41	82.59
1930	22	260	7.80	92.20
1936	410	296	58.07	41.93
1939	630	191	76.73	23.27
South Dakota:				
1926	1	158	.62	99.38
1930	7	192	3.51	96.49
1936	88	86	50.57	49.43
1939	94	41	69.62	30.38
Tennessee:				
1926	80	648	10.98	89.02
1930	161	340	32.13	67.87
1936	806	646	55.50	44.50
1939	2,204	1,438	60.51	39.49
Texas:				
1926	1,319	1,101	54.50	45.50
1930	420	782	34.94	65.06
1936	2,483	1,143	68.47	31.53
1939	4,666	604	88.53	11.47
Utah:				
1926	21	294	6.66	93.34
1930	4	381	1.03	98.97
1936	229	139	62.22	37.78
1939	195	336	36.72	63.28
Vermont:				
1926	83	226	26.86	73.14
1930	75	507	12.88	87.12
1936	723	326	68.92	31.08
1939	636	317	66.73	33.27
Virginia:				
1926	102	610	14.32	85.68
1930	188	1,090	14.64	85.36
1936	1,406	930	60.18	39.82
1939	2,829	830	77.31	22.69
Washington:				
1926	37	546	6.34	93.66
1930	113	543	17.22	82.78
1936	1,448	1,783	44.81	55.19
1939	3,696	2,018	64.68	35.32

TABLE 5.—*Trend in death-tax collections, 1926–39, by States*—Continued

[Many figures in thousands of dollars]

	Collections		Percentage collections	
	Federal	State	Federal	State
West Virginia:				
1926	54	801	6.31	93.69
1930	148	750	16.48	83.52
1936	522	491	51.53	48.47
1939	958	700	57.78	42.22
Wisconsin:				
1926	313	2,034	13.33	86.67
1930	488	2,461	16.54	83.46
1936	9,253	3,226	74.14	25.86
1939	3,195	3,635	46.77	53.23
Wyoming:				
1926	15	48	23.80	76.20
1930	29	67	30.20	69.80
1936	143	66	68.42	31.58
1939	110	43	71.89	28.11
Arizona:				
1926	97	102	48.74	51.26
1930	3	283	1.04	98.96
1936	52	26	66.67	33.33
1939	83	406	16.97	83.03
Total, by years:				
1926	39,584	90,608	30.40	69.60
1930	42,828	180,776	19.15	80.85
1936	301,061	117,108	71.99	28.01
1939	331,544	136,097	70.89	29.11

TABLE 6

Name and office	State and date of letter	Excerpt quoted from letter
George P. Alderson, State tax commissioner.	West Virginia, Aug. 15, 1941	"I fully endorse the proposed conference to determine the effect of the impact of pending Federal tax legislation."
Charles V. Galloway, chairman, State tax commission.	Oregon, Aug. 15, 1941	"The Oregon Tax Commission is deeply interested in the results of the survey you propose and whole heartedly favors a cooperative effort to reconcile conflicts between Federal defense taxation and the necessary revenue requirements of the States."
Elmer E. Barlow, commissioner of taxation.	Wisconsin, Aug. 14, 1941	"I feel this will be a very helpful conference and bring about some excellent results."
E. A. Dye, chairman, State board of equalization.	Montana, Aug. 15, 1941	"The competition between the States and Federal Government in their mad scramble for revenue is becoming a problem which must some day be solved. The taxing plans of the two governments should be harmonized. Both are invading the same field; a division of these fields by some equitable plan would enable the man who foots the bill to exercise his citizenship rights more directly and more forcefully."
J. D. Carmichael, chairman, tax commission.	Oklahoma, Aug. 12, 1941	"The pending legislation will materially reduce our income-tax collections."
John C. Curry, commissioner of revenue.	Alabama, Aug. 14, 1941	"We are, of course, concerned with the relationship of the Federal tax system with that of the States as a whole and we are willing to work in cooperation with the other tax commissioners in handling such matters."
Dixwell L. Pierce, secretary, State board of equalization.	California, Aug. 14, 1941	"It seems clear that as the Federal share of the tax dollar increases, the State will have greater difficulty in securing sufficient funds for its expenses. Every effort should be made by those responsible for the Federal legislation to minimize as much as possible its impact on State finances."

TABLE 6—Continued

Name and office	State and date of letter	Excerpt quoted from letter
Frank J. Brady, State tax commissioner.	Nebraska, July 31, 1941.....	"Certainly the Federal Government should not preempt every right of taxation."
Walter J. Kress, acting secretary of revenue.	Pennsylvania, Aug. 1, 1941....	"The contemplated cut in gasoline sales is going to seriously affect State revenues."
William S. Evatt, tax commissioner.	Ohio, July 29, 1941.....	"There appears to be no question but that the matter of the impact upon State revenue of a number of proposed Federal tax measures should be given consideration from a State viewpoint."
John G. Marston, secretary, State tax commission.	New Hampshire, July 25, 1941.	"We are ready to cooperate in any way possible that offers any protection to the States."
George E. Hill, State tax assessor.	Maine, July 28, 1941.....	"In order to maintain the integrity of the several States which comprise the Union, it is, of course, fundamental that the integrity of their powers of taxation be at all times preserved."
A. J. Maxwell, commissioner of revenue.	North Carolina, Aug. 13, 1941..	"Gasoline and general sales taxes will be affected by Government priorities that will reduce the sale of particular items of merchandise."
Will M. Lynn, chairman, board of equalization.	Wyoming, Aug. 2, 1941.....	"We certainly want to cooperate with you in every way possible on any legislation that will affect State revenues."
George H. Sheppard, comptroller of public accounts.	Texas, July 29, 1941..	"With reference to pending revenue legislation before Congress, I am of the opinion that conference held with State officials would probably be beneficial."
W. G. Query, chairman, tax commission.	South Carolina, July 29, 1941..	"Instead of the high rates contained in the pending legislation before Congress on the sources of State revenues, I would much prefer imposing higher excises on certain nonessential commodities."
John McCuish, chairman, State commission of revenue and taxation.	Kansas, July 25, 1941.....	"The State of Kansas is very much concerned about this legislation. It is apparent that our revenue would be affected adversely."
Henry O. Levin, chairman, State tax commission.	Maryland, July 25, 1941.....	"This matter has given us a great deal of concern."
Charles J. McLaughlin, tax commissioner.	Connecticut, July 24, 1941.....	"Relating to pending revenue legislation before the Congress which may severely affect State revenues, I heartily agree that something should be done about this matter."
A. H. Stone, chairman, State tax commission.	Mississippi, July 29, 1941.....	"I agree as to the wisdom of cooperative action to protect the States against the disastrous inroads of Federal revenue legislation."
George B. McKibbin, director of finance.	Illinois, July 29, 1941.....	"I concur with suggestion that State tax administrators take some action in calling to the attention of Congress any adverse effect which proposed Federal tax legislation might have on State revenues."
Gilbert K. Hewit, director, gross income tax and store license division.	Indiana, Aug. 6, 1941.....	"We would be very glad to cooperate in any way in order to clarify the situation as between the States and Federal activities."

The CHAIRMAN. Professor Lutz.

STATEMENT OF DR. HARLEY L. LUTZ, PROFESSOR OF PUBLIC FINANCE, PRINCETON UNIVERSITY, PRINCETON, N. J.

The CHAIRMAN. Dr. Lutz, do you desire to speak generally on this tax question, or particularly with reference to the suggestions heretofore made by you regarding the withholding of the tax?

Dr. LUTZ. Principally on that point, Senator.

The CHAIRMAN. Do you desire to make your main statement without interruption and yielding to questions thereafter?

Dr. LUTZ. I think that would be desirable, if the committee is willing.

The CHAIRMAN. Very well. You may proceed. We will not interrupt you until you finish.

Dr. LUTZ. Mr. Chairman, I should like to hand you a document entitled "Taxation v. Inflation," prepared jointly by Willard D. Arant and myself, to be inserted in the record at the conclusion of my remarks as a part of my testimony.

The CHAIRMAN. Yes. You may hand it to the reporter.

Dr. LUTZ. I have also handed you an outline of the remarks that I propose to make.

My purpose in this statement is to urge on the committee the adoption of a new and productive method of defense taxation as a substitute for the House bill. This method is a tax on all income payments to individuals, to be withheld or collected at source wherever possible. By income payments to individuals, I mean wages and salaries, interest and dividends, net rents and royalties, and entrepreneurial withdrawals. The tax is not intended to apply to the gross income of business as such.

I would label it a defense tax, and would suggest a time limit to its operation despite the unfortunate history of a similar limit in the First Revenue Act of 1940.

I. *Two major reasons may be given for this proposal.*—1. The vastly greater revenue productivity and ease of carrying the tax load under such a plan than under the pending tax program.

2. Some seriously objectionable features of the House bill (one highly objectionable feature has already been removed from the original bill by the House).

II. *A bit of background.*—1. In April, the Treasury proposed 3.5 billions of new revenues, to establish a ratio of one-third loans, two-third taxes in financing the defense program. In his statement to this committee in August, Mr. Morgenthau said of the House bill:

> The rapid developments of the last few months have made this bill inadequate even before it is passed.

2. Before this committee the Secretary of the Treasury also said:

> To solve that problem (i. e., the problem of adequate defense production) without impairing our economy or weakening the structure of democracy, our fiscal policy must be adapted to the needs of the times.

3. A third passage from Mr. Morgenthau's statement to this committee is the following:

> If, in an attempt to protect the incomes of our people, we hold down taxes and as a result, the cost of living rises, we shall have taxed them just as surely as if we had levied on them directly—and we shall still have the inflated costs of defense to pay later from taxes.

III. *Advantages of a tax on income payments to individuals.*—1. A tax on individual income payments meets the specifications so recently set out by Mr. Morgenthau more completely than any other proposal of which I am aware.

(*a*) *The present bill is inadequate for revenue purposes.*—A tax on individual gross income, at the rate which I proposed last January, namely, 10 percent, with no deductions or exemptions, will raise twice as much money as the present bill. According to testimony before this committee, the 1941 income will amount to eighty-eight to ninety billions of dollars. Allowing liberally for leakage, a 10-percent tax should produce seven billions. It will begin to produce at that rate at once. The House bill is not only inadequate as to the total yield but also as to prompt availability of such revenue as it may produce. The first full fiscal year under it would be 1942–43. Its inadequacy by that time I leave you to judge.

(*b*) *Fiscal policy must be adapted to the needs of the times.*—The House bill follows the conventional and obsolete pattern of the first World War taxes. By comparison, the plan which I offer is streamlined. It is unconventional, but if we try now to observe convention in finance, it would be like sending Pershing's army with its 1918 equipment against Hitler's mechanized divisions. We already have a widely accepted and generally approved instance of withholding today, namely, the social security tax on employees. In this case there is no question of exemption, dependents, or total earnings, except as to the income above $3,000, to which the tax does not apply.

(*c*) *In financing defense, the obvious choice is between taxation and inflation.*—The plan which I propose will be far more effective than the present bill as an inflationary curb because—

i. It will siphon off much more purchasing power;

ii. It will curtail proportionately the purchasing power of all consumers, instead of applying rigid curtailment to only a portion of the eighty-eight or ninety billions of national income;

iii. It will reach the great mass of purchasing power which cannot be reached under the present conventional methods of taxation;

iv. It will be a more effective inflation curb than price control;

v. It will preserve us from the regimentation inherent in price control.

So far as inflation is concerned, it is later than we think. Evidence accumulates to show that the pressure of purchasing power on the available supply of consumer goods is creating that ground swell of rising prices which is the forerunner of the disastrous tidal wave of inflation.

(*d*) The proposed tax provides the only way by which the income-tax base can be extended downward.

i. There is general agreement that the income base should be broadened;

ii. But there is no appreciation of the difficulties involved in doing this under the existing types of income tax, namely, by simply lowering the exemptions;

iii. The present tax is applicable, administratively, only to the well-to-do, since it involves accumulation of a tax reserve out of the income of 1 year for tax payment in the following year.

iv. Mr. Morgenthau's plan for a simplified return, as outlined to this committee, is ingenious, but it misses the main point, which is that the people with small incomes cannot and will not set up income-tax reserves for perfectly obvious reasons:

a. They have no bank account or safety deposit box and must hoard cash. The tax stamp or tax note plan has the same draw-back for the small taxpayer;

b. A cash hoard runs the double risk of loss by fire, theft, or carelessness, and of being raided for other purposes. As the "piggy" bank fills up the chances that it will be broken grow in geometric ratio. Even governmental bodies with large cash reserves have suffered from defalcation, and in other instances they have used cash reserves for purposes other than the earmarked one.

v. It does not follow that small incomes cannot or should not be taxed directly, providing this be done in a proper way. That way is by collection at source. When the tax is withheld the individual adjusts his plans to what is left. This is a very different matter from spending the income first and then becoming liable for a tax on it.

2. The tax on income paid out to individuals is superior to a general manufacturer's excise or a sales tax because—

(*a*) It will apply to a larger base and will produce far more revenue;

(*b*) It will avoid the price distortions caused by the pyramiding and shifting of excise or sales taxes;

(*c*) There is far less leakage through avoidance. Excise and sales taxes can always be avoided in some degree by not buying the articles that are heavily taxed.

3. This tax will keep debt increase to the minimum; and thus it will—

(*a*) Lessen the post-defense taxes for debt service;

(*b*) Lessen the risk of direct or indirect debt repudiation.

4. I would not urge this plan, however, except as a substitute for the present bill, or for the parts of it applicable to individuals. If the proposed tax rates are imposed, the burden of meeting the increase to be levied on 1941 income will fall in large measure on next year's income, or on capital funds, as pointed out below. That burden, plus the budgeting out of 1942 incomes for the heavier taxes that would be due on next year's income, will make it impossible for many to bear, in addition, a heavy tax collected at the source.

IV. *Some possible objections to the proposed tax.*—

1. It will unduly burden small incomes. My answer is:

(*a*) Defense production is now burdening them and will burden them still more as the diversion of goods from civilian use proceeds;

(*b*) Price inflation will burden them even more heavily than this tax;

(*c*) The proposed tax tends to limit the burden on the small-income group, while the method of collection makes the load easier to carry. Under inflation there can be no limit to the burden and no one can be shielded from it.

2. Difficult to collect from the self-employed.

(*a*) I grant this; but

(*b*) Many self-employed will provide their own informational check in ordinary income-tax returns.

Senator TAFT. Will not nearly every self-employed person have to file an income-tax return?

Dr. LUTZ. It depends on where you set the exemptions, Senator, but I think it is true that this obstacle has been exaggerated. I think you can get directly from the individual, or in other ways, a very substantial amount of informational control over the base to which I am referring here.

(*c*) Local revenue agents and county agricultural agents can be utilized as well to give aid and instruction to farmers and small entrepreneurs under this kind of tax as under the present income tax.

I was informed by my colleague in this document, Taxation Versus Inflation, Mr. Arant, who lives in Oregon, of an item in his own paper some months ago relative to the fact that the county agents were even then being instructed to aid farmers in the preparation of their income-tax returns under the anticipated income tax.

Now, if they can help them under that tax, certainly they can help them just as well in preparing returns under this tax.

3. It will lead to demand for pay increases.

(*a*) Such demands have already been made, and others will no doubt be made. I do not agree that any group would be so unpatriotic as to make a specific demand to shift a defense tax in this way.

(*b*) If the economic basis of defense and of fiscal policy were to be correctly and adequately put before the people, as a matter of good public relations, any attempt to avoid this tax by demanding pay increases would appear to be as unpatriotic as resistance to selective service.

V. *Some objections to the House bill.*—The time limit compels me to single out only certain features of the House bill for specific adverse comment. These are:

1. Retroactive application of the taxes on incomes and profits.

(*a*) Business concerns are likely to be less severely affected here than individuals, although there may be cases in which the earnings of the second half or of the last quarter will be insufficient to provide for the necessary enlargement of tax reserves.

(*b*) There may be a collateral effect upon individuals, arising from the possibility of sharp reduction of dividend payments through the remainder of this year as a result of the necessary increases of tax reserves. Individuals whose principal source of income is dividends may be acutely embarrassed to provide for their own heavier taxes under H. R. 5417, because of the sudden and unanticipated drying up of dividend income.

(*c*) In the case of most individuals, all income received during 1941 would be taxable at the new rates of the House bill. Retroactive taxation is the most indefensible of all tax policies. This would be clear if it were proposed to make excise taxes retroactive, thereby compelling all who had bought taxable articles since January 1, 1941, to pay more taxes.

Senator CLARK. They go back to July 1 in the case of furs and jewelry, I believe.

Senator CONNALLY. That is in reference to installments.

Dr. LUTZ. I have not caught that in the bill, but I think they will have a nice time collecting from all the people who bought furs since July 1.

Senator CONNALLY. That is only insofar as installment sales are concerned.

Dr. LUTZ. There you have a definite record. That is the kind of situation over which you might have some control. You could not exercise it over excise taxes generally, obviously.

For some curious reason, it is not perceived that the income which the great mass of the people received and spent during the first half of 1941 is gone as completely as are the beer and cigarettes consumed in that period. It is no more logical to ask them, at this late date, to pay additional tax on income that has disappeared than it would be to ask them to pay extra tax on the beer and cigarettes that have also disappeared.

(*d*) In order to bring out the appalling significance of the individual surtax increases I have prepared the following table:

Increases in surtax on 1941 individual incomes, as proposed in H. R. 5417, above surtax at the rates of the 1940 act, compared with the taxpayer's average monthly income

Surtax income	1940			1941			Increase 1941 over 1940		Taxpayer's average monthly income [1]
	Surtax	10 percent	Total	Surtax	10 percent	Total	Amount	Percent	
$2,000				$100	$10	$110	$110		$333
$4,000				260	26	286	286		500
$6,000	$80	$8	$88	480	48	528	440	$500	667
$8,000	200	20	220	780	78	858	638	290	833
$10,000	360	36	396	1,160	116	1,276	880	222	1,000
$12,000	560	56	616	1,600	160	1,760	1,144	186	1,167
$14,000	800	80	880	2,100	210	2,310	1,430	162	1,333
$16,000	1,100	110	1,210	2,660	266	2,926	1,716	141	1,500
$18,000	1,460	146	1,606	3,280	328	3,608	2,002	124	1,667
$20,000	1,880	188	2,068	3,940	394	4,334	2,226	109	1,833
$22,000	2,360	236	2,596	4,660	466	5,126	2,530	97	2,000
$26,000	3,440	344	3,784	6,220	622	6,842	3,058	81	2,333
$32,000	5,240	524	5,764	8,740	874	9,614	3,850	67	2,833
$38,000	7,220	722	7,942	11,440	1,144	12,584	4,642	58	3,333
$44,000	9,380	938	10,318	14,320	1,432	15,752	5,434	53	3,833
$50,000	11,780	1,178	12,958	17,320	1,732	19,052	6,094	47	4,333

[1] The average monthly income is computed on the assumption that the taxpayer had $2,000 in addition to his surtax income, being his personal credit as a married person or head of a family, without dependents.

This table shows the increases in surtax only, at the rates of the House bill, over the amounts that would be payable under the rates of the 1940 act. It takes no account of normal tax, which would be the same in any case. The last column of the table shows the taxpayer's average monthly income, assuming that in each case there is to be added to the surtax income the $2,000 now permitted married persons and heads of families, without dependents.

The person with surtax income of $2,000 is therefore deemed to have total annual income of $4,000. His surtax increase will require one-third of a month's income. The person with $6,000 has an increase of more than half a month's pay. At every point between an annual income of $14,000 and $52,000, the surtax increase will require more than 1 whole month's salary to meet it.

In the case of a person with $52,000, you know it will take a month and a half on the total income which he would receive from now until December 31, in order to pay simply the increase in his surtax, which he would have to pay at the present House rate.

When we consider the fact that we are now in mid-August, and that a considerable time must yet elapse before the bill is finally passed and the rates estabished, it becomes apparent that many persons will be wholly unable to make provision for this increase out of

the remainder of the current year's income. They dare not carry too much of the 1941 tax into 1942 as a charge against 1942 income, for they must begin to budget the whole of the new tax against that year's income. It is to be confidently anticipated, if rates such as these are made retroactive, that many persons will finance their taxes by loans on insurance policies, by loans from banks and personal finance companies, and by selling securities or other property.

This kind of taxation forces the individual into deficit financing, and an individual's deficit is always a reduction of his net worth. In other words, the tax is very likely to be, in fact a tax on capital rather than on income.

2. I have three objections to enter, very briefly, against the proposed changes in the so-called excess-profits tax. These are:

(*a*) The change in the tax deductions, whereby excess profits are determined prior to deduction of ordinary income tax.

(*b*) The graduation of excess-profits tax rates to the absolute amount of such profit, and particularly the proposed rate increase while this rule is used.

(*c*) The special 10-percent tax on profits which exceed base-period income although not in excess of credit allowable on invested capital.

All of these points have a common basis, namely, that the matters referred to have no relation to any reasonable or logical conception of excess profit.

(*a*) With respect to measuring excess profit by earnings before deduction of ordinary income tax, it is clear that there can be no question of earnings or profits of any sort until all of the fixed charges have been met. The ordinary corporation tax, having been in effect since 1913, and being intended to remain in effect long after the excess-profits tax will have been repealed, is certainly one of these fixed charges. Whether a corporation has earned normal, subnormal, or excess profits in relation to average base-period earnings, or invested capital is a matter of significance only as it indicates the relative return to shareholders. Whether that return is to be regarded as more or less than it should be is a question that can be answered only by reference to the earnings after taxes. The whole subject of an excess profit is hopelessly obscured and befuddled by any other approach.

(*b*) A similar criticism applies to the basis of graduating the excess-profits tax rates. Whether the amount of excess profit be determined by reference to average base period earnings or to invested capital, this absolute amount has significance, as an excess, only by reference to the appropriate base. Because of this wholly indefensible departure from the logic of an excess profits concept, any further increase of the rates of tax deserves to be rejected.

(*c*) The special 10-percent tax is described as follows in the Ways and Means Committee report:

> The existing law does not subject to the excess-profits tax earnings which are not in excess of the greater of the average earnings for the base period and the invested capital credit. Thus, many corporations which are making added profits directly or indirectly attributable to Government expenditures for the national defense are paying no additional taxes upon such profits. It is felt that such corporations, benefiting so substantially from the defense expenditures, should make a larger contribution from their increased income even though their income for the taxable year is still less than the invested capital credit.[1]

[1] Committee on Ways and Means, report to accompany H. R. 5417 (77th Cong., 1st sess., House of Representatives, Rept. No. 1040), p. 25.

There is also a scuttling of the excess-profits concept. The law provides that only the earnings above a certain rate on invested capital shall be deemed to be excess profits. By the above proposal, any increase of earnings is to be regarded as an excess profit even if the total earnings, after the increase, are still below the rate on invested capital which the law says shall not constitute an excess profit.

As we consider these and other devices in the House bill, its undesirability becomes more evident. In order to make up a total of 3.5 billions by conventional tax methods, it was necessary to scrape the bottom of the barrel by including nuisance taxes estimated to yield, in some cases, only a million dollars or so.

I submit to you that the time is at hand to make a bold departure in taxation for defense by substituting such a tax as I have proposed.

The time for it is ripe—

Fiscally, because of the urgent need of revenue; politically, because it provides universal support for the defense program; economically, because the dread spectre of inflation haunts us, and it can be exercised most effectively by drastic taxation now.

(The treatise referred to and submitted by Dr. Lutz, entitled "Taxation versus Inflation" is as follows:)

TAXATION VERSUS INFLATION, A STUDY IN THE ECONOMICS OF DEFENSE FINANCING

By WILLARD D. ARANT, Research Director, the National Economy League, and HARLEY L. LUTZ, Professor of Public Finance, Princeton University. Published in the Nation's interest by the National Economy League

FOREWORD

During the War between the States, Secretary Chase told a group of New York bankers: "Gentlemen, the war must go on until this rebellion is put down, if we have to put out paper until it takes $1,000 to buy a breakfast."

This statement indicates a fundamental fallacy in regard to war or defense financing. Wars are not won by money but by the labor of human beings diverted from peacetime pursuits. While the issue of greenbacks under Chase's administration did not raise the price of a breakfast to $1,000, inflation was allowed to proceed far enough to increase the cost of the war by 25 percent, and the economic results of inflationary financing were felt for a generation. Our experience during the World War was much the same.

The present defense effort has been financed thus far largely by borrowing, and a sharp price rise, which was forecast if this method were pursued, is already in evidence. Congress has under consideration a tax measure to raise $3,500,000,000 annually in new revenue, but the taxes included therein are both inadequate as to aggregate amount and poorly distributed in their effect on different segments of the national income. That a system of universal taxation at a substantial rate is urgently needed, is now recognized by the Chairman of the House Ways and Means Committee.

This study sets forth the reasons why prices cannot be controlled by democratic means as long as the budgetary position is unsound. Various possible taxes are reviewed, and a universal income tax collected at the source is recommended as a special defense measure. This tax was first proposed by Professor Harley L. Lutz in a pamphlet, Financing the Defense Program, published by the League in February 1941. It is now reconsidered in the light of criticisms that have been made, and in the light of the present financial outlook.

H. G. W. SUNDELOF, *Executive Director.*

AUGUST 1941.

TAXATION VERSUS INFLATION

The purpose of the defense effort is to obtain the greatest output of supplies for the soldier while maintaining as far as possible the necessary supplies for the civilian. Under emergency conditions, direct economic controls replace to a large extent the normal and somewhat cumbersome functions of money, credit, and prices.

The purpose of war finance is only to make the stream of dollars flow along the course which has already been marked out by the compulsions of defense. The stream will not change its course automatically. Financial engineers must construct diversion dams to direct the flow into the channels previously agreed upon by the defense engineers.

Defense needs will be met in any case, partly by normal marketing processes, direct negotiations, and cooperative action but, when necessary, by governmental law or decree. Those goods and services which are less important will be, and are being, curtailed when they conflict with defense. The prospect is for automobile production to give way to tank and aircraft production. Household fixtures may give way to naval equipment, and silk stockings to parachutes.

Consumers in normal times vote with their dollars as to what will be produced, and the more or less automatic price changes control the economic decisions of the Nation's factories. In a wartime economy, a consumer may "vote" for an aluminum utensil, but he will not have his wish fulfilled, since he has already voted, through governmental processes, to use the available aluminum for bombing planes.

What, then, does he buy with the money he would otherwise have spent for the restricted articles? In the absence of controls over his total spending he attempts to purchase more of such articles as are available to him. Other consumers pursue the same course, and at the present time nearly one dollar out of every ten which cross the retailer's counter is a dollar which has been added to the money stream of the country through credit expansion—the Government has borrowed money from the banking system and injected it into the marketplace through defense spending, without at the same time taking adequate steps to reduce the money supply at other points.

The output of goods to meet this new demand can be expanded somewhat, but thus far the expansion has proved disappointing to those who predicted no difficulty in "finding expression" for consumers' desires to spend. Defense needs cover a wider field than had been realized in some quarters. When no further expansion is possible, consumers' money demand is expressed, not in more sales, but in higher prices. A sharp price rise disrupts the processes of exchange which must be performed by money even in a defense economy, slows down the defense effort, and has serious repercussions on civilian morale.

Some ground has already been lost in the effort to stop inflation. ("Inflation" will be used here to indicate a serious price rise such as that which occurred in the United States during the World War period, when the cost of living more than doubled; not to indicate an explosive movement which completely destroys the value of the currency.) The cost of living has risen 4 percent since February 1941. Wholesale prices have increased 12 percent in the last 18 months, and the Bureau of Labor Statistics index is currently rising about 1 point a week. The Bureau of Labor Statistics index of sensitive commodity prices, which foreshadows further increases in wholesale and retail prices, now stands 48 percent above the pre-war level.

Forces converging on prices

Of the various sources of new money operating to intensify the demand for goods, relative to their supply, the Federal deficit is the most important. However, emphasis on fiscal theory in recent years has tended to focus attention unduly on the deficit, to the exclusion of other powerful factors which are now beginning to operate. The omission of many of these forces from the calculations of fiscal optimists is, at least in part, responsible for our late start in attempting to control inflation.

The extent to which Federal credit is employed outside the Budget, through governmental corporations and credit agencies, has been too little recognized by the public, and this fact makes their operations especially insidious as an inflationary influence. While the Treasury has taken some steps to finance the budgetary deficit outside the banks, no such concern has been evidenced over the marketing of the obligations of Government corporations, practically all of which are exchanged for new bank credit. The Reconstruction Finance Corporation has made large commitments for plant construction, purchase of strategic materials, farm security, farm tenant, and rural electrification loans. The Commodity Credit Corporation has been granted additional authority to lend over $1,000,000,000 on farm crops, and the extent of these loans is made directly dependent on the price level by the "parity" formula. Government loan rates will rise *pari passu* with the level of nonfarm prices. Further use of credit is stimulated by Federal policies in the housing field, which have been maintained in spite of the reversal of the economic conditions under which they were

established. Substantial issues of local housing bonds, under the United States Housing Authority program, are being purchased currently by financial institutions, and Congress has recently extended and expanded the Federal Housing Administration program. None of these activities is reflected in the official Federal deficit, yet all serve to expand the money demand for commodities.

National-defense contracts have an effect on business spending long before Government funds actually leave the Treasury. For example, the Defense Contract Service of the Office of Production Management recently reported that banks in 101 cities had made defense loans and commitments of $1,100,000,000.

Apart from credit expansion, which increases the quantity of funds in circulation, the employment of funds previously held idle is a strong factor in forcing up prices. Business balances are now being used to finance plant expansion in both defense and nondefense fields, and the balances of consumers—supplemented by installment credit—are circulating more rapidly.

Liquidation of foreign assets to pay for war materials ordered in this country is also a source of upward pressure on commodity prices, insofar as the funds are obtained from idle balances or new bank loans.

The effect of these various types of Government, business, and consumer spending is indicated in the Federal Reserve Board's report that bank debits in 274 reporting centers for the 3 months ending July 31, 1941, were 24 percent above the volume of the corresponding 1940 period. A part of the increase corresponds with increases in employment and production. The remainder was permitted, through the hesitancy of the Government to apply adequate controls, to be reflected in the price rises already noted.

The requirements of "all-out" defense

Although the Federal deficit was only one of the stimulative elements in the economy during the last year, the defense spending outlined for the coming months will place the Federal Budget in a dominant position. The manner in which Federal finances are managed will determine the functioning of production and trade, the distribution of income, and the success of the defense program itself.

During the fiscal year ended June 30, 1941, Federal expenditures exceeded revenues by $5,200,000,000. Of the total expenditures of $13,100,000,000, national defense accounted for $6,000,000,000 and nondefense expenditures for $7,100,000,000. Regular sources of income provided $7,300,000,000, and $600,000,000 was obtained from surplus funds of Government corporations—a nonrecurring item.

The first Revenue Act of 1940 contained special tax levies to be earmarked for defense, but the unfortunate fact has been that the proceeds of both the First and Second Revenue Acts of 1940 have not sufficed, thus far, to cover the ordinary Federal expenditures apart from the emergency defense program. Revenues in the fiscal year recently closed exceeded nondefense expenditures by the slight margin of $200,000,000, exclusive of capital funds returned to the Treasury. Assuming that the national-defense outlay of $1,500,000,000 in the fiscal year 1940 represents the preemergency cost of defense, the revenues of 1941 failed to cover the "ordinary" expenditures by $1,300,000,000. Even if capital funds returned are counted as revenues—which may perhaps be justified for the year in which they are realized—the 1941 deficit in the nonemergency budget stands at $700,000,000. It is therefore correct to say that only after a year of intensive defense preparation have we come at last to a consideration of how and where to get the money to meet the extraordinary costs.

The rate of defense spending will increase sharply during the fiscal year 1942. The Bureau of the Budget has revised its January estimate of $10,800,000,000 upward to $15,500,000,000, and the Office of Production Management has estimated that approximately $24,000,000,000 would be spent on the basis of an all-out effort. Even on the basis of the Budget Bureau's figure, total Federal expenditures would be $22,200,000,000. With revenues from existing taxes now estimated at $9,400,000,000, the deficit to be covered by new taxes and by borrowing is $12,800,000,000.

The rate of expenditures, and therefore the financial problem, may be increased still further by the demands of new appropriations and more speedy letting of contracts. Defense production will require an enormous diversion of machinery and labor from peacetime pursuits in any case, but the lack of a comprehensive plan of defense and of an integrated defense administration means there will be an intense competition among those in the Goverment who think that naval ships, or merchant ships, or aircraft, or other things are most essential. The result of

this may be an undue increase in prices and costs. Additional defense appropriations should be viewed in the light of industrial experience in meeting the requirements of earlier appropriations. As recently expressed by the New York Times:

"Congress has been in the habit of passing these defense appropriations not only without real debate but even without that sort of careful examination which makes clear to the country the purpose for which the money is being spent, and which makes sure that the funds are going for the right things and not for wrong things. * * * It may only cause needless concern about the Budget, while not speeding up but rather retarding our real defense effort, to keep piling up new appropriations without constantly reviewing old ones. The defense program can get in its own way unless it is subject to a constant over-all supervision and to its own internal system of intelligent priorities as worked out by a general War Planning Board."[1]

It is not generally appreciated, as yet, that the "all out" defense program, when it eventually hits its full stride, will require a substantial part of our total current production. The critical situation already in evidence with respect to certain materials will spread over a much wider area. Some products will be wholly withdrawn from the civilian market. The supply of others will be drastically reduced. The underlying theory of priority control is the curtailment of private use.

The standard of living must be correspondingly lowered. We face a situation which to some may appear paradoxical; a rising "national income" and a lowered standard of living. But the standard of living depends upon the quantity of goods available for consumption rather than upon the flow of purchasing power which goes to make up the aggregate of national income expresses in money terms. Leon Henderson, who until recently held an optimistic view of the Nation's ability to expand production without curtailing consumer purchasing power, on July 14 warned against "a spurious prosperity based on production of goods that we can't wear, or eat, or live in." Wages and profits received for the production of armaments cannot be spent by individuals for the product of their own labors. Only the Government can pay for armaments, through the commandeering of purchasing power equivalent to the value of the goods it must commandeer for defense.

The automobile program for 1942 has already been cut by 20 percent, or 1,000,000 units. At an average value of $800 per unit, this priority step releases $800,000,000 in consumer purchasing power. An equivalent amount of money should be transferred to the Government by taxation at the same time that automobile labor and plant resources are transferred to defense work. If this is not done, the flood of purchasing power pressing against the prices of living necessities will overwhelm those who have been unable to get their own incomes on higher grounds.

It is clear therefore, that sacrifices must be made by the present body of consumers, to the extent necessary for defense. The choice lies between bearing the burden through orderly taxation, or bearing it through the disorders of a price inflation. A decision to pay as we go through an evenly distributed system of tax levies is much to be preferred to the erratic penalties of a drastic price rise.

In an inflationary period a few persons are in a position to ride the crest of a speculative wave, others are barely able to keep their heads above water, and many are submerged under a rising tide of prices. Taxation reduces speculative activity by siphoning off the purchasing power which serves to raise prices. (Strictly speaking, the problem is to reduce the number of dollars in the market place, not to reduce "purchasing power." Purchasing power—the ability to buy things—will be reduced by inflation if it is not reduced by taxation.) There is little question but what a substantial part of the rise in the cost of living which has already occurred would have been prevented by an adequate tax program.

The dislocations of the post-armament period will be held to a minimum only if financial management during the armament period has been competent. Donald M. Nelson, Director of Purchases for the Office of Production Management, recently said:

"I see all the elements working up for a runaway price situation and my one hope is that we are going to be smart enough and energetic enough to head it off. I doubt very much whether even as great a country as ours can stand two great deflations in one lifetime without bringing about fundamental changes in its form of government and its economic system."

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[1] New York Times, July 15, 1941. Cf. The National Economy League, Defense Planning: A National Need, Dec. 23, 1940.

Price fixing not sufficient

Price controls and taxation are not to be considered entirely as alternative weapons in the fight on inflation. Both are needed. Even though purchasing power were not increased by loan financing, some prices would be affected by extraordinary demands or short supplies, including rents in some areas, and control over these, by governmental authority if necessary, is desirable. But the control of strategic prices is a far simpler task than the control of all prices. The World War experience proved that purchasing power prevented from being used at one point soon found its way to other points in the system, forcing up prices there, just as a toy balloon which is depressed at one point will be further inflated at others. Commenting on the experience of the War Industries Board in his book, Taking the Profits Out of War, Mr. Bernard Baruch has said, "Individual price fixing can never stop inflation." Consequently, Mr. Baruch recommends a "price ceiling" plan to fix maximum levels for all prices, subject to revision with Government approval.

The price-control bill introduced in Congress on August 1 would provide legal authority for carrying out the price-ceiling plan. While first operations would be restricted to specific commodities, the possibility of extending control over commodities in general was admitted by Mr. Henderson in testimony August 6. The effectiveness of the measure is severely hampered by the absurdly high levels set for farm commodities (110 percent of "parity," or the price on July 29, 1941, whichever is higher). Another possible source of failure is the omission of legal authority to control wages. While prices in most cases are pulled up by the increased money demand of consumers, rather than being pushed up by wage increases, the attempt to control prices will be extremely difficult so long as both of these conditions prevail: (1) The money demand for commodities is not reduced, and (2) wages are left free to rise. If purchasing power is reduced by adequate taxation, it may not be necessary to apply wage controls generally.

The inevitable ramifications of the price-ceiling plan have not been adequately appreciated. When there is a shortage of real supplies and a surplus of nominal purchasing power at prevailing prices, the temptation is strong to engage in transactions at prices above the ceiling. In order to maintain the ceilings on every commodity and every service, the Government would require a police force of tremendous proportions, and would have to be prepared to enforce drastic penalties to prevent bootlegging in scarce commodities. To extend this process over the whole economy would be to adopt the totalitarian way of solving economic problems.

No form of compulsion that can be exercised in a democracy will be capable of preventing inflation as long as the Government continues to add to the public's supply of liquid funds through defense spending, and fails to withdraw an adequate amount in taxes.

Defense bonds a partial remedy

Insofar as borrowing is necessary, the sale of bonds to the public and to savings institutions is a much safer procedure than the sale of bonds to commercial banks. The defense-bond campaign, by taking dollars that would otherwise be spent, absorbs income, while bank financing creates dollar income. The most optimistic estimates of defense-bond sales, however, fall far short of the prospective deficit for the fiscal year 1942. The failure to economize in nonessential spending is one factor discouraging the sale of defense bonds. The amount that would have to be borrowed from the banking system, on the basis of the present outlook, is of a magnitude carrying immediate inflationary dangers.

Recognizing the limits to voluntary purchase of defense bonds, some students of the problem have urged the Government to inaugurate a system of forced savings. By this method, a portion of the people's income would be forcibly taken by the Government to pay for the goods which have been taken for armament. The immediate result, as far as inflation is concerned, would be the same as if the income had been taken by taxation. Both methods involve compulsion, and when compulsion has to be used, there is little reason to prefer borrowing over taxation.

Future burden of debt

Up to this point consideration has been given to the task of controlling inflation during the armament period. The financial program should also be viewed in terms of debt increase.

The defensive arming of a nation should proceed on a pay-as-we-go basis, President Roosevelt said on December 5, 1938. Armament, he added, was not a self-liquidating program. However, the current official attitude on defense financing and the long-range debt problem is expressed by a statement in the Budget message of January 3, 1941, that "the main fiscal problem is not the rise of the debt, but the rise of debt charges in relation to the development of our resources."

The real burden of the debt is not to be judged in such boom years as the defense spending may produce, but in the worst years that may lie ahead of us. We do not measure the debt-carrying capacity of a private business by the ratio of debt charges to earnings in its best years, but by that ratio in the leanest years of the business. We have excellent prospects of being burdened with a debt of $90,000,000,000, as Secretary of Commerce Jesse H. Jones has predicted, or of $100,000,000,000, or more. Interest on a debt of $100,000,000,000 would cost $2,500,000,000 to $3,000,000,000 annually, and it should be borne in mind that this cost will be added to an enormous post-defense budget, which will include not less than $5,000,000,000, and possibly as much as $6,000,000,000, as the annual cost of maintaining the new Army and Navy. The interest burden and the ultimate cost of repaying the debt will be with us whether present borrowing is done through banks or through the savings bonds campaign. We have paid $15,000,000,000 in interest on the World War debt, and more than half of that debt remains unpaid.

There are some who say that a public debt, internally held, involves no burden on the Nation. While this idea is not new—in 1826 Sir Robert Peel, the elder, said, "The public debt is due from ourselves to ourselves"—it has gained currency in recent years with attempts to rationalize deficit spending. It is technically true that an internal debt merely involves a transfer of payments from some citizens to other citizens, but to say that this transfer involves no burden is to assume that each taxpayer owns bonds in proportion to his tax liability. Since only a relatively few persons can afford to own bonds of any sort, this condition obviously is not met. The taxpaying and bondholding groups are by no means identical.

It is shortsighted in the extreme to believe that the burden of the present defense effort can be transferred to succeeding generations. The burden will be borne now, either by taxpayers or by victims of inflation. Interest and debt repayment in the future will constitute a second burden on those who will have to pay taxes to meet the service on bonds owned by others. In general, the people who will be in that position will be the children of the present victims of inflation. That is why it would be a fiscal kindness to levy sufficient taxes to pay the defense cost as we go along, even though that would require seemingly high taxes on low-income groups.

The fallacy in the belief that borrowing postpones the defense burden may be further explained as follows:

"A payment involves two parties. If the next generation is to pay this bill, to whom shall it make payment? The answer is clear: the less fortunate of the next generation will pay to the more fortunate of the same generation. Looking forward to a better society for coming generations—and this we claim is at least in part our present purpose in defense—is it good social policy to plan deliberately that because of our present defense efforts some of our children shall be in a position to command the services of others of our children?"[1]

We started our defense effort with a public debt of $43,000,000,000, now increased to $50,000,000,000. We have already used up the cream of our credit resources. It is not now a question of a first mortgage on our future resources, but of second and third mortgages. Accumulation of a huge debt would be a national disaster that could not be compensated by any number of military or naval victories. On this basis, no financing plan can be adequate or acceptable which does not aim at a cash-basis defense, or which, failing of that objective, yet comes close enough to it to keep debt increase at a minimum.

The case for taxation summarized

Heavier taxation during the course of the defense effort means, in the long run, economy in Federal expenditures. This assertion may be supported on four significant grounds:

[1] Rainard B. Robbins, Defense Bills Payable, in the Watch Dog, the National Economy League, March 1941.

(1) By drawing off purchasing power, taxation will check price increases and prevent the cost of armaments from soaring. During the World War inflationary fiscal methods added billions to the cost of war supplies.

(2) Avoidance of inflation now will make easier the task of returning to a peacetime economy. The deflation will be less severe; consequently, there will be less need for public works and other depression-relief expenditures.

(3) To the extent that debt increase is avoided, interest costs will be saved. Public revenues required to pay interest are not available for other social services.

(4) Direct taxes will make people conscious of the cost of government and insistent on avoidance of waste in the programs which their taxes support.

Without adequate taxation, price control in the present and debt control in the future will require comprehensive and universal controls involving great loss of freedom for individuals. Taxation will make these types of bureaucratic controls unnecessary. Taxation is the way to preserve democracy. The rise of a huge debt, with autocratic controls over individual choices and actions, leads to the authoritarian state and the loss of civil liberties.

THE PENDING TAX MEASURE

The tax bill now under consideration in Congress was based on Secretary of the Treasury Morgenthau's statement that he believed it would be good policy to finance two-thirds of the total Budget by taxation and one-third by borrowing.

The official Budget for 1942, presented in January, called for total expenditures of $17,500,000,000. When the Ways and Means Committee began hearings on the tax bill in April, expenditures were estimated at $19,000,000,000, and the ratio suggested by Mr. Morgenthau required new revenues of $3,500,000,000. On June 1 the Bureau of the Budget announced a revised Budget totaling $22,200,000,000, which would require a further increase of $2,000,000,000 in taxes according to the Morgenthau formula, but on the following day the Secretary said there would be no change in the tax program. "If the Budget Bureau is right, and my guess is that their guess is pretty good, we shall have to borrow more." On July 17, however, the Secretary said that in spite of the new Budget figures and subsequent requests for additional defense appropriations, he would stick to his original $19,000,000,000 estimate, adding that he hoped he was wrong and that more could be spent.

Out of this confusing array of predictions, it is manifestly impossible to judge whether the present $3,500,000,000 tax program will fulfill Mr. Morgenthau's hope of meeting two-thirds of the expenditures from taxes. The probabilities are that the revenues will fall short of this goal, perhaps by several billions. In any case, there is no necessary virtue in the 2-3 formula. At the present rate of spending, bearing in mind the extra-budgetary operations of governmental corporations, a failure to cover more than two-thirds of the Budget by taxes is an invitation to inflation.

Although the most vulnerable aspect of the present financial program is that it proposes to borrow too much, the Ways and Means Committee found that it had to bring in virtually all of the conventional types of taxes in order to raise even the $3,500,000,000 set as a goal at the beginning of its deliberations.[3]

In broad outline the measure would increase tax revenues approximately as follows:

Corporation income and excess-profits taxes	$1,322,000,000
Individual-income taxes	1,152,000,000
Estate and gift taxes	151,900,000
Miscellaneous and excise taxes	902,400,000
Total increases	3,529,200,000

As this outline reveals, the proposal is only the first World War tax system with the dust brushed off. Excessive reliance on conventional taxes prevented the consideration of methods that would be more effective. But if we limit taxation today to the methods used in the first World War, we shall be making as great a mistake as it would be to send General Pershing's 1918 army, equipped as it was then, into the field against Hitler's 1941 mechanized divisions.

[3] After the Ways and Means Committee had reported the bill, the House eliminated the provision requiring joint income-tax returns from husband and wife, thus reducing the revenue total to $3,200,000,000. However, since the final total remains in doubt at this writing, the original goal of $3,500,000,000 is used throughout this paper in references to the bill. This figure refers to a full year's operation; the actual yield in the fiscal year 1942 will be somewhat smaller.

As an anti-inflation measure the pending bill is both inadequate as to total amount and poorly distributed in its impact on different segments of the national income. With exemptions unchanged from present law, the individual-income tax will require payments from only about 15 percent of income recipients. Since corporation stocks are owned in greatest part by persons earning more than $2,000 a year (the income-tax exemption for a married couple with no dependents), the corporation-income and excess-profits taxes will fall largely on the same group. Estate and gift taxes similarly will affect only a very small percent of the population. The excise, or selective sales, taxes will affect the pocketbooks of nearly every family in some degree, but will draw from the income stream less than $1,000,000,000 a year.

In the aggregate, approximately one-sixth of income earners and not more than one-half of the national income will be taxed directly under the Ways and Means Committee program. An inordinately large proportion of the vast reservoir of purchasing power created by the defense boom will not be reached at all through direct taxes, and only to a relatively slight extent through indirect taxes.

Another serious fault of the pending bill as a check on inflation is the lapse of time between the receipt of income and the date when taxes must be paid. This has long been recognized as a shortcoming of the traditional income tax (both individual and corporation) as an instrument of fiscal control. For example, the Annual Report of the Secretary of the Treasury for 1939 says, "The lag between the time income is received by the taxpayers and the time of receipt of income taxes based upon such incomes is particularly important in its effect upon total tax receipts in any given year." The new provision for tax-anticipation warrants, to allow advance payment of taxes as income is earned, is a step in the right direction. However, it is likely that only relatively large taxpayers will invest in these warrants. Small-income taxpayers, granted the doubtful premise that they might have the inclination and foresight to pay taxes in advance, seldom have the facilities for safekeeping of securities of this type. Many taxpayers will undoubtedly continue to exercise the privilege of paying taxes quarterly in the year following the receipt of income. Thus, it will be possible for a taxpayer, using tax-anticipation warrants in part, to spread his payments over a 2-year period. Under these conditions there can be no assurance that income taxes will be effective in drawing off purchasing power at the time when such action is imperative from the point of view of preventing inflation.

Many of the excise taxes proposed by the House bill are of the "nuisance," "chicken-feed" variety, which cause a large degree of popular irritation in proportion to their revenue yields. Moreover, the administrative burden which these taxes will place upon the collections divisions of the Bureau of Internal Revenue will be excessive in many cases. A mere listing of the commodities and services to be taxed indicates the difficulties involved. In addition to increases in rates on commodities already taxed, the bill provides levies on the following: Passenger transportation, telephone bills, jewelry, clocks, watches, radio broadcasting, photographic apparatus, sporting goods, luggage, phonographs and records, musical instruments, bowling alleys, billiard establishments, slot machines, pinball machines, optical instruments, furs, soft drinks, and the use of automobiles, yachts, and private airplanes.

Cost of collection of several of these taxes will probably equal the revenue obtained. In 1938, Congress repealed excise taxes on furs, sporting goods, phonograph records, cameras, and certain toilet preparations after the Ways and Means Committee had found that some were difficult to administer and others produced little or no revenue in excess of collection costs. In spite of this record, the present Ways and Means Committee has included most of these products in its proposed bill.

Among the increases in existing rates is a jump to $4 a proof-gallon on distilled spirits, compared with $3 under the present law and $2.25 prior to the Revenue Act of 1940. Compared with the rate 2 years ago, the proposed tax would add $1.75 a gallon to the profit margin of bootleggers, whose operations were already astoundingly high. Competent authorities doubt whether an increase in liquor rates is advisable in view of the probable shift of trade from taxpaying, legitimate dealers to bootleggers. It is certain that enforcement of the new rates would involve a large increase in the staff and the expenditure of the Alcoholic Tax Unit.

One declared purpose of the excise taxes is to cut down consumption of goods, the production of which competes with defense. While it is true that a tax, added in large part to the price, will discourage consumption (and hence to

some extent defeat the revenue purpose), the argument that such a course aids the defense program is particularly weak. Production of goods which make demands on the heavy industries will be reduced by decree. Once that is accomplished, there is little to be gained by raising the prices of goods which remain to consumers. Available goods would go to those consumers with the longest purse, and less fortunate consumers would have to "do without" in effect defeating one of the primary purposes of the Federal price-control program. In any event, the manipulation of particular excise tax rates could never be effectual in synchronizing the reduction of consumer goods with the requirements of defense. Since many of the excise taxes have been levied on goods and services which do not compete with defense, the result will be a distortion of relative prices and a partial veto of consumers' desires, without any corresponding advantage for the defense program. Excise taxes will prove a poor weapon for directing production into desired channels, as long as consumers' total purchasing power is not reduced by adequate, universal taxation.

Taxes on specific products are a source of bickering in Congress, since Members representing different States in which certain taxed commodities are important form blocks to bargain and trade and sometimes to inflict damage on other areas.

THE NEED FOR UNIVERSAL TAXATION

It has already been indicated that the aim of a defense-tax program should be cash financing—pay as you go—or as near an approach to it as possible. Before examining methods of achieving this goal, it will be well to review the prospective income and outgo totals, and the deficiency which may be expected under the present program.

Assuming that the Budget Bureau's estimate of expenditures for the year ending June 30, 1942, is an acceptable medium estimate, we have a total of $15,500,000,000 for defense and $6,700,000,000 for nondefense expenditures, or a total budget of $22,200,000,000. From the standpoint of inflationary fiscal operations, the net outgo of borrowed funds under the auspices of governmental corporations and credit agencies should also be taken into account. Probably not less than $3,000,000,000 will be added to the stream of purchasing power through these operations.[4] The total of Federal outgo, all of which should be financed by noninflationary methods, may therefore be placed at approximately $25,000,000,000.

On the income side the present tax structure will yield $9,400,000,000, according to the revised Budget of June 1. The revenue bill now under consideration is estimated to yield $3,500,000,000, making a total of $12,900,000,000 in tax revenues. The budgetary deficit would be approximately $9,000,000,000, and borrowing outside the Budget would raise this figure to $12,000,000,000.

Not all of the necessary borrowing will have an inflationary effect. Defense bonds and stamps, purchased out of income, will merely transfer purchasing power to the Government. However, not more than $4,000,000,000 may be expected from this source on the basis of the present outlook. In addition, Government trust funds, such as social-security reserves and retirement funds, will absorb approximately $1,500,000,000. After taking account of these offsets, the portion of Federal expenditures and loans having an inflationary stimulus may be placed at $6,500,000,000. Thus, the goal of a new tax measure should be $10,000,000,000 instead of the $3,500,000,000 now under consideration.

Expansion of business and consumer spending will have a further stimulative effect, but the reduction of activity in nondefense industries through the priorities program may prove depressive in some areas. No estimate of the net change in private spending is possible, but it should be noted that a strong upturn in nongovernmental spending may require an even greater increase in taxation, if inflation is to be prevented.

The proper fiscal policy under these circumstances was well stated in the unanimous report of Federal Reserve officials on January 1:

"Whatever the point may be at which the Budget should be balanced, there cannot be any question that whenever the country approaches a condition of full utilization of its economic capacity, with appropriate consideration of both employment and production, the Budget should be balanced. This will be essential if monetary responsibility is to be discharged effectively."

[4] This is not a precise calculation but only a rough addition of prospective loans from Reconstruction Finance Corporation funds (defense plants, British loan, rural electrification, farm security, farm tenants, etc.); Commodity Credit Corporation, farm-crop loans; Export-Import Bank and stabilization fund, international loans, largely for expenditures in this country; and housing loans under Federal auspices.

That it is possible as well as desirable to finance the armament expenditures on a pay-as-you-go basis has been stated succinctly by Harold G. Moulton: "The answer to the question whether the defense program can be financed without a great increase in the public debt is 'yes.'"[5]

According to the above analysis, the gap in Federal finances which must be closed in order to prevent inflation is $10,000,000,000. (From the standpoint of preventing an increase in the public debt, the requirement is even greater.) It may be confidently expected that before taxes of this magnitude are imposed, the public will demand all possible economies in nondefense expenditures.

The program of the National Economy League calls for savings of $1,600,000,000, the details of which follow:[6]

[In millions of dollars]

	Federal Budget	National Economy League proposals	Savings
General Government	997	897	100
General public works program	503	240	263
Work relief	1,034	555	479
National Youth Administration and Civilian Conservation Corps, nondefense	363	162	201
Aids to agriculture (except Department of Agriculture)	1,062	500	562
Social security	462	430	32
Veterans' aids	565	550	15
Other nondefense	1,689	1,689	None
Total	6,675	5,023	1,652

After deducting this amount from the expenditure side, the need remains for approximately $8,500,000,000 in additional revenues. The length of time required for the Ways and Means Committee to formulate the present $3,500,000,000 measure is adequate proof that traditional taxes are inadequate for the task. What is needed is some form of universal taxation, convenient to the taxpayer, which will yield a large amount of revenue without an inordinate cost of collection.

The three possible means of reaching a large share of the national income are (1) "broadening the base" of the present income tax, (2) a Federal sales tax, and (3) a flat tax on all income payments, collected at the source.

Extending present income tax

The First Revenue Act of 1940 reduced personal income tax exemptions of married couples from $2,500 to $2,000 and of single persons from $1,000 to $800. While exemptions could be lowered still further, with a consequent increase in revenue from new as well as old taxpayers, the cost of collection increases rapidly in proportion to the yield. The recent recommendations of the President and the Treasury for exemptions of $1,500 for married couples and $750 for single persons could probably be handled without great difficulty by the Bureau of Internal Revenue, but the additional collections would be relatively small. This change, if adopted, cannot be viewed as meeting the need for widespread and substantial taxation.

The reduction of exemptions last year approximately doubled the number of persons filing returns and necessitated a considerable increase in the staff of the collection agency. Further "broadening of the base" of the present type of tax, to a degree commensurate with the revenue need, would enormously increase the burden of collection. Persons in low-income groups are seldom able to report accurately their income for the year, or to pay a lump sum tax, when returns are required on an annual basis. The conventional form of income tax is complicated at best, and it would be difficult to educate the smaller taxpayers to the task of filling out a return.

Exceedingly high rates in the higher brackets, in excess of those already in effect, are suggested by some as the best application of the theory, or slogan, of "ability to pay." Since persons receiving large incomes are few in number, the revenue possibilities of such taxation are distinctly limited. Disregarding

[5] Fundamental Economic Issues in National Defense, The Brookings Institution, Jan. 13, 1941, p. 16.

[6] Cf. W. D. Arant, Nondefense Economies, the National Economy League, May 27, 1941.

the fact that excessive taxation will soon convince people that a high income is not worth the effort and risk to attain it, complete confiscation of all incomes in excess of $10,000, would yield the Government only $2,300,000,000 additional revenue, and complete confiscation of all incomes in excess of $3,000 would increase revenues by only $6,500,000,000.[7]

The sales tax

A Federal sales tax has possibilities for a substantial increase in revenues, the yield would be stable, and the payments would be made at approximately the same time that income is received. Moreover, a sales tax would effectively reach those whom it would be most difficult to reach by any other form of taxation.

John L. Sullivan, Assistant Secretary of the Treasury, told the Ways and Means Committee that the sales tax had been considered and rejected in favor of the higher excise taxes. One objection to it, he said, was that it would fall "more heavily on the lowest income groups." While there is some force in this contention, it certainly would not fall more heavily on the lowest income groups than the burden of an inflated cost of living. If we were building a tax system anew, there would be much weight to the argument that a sales tax is inequitable, but when the existing tax system as a whole is progressive, and steeply so in the higher brackets, there is less reason to fear this consequence. Many of the objections to a sales tax apply equally to the excise taxes included in the pending bill.

The principal objection to a Federal sales tax is that the base would be much smaller than the total income received by individuals. The tax would apply only to that portion of incomes spent on retail sales (or manufacturers' sales, as the case may be) and would not reach the portions of income not so spent. In 1939 national income was $68,000,000,000 but retail sales totaled only $42,000,000,000. Of this amount, $10,000,000,000 represented food purchases, which presumably would be exempt from tax. The Treasury has estimated that a manufacturers' sales tax, along the lines proposed in Congress in 1932, at a rate of 2¼ percent, would yield approximately $50,000,000. Assuming that retail sails in 1942 reach a total of $50,000,000,000, and that no exemptions were allowed, the revenue goal of $8,500,000,000 would require a sales tax rate of approximately 17 percent at retail. If the pending tax bill be accepted, and the sales tax relied upon for the additional $5,000,000,000 required to control inflation, the necessary rate would still be a magnitude of 10 percent at retail. Since exemptions would probably be granted on such items as food, fuel, medicines, and articles already subject to excises, the necessary rate would be much higher.

Rates of this sort would cause price distortions and economic dislocation, which could be largely avoided by a universal tax upon income.

Universal income tax

A substantial tax on all income paid out to individuals, collected at the source at the time payment is made, meets most of the objections to a sales tax or to a net income tax collected annually. The concept of the tax is exceedingly simple. Possibly this is an obstacle to its adoption, when tax administrators and legislators have become used to the complexities of the conventional tax system.

Following the first proposal of this tax,[8] it has sometimes been misinterpreted as a tax solely on wages, and has been condemned, therefore, as discriminatory. Actually, the plan calls for tax deductions on all payments of income of whatever sort: wages, salaries, other personal earnings, interest, dividends, royalties, rents, and entrepreneurial withdrawals. Thus, it would apply to the entire amount of national income paid out to individuals—a much broader base than that to which a sales tax would apply.

Collections would be made currently as income is paid; weekly in the case of wages, quarterly in the case of dividends and interest, and so on. This method of collection would have distinct advantages both for the Treasury and for the taxpayer. Revenue would flow into the Treasury at a steady rate throughout

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[7] W. L. Crum, The Maximum Possible Yield of Ability Taxation, in the Watch Dog, the National Economy League, March 1941, p. 7. The estimates are based on income-tax returns for 1937.

[8] Cf. H. L. Lutz, Financing the Defense Program, the National Economy League, February 1941.

the year; there would be no lag as in the case of the regular income tax. This is an important consideration in devising tax measures to control inflation.

From the standpoint of the taxpayer, the tax burden which the defense program makes necessary can be borne with much less discomfort when payments can be spread over the year. Very few persons in the low-income groups have the facilities for accumulating a tax reserve. None of them can pay an annual tax under the present system without great hardship. Under the collection-at-source plan, the tax would be paid in small installments, just like the rent and grocery bills. Anyone can endure a heavier tax, if collected at the source, than can be endured if payment must be made in a few large installments long after the income on which the levy has been made has been spent. The Treasury plan for the tax anticipation warrants is an admission of this fact. The English are now subject to a standard income-tax rate of 50 percent. They can endure such a rate only because of widespread collection at the source.

This method of collection has had a successful trial in this country through the social-security system, and in Canada under a special national-defense tax collected at the source. The Canadian administration takes much of the bookkeeping burden off the hands of business enterprises by calculating the tax from pay-roll records and rendering a bill. The business firm merely furnishes the pay-roll data and is relieved of the duty of computing the tax.

No exemptions were provided in the original exposition of this plan. It was believed that the administrative difficulties of allowing exemptions, when the tax is collected weekly, monthly, or quarterly would be prohibitive, and moreover, it is doubtful whether an adequate amount of revenue to finance the defense program can be obtained without imposing a uniform tax upon the whole national income.

In this connection, it should be noted that social-security taxes are levied on the total earnings of the individual. No personal exemptions or credits for dependents are allowed. It is true that the social-security system involves both contributions and benefits, but the individual's contribution is nevertheless a tax in every sense of the word, and benefits are established with reference to other factors than the amount contributed. In the realm of semipublic finance, the trade union check-off of dues is a perfect example of a tax collected at the source without reference to the status of the individual or his dependents.

It may be necessary to remove the income-tax exemptions entirely and to collect taxes from everyone. Representative Doughton, chairman of the House Ways and Means Committee, declared on July 28, "If it should prove impossible to obtain congressional approval for this step, some exemptions might be allowed, in the manner provided by the Canadian national-defense tax. However, the rate that would have to be levied on the remainder of the national income, in order to meet revenue requirements, would be correspondingly increased."

A rate of 10 percent was originally suggested as a reasonable approximation of the diversion of income necessary to parallel the diversion of goods to military uses. With expansion of the defense program in recent months, a higher rate would be necessary to put the program completely on a cash basis. However, according to the analysis given above (allowing for income-absorbing borrowing) a rate of 10 percent would come close to reaching the antiinflation goal of $8,500,000,000 in additional taxes. This assumes economies in nondefense expenditures. The new tax would reduce the yields of existing taxes by approximately 10 percent (somewhat more in the higher brackets of the income tax). Assuming that the national income paid to individuals reaches a total of $90,000,000,000, the proposed tax may be expected to yield approximately $8,000,000,000.

State tax revenues would also be reduced to some extent, but such an effect would follow from the imposition of any new tax. As a matter of policy, there can be little objection to this result, when the Federal Government is burdened with defense, and when the defense boom would otherwise tend to increase State revenues.

Two principal objections must be considered:

First, it is held that the burden would be too great on the low-income groups. This objection is stated, for example, in the following excerpt from an editorial on the original publication of this proposal:

"Take the wage earner with wife and children, earning $2,000 a year and now exempt from income taxes. His present budget has no room for a $200 tax bill."

Although superficially reasonable, this statement shows a complete lack of appreciation of the functioning of a wartime economy. Whether a person's

budget, judged by peacetime standards, has room for the burden of defense or not, that burden is here and will be met. If the individual referred to does not pay his share of the cost in the form of a $200 tax bill (which should be spread over 52 pay days), he will pay it in small amounts when his wife goes shopping to find that prices have risen. If he is among those who cannot increase his income, he may pay much more than $200 a year. During the World War period, the cost of living more than doubled. In 1920 it took $2.07 to purchase what $1 would have purchased in 1914. A serious price inflation would be a far greater burden than the proposed tax, and when prices rise rapidly, low-income groups are most severely pinched. The tax would not increase the burden, it would merely distribute it more equitably. Since all existing taxes would be retained, the tax system as a whole would remain progressive.

The second objection is that collection will be difficult in the case of farmers, the professional groups, and other self-employed persons. In 1940 individuals in these groups received about 20 percent of the national income. Since many of them are required to file returns under the existing income-tax law, which provide an informational check on gross personal incomes, the percentage involving an administrative problem is actually much smaller. It is true that collection at the source cannot be used in these cases, and that a system of individual returns will be necessary.

So far as farmers are concerned, the agricultural program over the past 8 years has brought about a great improvement in the keeping of farm accounts, and county agricultural officials have recently undertaken to advise farmers with respect to their income-tax returns under the lower exemptions of last year. This aid could easily be extended, perhaps, with the cooperation of the newly established county defense committees for agriculture. Certainly the Federal Government could deduct the tax at the source with respect to Federal benefit payments. That farmers are willing to follow a pay-as-you-go tax policy is indicated by the following sentence included in the "Statement of policy of the farm conference on the national emergency," held in Chicago, June 5, 1941, representing the National Grange, the National Council of Farmer Cooperatives, and the American Farm Bureau Federation:

"In order to prevent dangerous inflation and an undue accumulation of debts as a result of the enormous expenditures for national defense, we urge that, insofar as practicable, the costs of the defense program be paid from current income."

The collection of the proposed tax from self-employed individuals is not an insuperable obstacle. On the whole, the simplicity, the timing, and the convenience of the tax will make it more efficient than any other tax, or set of taxes, that could raise a comparable amount of revenue.

SUMMARY AND CONCLUSION

The financial requirements of the defense program impose upon the country three alternatives, (1) inflation, (2) complete price control, or (3) drastic taxation.

Inflation is the worst consequence to be feared; worse even than unemployment—it would in fact increase unemployment in the long run.

Price control is necessary in limited fields. But to extend it over the whole economic structure as a substitute for sound financial policy is to adopt totalitarian methods. No authority that a democratic government can enforce will succeed in keeping prices down as long as the public has at its disposal an increasing quantity of purchasing power.

Taxation on a scale commensurate, or nearly so, with the level of expenditures is necessary both to prevent inflation now and a crushing debt load in future years. When account is taken of governmental outlays through extra-budgetary corporations, the amount of taxation required to prevent inflation is of the magnitude of $10,000,000,000. Reductions in nondefense expenditures could reduce this figure to $8,500,000,000.

The most effective, if not the only, form of taxation that will divert this sum of money to the Government is a universal, special defense tax on all income paid out to individuals, collected currently at the source. A substantial rate is necessary; 10 percent has been recommended. While this is drastic, it is not greater than the economic burden which defense imposes upon us in any case.

THE NATIONAL ECONOMY LEAGUE

A nonprofit organization founded and incorporated in May 1932, to revive the American principle of representative government for the common good, and particularly to secure the elimination of wasteful or unjustifiable Federal expenditures.

The league's present objectives are:

1. To record the facts and arguments for sound Federal finance and distribute to the widest extent within its means "fact-studies" on Government fiscal policies.

2. To reveal raids on the Federal Treasury by self-seeking minorities and pressure groups.

3. To push for a balanced Federal Budget—the only way now to avoid the complete collapse of our national credit, our system of free government, and loss of our civil liberties.

All publications of the league are distributed without charge and are sent to all Members of the Congress. Additional copies of this pamphlet may be obtained upon request. Since such distribution is made possible by voluntary gifts, individual contributions will aid materially in wider circulation and a broader, more effective, educational program, as well as make possible special research projects for which funds are not now available. A convenient form is enclosed for your use.

The National Economy League officers: Ernest Angell, chairman; Duncan M. Spencer, treasurer; Graham D. Mattison, secretary; Harley L. Lutz, consulting economist, H. G. W. Sundelof, executive director; Willard D. Arant, research director.

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The CHAIRMAN. Are there any questions from any member of the committee?

(No response.)

The CHAIRMAN. Thank you very much, Dr. Lutz, for your appearance.

Dr. LUTZ. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bunker.

STATEMENT OF HON. BERKELEY L. BUNKER, UNITED STATES SENATOR FROM THE STATE OF NEVADA

Senator BUNKER. Mr. Chairman, I wish to speak on the subject of mandatory joint income-tax returns. I would like at this time to urge that the action of the House of Representatives be sustained insofar as that body voted to omit a mandatory joint income-tax return provision from the revenue bill of 1941.

One of the oldest and soundest of the laws of Nevada, and of other States with a Spanish heritage, is that which recognizes a married woman as a full partner of her husband, with an equal right to the fruits of their joint labor—this is opposed to the old English common law which made here his chattel and the product of her efforts, and their joint efforts, his sole property.

We in Nevada are proud of our rights under this law, in which we feel equality and social justice are the keynotes. The State of Nevada is happy and willing to assume its share of the taxation necessary to pay for the national-defense program, just as she has been willing to assume her share in every emergency which has confronted the Nation since her admission to Statehood. But she is strongly opposed to a discriminatory tax by which residents of the State would lose the right to file separate returns in keeping with her laws. Even if the revenue involved, which is estimated at some $350,000,000 were tenfold greater, it could little compensate the Government for the sacrifice of sound social principle and the loss of priceless heritage entailed.

May I respectfully call the attention of the committee to the legality of the community property law? The provision for the taxation of the combined income of husband and wife, as though it were the income of one person, violates the fifth amendment of the Constitution of the United States in that it would deprive the taxpayer of his property without due process of law. The tax contemplated by a mandatory joint income-tax return provision is a tax levied upon the husband based and computed upon the income and property of another person, his wife. This practice has been heretofore condemned by the Supreme Court in *Knowlton* v. *Moore* (178 U. S. 41) and in *Hoeper* v. *Tax Commission of Wisconsin* (248 U. S. 206). With further reference to this subject I mention *Heiner* v. *Donnan* (285 U. S. 315), in which it is settled that there is no distinction between the "due process" of the fourteenth amendment and the "due process" of the fifth amendment. I would also like to cite *Schlesinger* v. *Wisconsin* (270 U. S. 230), *United States* v. *Baltimore and O. R. Co.* (17 Wall 322, 325, 21 L. Ed. 597, 599), *Reinecke* v. *Smith* (61 F. (2d) 324, 325), *Darcy* v. *Commissioner* (66 F. (2d) 581, 585), and *Helvering* v. *City Bank Farmers Trust Co.* (296 U. S. 85).

The provision for taxing separate incomes as joint income would effect an unconstitutional usurpation of the States' power to regulate property. A requirement for the filing of joint income-tax returns in effect would state that one of the incidents of the ownership of property by a married person is that the spouse of such person shall be taxed thereon. This is an assumption of the power of the State to regulate the ownership of property, and such assumption of power is unconstitutional, under the tenth amendment, which provides that "the powers not delegated to the United States by the Constitution, nor specifically prohibited by it to the States, are reserved to the States respectively, or to the people."

The term "incomes," as used in the sixteenth amendment, never contemplated the inclusion of a wife's income in her husband's taxable income. In furtherance of this point I refer to *Eisner* v. *Macomber* (252 U. S. 189), *Blair* v. *Rosseter* (33 Fed. (2d) 286), *Noel* v. *Parrott* (15 Fed. (2d) 669, 671), and *Towne* v. *Eisner* (242 Fed. 702, affirmed 245 U. S. 418).

The theory underlying a provision making mandatory joint tax returns is that the legal rights of the separate spouses to their separate incomes are to be ignored and that the joint income is to be treated as available to meet the family obligations imposed upon the husband. This assumes a status which is contrary to the laws that exist in most of the States as well as to the experience of the average couple where both have means.

And further, by making mandatory the filing of separate incomes jointly and thus placing many couples in surtax brackets, the proposal amounts to a penalty tax on marriage. This is a definite reversal of what has always been encouraged, and for this reason higher taxes have been placed on single persons in the way of lower exemptions, and so forth. Never before has anyone thought of reversing this procedure and taxing marriage. By the Government's offering a premium to individuals who remain or become unmarried, in effect, a social problem of the first order would thus be presented.

We in Nevada are fully cognizant of the great problem confronting the Senate Finance Committee in the necessary creation of a tax bill which would bring in sufficient revenue for our defense program so vital to our national life. The committee deserves sincere commendation for its honest and diligent work in this respect.

But in facing all emergencies that come to our country we must ever bear in mind that there can be no letting down of the ideals and principles of the constitutional rights on which our Nation was founded.

May I again urge consideration of these views, which Nevada presents unanimously.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

There is a witness here, I understand, who wants to get away. We will call the next witness somewhat out of order.

Mr. W. J. Salmon. Do you wish to file a statement?

Mr. SALMON. Thank you very much. Could I read it? It will take me only 5 minutes.

The CHAIRMAN. Yes.

STATEMENT OF WALTER J. SALMON, NEW YORK, N. Y.

Mr. SALMON. Mr. Chairman and gentlemen of the committee, my name is Walter J. Salmon. My address is 11 West Forty-second Street, New York City.

I am fully aware of the tremendous task which faces this committee, and also of the fact that the demands upon your time are almost unlimited. I deeply appreciate the opportunity to appear. I shall take only a few minutes to present to you one problem which seems to be of particular importance just now, and to suggest a partial remedy. I know you will give it most careful consideration.

I have been actively engaged in the real-estate business in New York City for about 45 years. At the present time I am managing and operating a number of office buildings in what is called the midtown

section, in the neighborhood of Fifth Avenue and Forty-second Street. In most cases the properties are held under long-term leaseholds, which in turn are held by various corporations. I am appearing on behalf of those corporations and on my own behalf. However, I know that many other businesses and many other businessmen have a similar problem.

Many people, I think, are under the impression that the operation of a large office building in New York City is a safe and certain way to make money. You gentlemen probably know, at least by hearsay, and I know from sad experience, that this is not the case. It is unfortunate, of course, but true, that what we call the American "profit" system is in reality a "profit and loss" system. No one has yet devised any method of guaranteeing profits. I regret to say that the business in which I am engaged has proved an all too striking example of that rule.

The fact of the matter is that the properties of which I have personal knowledge have an almost unbroken record of losses for over 10 years. Up to about 1929, conditions in the business were fairly stable. It was possible to rent a fair percentage of the available space, not all of it, but enough in some cases at least, to produce a modest profit. Since the early thirties, however, the situation has been entirely different. General business, as we all know, fell off alarmingly, and that was, of course, a very important factor. A more specific factor, affecting particularly those of us who operate in the midtown section, was overbuilding. I can cite as an example which will be familiar to all of you—the Radio City development. Magnificent as that development is, I do not think it can be successfully asserted that it was economically justified, that the additional space which it provided was required in that area. Those interested in that project had, and still have, unlimited resources. Losses would not matter so much to them as they would to the rest of us, who had devoted what capital we had, and all our efforts over a long period of years, to the development and maintenance of less extensive projects.

The typical method, and usually the only available method, of financing an office building in New York has been to borrow money on the leasehold, and then repay the loan out of future profits. Where there have been losses, the operators have usually had to finance those losses themselves. That has been our situation. We have had to dig deeply to keep our enterprises going, and the only reason why we did it, the only justification for doing it, was the hope that sometime in the future there might be some profits available with which we could recoup at least a portion of our losses.

We have now come to the point where it is possible to say that some very modest profits may perhaps be made in the next few years. The improvement in general business conditions has brought that about. How much of that is due to the impetus of the defense program, and how much of it will disappear in the post-war depression, are questions on which I cannot comfortably permit myself to dwell. I can only go on the assumption that we cannot look forward to good business permanently.

The principal point I want to make before you today is that it is utterly unfair, in such a business as ours, to measure the taxes for any single year on the basis of the results of that year alone. As I have

said, we have had large losses for many years. Such profits as we may make in the next few years will not be true profits, obviously, until we have recouped our losses. If we recoup one-tenth of our losses we shall be very happy.

For businesses which are fortunate enough to show profits year after year, measuring the income of each year separately is fair enough. Few businesses are that fortunate. I can think of many, other than my own, in which it is altogether unrealistic to measure income on a year-by-year basis. For example, it usually takes a long time, and much expense, to develop a patent. If it is sold in one year, the income does not really all belong in that year. The building of a dam, or a bridge, or a subway, may require many years. If payment is made only upon completion it should not be treated as income only of the year of completion. Lawyers are often engaged upon cases for many years, receiving their fees only when they finish. They do not earn that income only in the year in which it is paid. These are only a few examples.

If the man who develops a new patent cannot charge his expenses and losses against the proceeds which he finally derives from it, he is paying income taxes without having any real income. The same is true of the builder who is paid only in a year other than the one in which he incurred his expense. The lawyer who is paid in one year for work extending over many pays much higher taxes than his neighbor who might make the same aggregate amount over a number of years. In our situation, if we cannot first recoup our losses, we will be paying taxes although we have no real income.

I am not a tax expert, but as a layman I can see the necessity for requiring annual income returns and annual tax payments. It is much more convenient, from the administrative standpoint, to do it that way. On the other hand, also as a layman, I know that our Federal tax system is supposed to have as its foundation the principle of "ability to pay." This principle is a sound one, of course, and it is much more important than any rule of convenience which requires measuring income by short, fixed periods.

Congress has already recognized this. Before 1932, the revenue acts permitted us to carry over losses for 2 years. We did not have this privilege from 1932 to 1939, but it was restored in 1939. I understand also that a number of special situations have been taken care of. A builder with a long-term contract can spread his income over the term of the contract. A lawyer spending more than 5 years on a case can spread his fees over those years.

These provisions are all beneficial. However, they afford no substantial relief in those situations in which relief is most necessary. For example, in our business, which has gone through over 10 years of losses, we can recoup only a very small fraction of those losses under the present 2-year net-loss carry-over provision. Again, a business which has suffered a very heavy loss in one year may be unable to offset that loss fully in the next 2 years. On the other hand, the more fortunate business, which has moderate losses in not more than 2 years, can offset its entire losses.

I want to urge upon you, as a practical solution of the problem, a 5-year carry-over of net operating losses and net long-term capital

losses. This would not eliminate all the inequities, but it would go a long way. I cannot conceive of its reducing the revenues seriously. In any event, in these days of extremely high tax rates, equity and fairness are even more important than when the rates are moderate. Great Britain's need for revenue is certainly even greater, yet I understand its law permits a 6-year carry-over, which I am told works very well.

Many well-known and competent authorities have urged for many years that a 5-year net-loss carry-over be allowed. Among these I might mention Mr. Leon Henderson. In his testimony before the Committee on Ways and Means, on this very bill, he expressly approved a 5-year carry-over. I am sure no one would question its fairness. I respectfully urge its adoption.

Thank you for your courtesy in hearing me.

The CHAIRMAN. Thank you.

Now Mr. Jarvis Farley, you may state for whom you are appearing and in what capacity.

STATEMENT OF JARVIS FARLEY, BOSTON, MASS., REPRESENTING THE MASSACHUSETTS INDEMNITY INSURANCE CO.

Mr. FARLEY. My name is Jarvis Farley. I am the actuary of the Massachusetts Indemnity Insurance Co. of Boston. I want to thank the committee for the opportunity to present now for your consideration a detail which, up until now, has not received attention. You have before you, I think, a paper entitled "Memorandum on Excess Profits Tax Treatment of Reserve Funds of Companies Taxed under Section 204." I will read it rapidly as I wish to finish in the time allotted to me.

The CHAIRMAN. You may proceed.

Mr. FARLEY. The House and Senate Committee reports accompanying the 1941 excess-profits tax amendments pointed out that the high tax rates are fair if the income is of the type intended to be reached. A recent Treasury decision (T. D. 5059, July 1941) has the effect of imposing the high excess profits tax rates upon a part of the truly normal income of certain nonlife, nonmutual insurance companies whose net income is defined in section 204.

This situation arises because T. D. 5059 rules that insurance reserves cannot be classified as equity invested capital. This ruling of the Treasury Department attempts to nullify long established legal precedents holding that such reserves are invested capital. The definition of invested capital in the excess-profits tax laws of 1917 and 1918 was, except for minor changes of phraseology, synonymous with the definition of equity invested capital in the present law.

Over a period of 13 years, that is, from 1917 to 1931, and by a series of administrative rulings and court decisions, it was finally established to the satisfaction of all parties that insurance reserves were equity-invested capital under the 1917 and 1918 law. (See table of rulings and regulations and court decisions marked "Exhibit A.")

Exhibit A is a table of the rulings involved. I would like to leave for the files of the committee a brief expanding upon that list; I don't ask that it be in the record unless you gentlemen feel it should be.

Note specifically that the Commissioner of Internal Revenue in 1931 acquiesced in the *Federal Life Insurance Co. case*, thus bringing all the parties into agreement on the question.

Because the Treasury Department by T. D. 5059 has now seen fit to upset the above-mentioned arduously established agreement, it will be necessary for the affected companies to relitigate the same question in order to protect themselves from a confiscatory tax unless legislation removes the necessity.

The total exclusion of insurance reserves from equity-invested capital—as is required by T. D. 5059—would seriously prejudice and impose undue hardships on the weaker companies taxed under section 204.

Furthermore, it patently seems unfair, in view of the above historical background under which an agreement was reached by both parties, to make these companies incur the heavy expense and business uncertainty of another 13-year period of litigation. I would like to interpolate here a comment with regard to that litigation. You gentlemen are all familiar with the rule of reenactment as applied by the courts. As I understand it, if the Treasury issues a formal ruling interpreting an existing law, and if thereafter Congress reenacts the same provision, the Courts are prone to assume that Congress agreed to the published interpretation. The omission of the correction from the present bill may cause serious injustice which later retroactive legislation could not entirely erase. I understand the first cases of litigation are in the making now. It would be unfortunate if such injustice were to be brought about merely because of lack of time to consider the proposal now or because the change could not be made for purely technical reasons only, quite aside from the merits of the proposal. It seems especially senseless and useless to force relitigation since by a simple amendment to the excess-profits-tax law Congress can at one time establish the proper definition for the treatment of insurance reserves as equity-invested capital and make the litigation unnecessary.

Senator DANAHER. When you say a "simple amendment," do you want us to define what is equity-invested capital?

Mr. FARLEY. At page 5 of the memorandum there is a specific proposal with respect to that.

Senator DANAHER. All right.

Mr. FARLEY. Section 204 must not be confused with sections 201–203, which define the net income of life-insurance companies. Section 204 brings the companies' entire income into the range of taxation. We consider that section 204 provides, in the main, a tax basis which is fair and satisfactory to both the taxpayer and the Treasury. It does not give unusual credits or special privilege, but merely provides a special method of determining the net income of such nonlife, nonmutual companies. The special method was made necessary by the unique nature of insurance operations—especially by the special accounting problems introduced by the actuarial reserves which are inherent in insurance operations. It is these same reserves which were agreed upon as being invested capital under the earlier laws and which impose the present problem.

The unearned premiums and the unpaid losses of a nonlife, nonmutual company are true insurance reserves, representing the present value of the company's future obligations to policyholders. These reserves are recognized by the Internal Revenue Code. (Sec. 204 (b) (5) and (6); see also the testimony of Professor Adams before the Senate Finance Committee on October 5, 1921, p. 394 of the confidential hearings.)

They are normal, proper, and necessary in insurance operations, and appear, like capital and surplus, on the liability side of the balance sheet as showing the source of assets invested in the business. These assets are literally paid in by policyholders under policy contracts. The assets are normally invested and the income from such investments is taxable income to the company.

If the reserves are excluded from invested capital every dollar of this normal and proper income in most cases becomes "excess profits" under the invested-capital method of computing the excess-profits credit, thus imposing an undeserved penalty upon the company forced to use that method. A company which had abnormally heavy losses or expenses during the base period would have an exceptionally small excess-profits credit based on income.

Under the present law, therefore, the company with normal base period earnings is not affected and the company with a substantial surplus is not so seriously affected. The weaker company alone, with its small surplus and abnormally low base period income, is required to pay the tax, solely because invested capital is not now properly defined. To deny the reserves as invested capital—that is, to consider the investment income from the assets in most cases as entirely excess profits—is, in effect, to deny the right or propriety of making productive use of the corresponding assets. This was recognized under the 1917 and 1918 acts and we believe that Congress would not intentionally impose such a penalty now.

Senator GEORGE. Aren't those reserves usually and generally invested in securities? How do you carry your reserves?

Mr. FARLEY. They appear on the books as a liability of the company——

The CHAIRMAN. Aren't they invested as assets earning some tax-exempt dividend?

Mr. FARLEY. They may be, but there is a table here which shows the situation on the assumption that the income from tax-exempt bonds is included in excess-profits net income in order to include the securities in admissible assets, except stock which cannot become admissible assets.

The historical approach outlined above would establish the insurance reserves as equity-invested capital. It might be argued that the reserves should be considered as borrowed invested capital, for the assets are figuratively borrowed from policyholders. If they are considered to be borrowed invested capital, it would require an amendment to the law to permit that treatment.

The simplest and most practical amendment would be to add the following sentence to section 719 (a) (I):

The insurance reserves of companies subject to taxation under section 204 shall be included in borrowed invested capital.

More complicated legislation would be required to define more exactly the normal income of such insurance companies, and to do full justice to the weaker companies. The proposed amendment still hits the weaker companies hardest, but at least it does approximate justice and has the advantage of being simple.

A table is attached as exhibit B—it is the last page of this memorandum—showing the effect of that proposal on the aggregate figures of nonlife, nonmutual insurance companies, for the base period 1939. The last line of figures on the table shows the estimated normal income of the company subject to this provision. It shows it as $89,000,000. The computation of that is determined as indicated in the second paragraph of the table. This figure is after taxes so that the income before taxes would be, I estimate, in the neighborhood of $100,000,000.

Compared with this normal income are the excess-profits credits with reserves included as equity-invested capital, as borrowed invested capital, and excluded from invested capital.

The table shows that with the reserves as equity-invested capital the excess-profits credit would be approximately equal to the aggregate normal income. With reserves as borrowed invested capital a large portion even of normal income is classed as excess profits. When applied to individual companies it would be found that the weaker companies would be the ones to pay the bulk of the excess-profits tax and the stronger companies would be relatively free from that tax. For this reason it would be equitable for the amendment to provide that the reserves should be included in equity invested capital.

Such a provision would be fair in practice, even though it may not be entirely consistent with the possible nature of the reserves as borrowed capital, for it would give reasonable relief to the weaker companies without materially affecting the stronger companies. If the amendment were to provide that the reserves should be borrowed capital only, Congress would still have recognized and at least partially corrected a very real defect in the existing law.

Senator DANAHER. That proposed amendment then would not accomplish a complete reversal of T. D. 5059?

Mr. FARLEY. I think it would, if I understand your question.

Senator DANAHER. It doesn't seem so from what you say. I don't think that is what this shows.

Mr. FARLEY. Excluding the reserves would produce the right-hand column. I propose two alternative amendments—one of them to call the reserves borrowed capital; the other to call the reserves equity capital; calling the reserves borrowed capital would still leave one-third of the normal income to be taxed.

Senator BROWN. Your amendment on page 4 would bring about the result you state in the second column?

Mr. FARLEY. That is right; and calling the reserves equity invested capital would bring about the result stated in the left-hand column of the table.

On page 5 I end up the memorandum by referring to one or the other of the alternative amendments which I will get to in a moment.

There are relatively few companies who are adversely affected under the existing law and who need this legislation. To those few companies, however, the existing situation is an extreme hardship.

The amount of taxes now involved would be very small compared to the total, but to the companies affected these "improper" taxes are heavy and are paid out of their very life's blood. The credit of an insurance company is its stock in trade. Payment of the taxes primarily by the weaker companies accentuates their competitive disadvantage and failure to include reserves as invested capital would have the effect of perpetuating and strengthening the natural advantage of the stronger companies.

This subject is necessarily very technical. We have attempted to keep this memorandum as brief and nontechnical as possible and still present the outlines of our case. If further information or more detailed exposition is wanted, we will be glad to be given the opportunity to furnish it.

Specifically, this memorandum is directed to either one or the other of alternative amendments, which are as follows:

First choice.—To include the reserves in equity-invested capital by adding the following paragraph to section 718 (a):

(6) *Insurance reserves.*—The insurance reserves of companies subject to taxation under section 204.

Second choice.—To include the reserves in borrowed capital by adding the following sentence to section 719 (a) (1):

The insurance reserves of the companies subject to taxation under section 204 shall be included in borrowed invested capital.

EXHIBIT A.—*List of rulings, regulations, and decisions involved in the historical approach arriving at the agreement to treat insurance reserves as invested capital under the 1917 and 1918 excess profits tax laws.*[1]

Rulings:

Bulletin H, Income Tax Rulings Peculiar to Insurance Companies, 41-42 (1921).

A. R. R. 3202 (II-2 C. B. 275-1923)

Regulations:

T. D. 3153 (4C. B. 398-1921).

T. D. 4053 (VI-2 C. B. 292—1927).

Court Decisions:

Duffy v. *Mutual Benefit Life Ins. Co.*, 272 U. S. 613 (1926)

Moncure v. *Atlantic Life Insurance Co.*, 35 F. (2d) 360 (E. D. Va. 1929), aff'd 44 F. (2d) 167 (CCA-4, 1930), cert. den. 283 U. S. 823 (1931).

Federal Life Ins. Co. v. *Commissioner*, 22 B. T. A. 132 (1931) Acquiescence X-2 C. B. 23.

EXHIBIT B

The figures are obtained from Best's Fire and Casualty Aggregates and Averages, 1940 edition, pages 62, 68, and 82. They are reported there on the statutory basis required for reports to insurance departments of the various States. The statutory report is the basis of the tax reports (cf. sec. 204 I. R. C.), and a rough attempt has been made to adjust the insurance basis to the tax basis. The figures below, while they are approximations, are sufficiently accurate to illustrate the point. Dividends received are excluded from investment income and interest on tax-exempt securities is included, so that the only inadmissible assets are stocks.

[1] A detailed brief setting forth the scope of these rulings, regulations, and decisions has been prepared and will be furnished if so desired.

In the base period year 1939 stock casualty companies in the aggregate earned from underwriting operations (after Federal income taxes)	[1] $58,000,000
And from investments they earned $46,000,000, of which about one-third was tax-exempt dividends, so that the taxable income for excess-profits tax purposes was	31,000,000
Or a total of	[1] 89,000,000
The total assets of the companies, at cost value, were	1,615,000,000
The inadmissible assets (stocks) were	356,000,000
So the ratio of inadmissible to total assets was 22 percent.	
Capital, surplus, and special accounts (which are unquestioned equity invested capital) were	610,000,000
Adjust to cost value—add	57,000,000
For equity invested capital of	667,000,000
The true insurance reserves (unearned premiums and unpaid losses) were	846,000,000

[1] This estimate is of income after Federal income taxes were deducted. The amount of such taxes is not readily available, but taxable income (before taxes) may be crudely estimated as at least 10 percent higher. Thus even the credit including reserves as equity invested capital is less than the normal income.

	If the reserves are—		
	Equity invested capital	Borrowed invested capital	Excluded from invested capital
The average invested capital is	$1,513,000,000	$1,090,000,000	$667,000,000
The invested capital (reduced on account of inadmissible assets) is	1,180,000,000	850,000,000	520,000,000
And the excess-profits credit (at 8 percent) is	94,000,000	68,000,000	41,000,000
Compared with normal income of	[1] 89,000,000	[1] 89,000,000	[1] 89,000,000

The comparison of the credits with the normal income shows that in the normal year 1939 the credit counting reserves as equity invested capital is reasonable—the credit counting reserves as borrowed invested capital develops excess profits even in a normal base period year, and the credit with reserves excluded falls utterly to reflect the normal income.

[1] This estimate is of income after Federal income taxes were deducted. The amount of such taxes is not readily available, but taxable income (before taxes) may be crudely estimated as at least 10 percent higher. Thus even the credit including reserves as equity invested capital is less than the normal income.

LEGAL HISTORY OF RESERVES AS INVESTED CAPITAL OF INSURANCE COMPANIES SUBJECT TO TAX UNDER SECTION 204

The documents reproduced here are four in number:

(*a*) A letter dated February 21, 1941, and addressed to the Bureau of Internal Revenue, requesting a ruling on the problem of the treatment of insurance reserves in the computation of equity invested capital under the Second Revenue Act of 1940 and transmitting a brief on that subject.

(*b*) The brief itself, presenting the legal history of the treatment of reserves as invested capital.

(*c*) A letter dated March 6, 1941, addressed to the Bureau of Internal Revenue and pointing out that the excess-profits-tax amendments of 1941 apparently did not, because of lack of time adequately to consider the problem, provide completely adequate relief for abnormalities and that those working on the legislation had expressed the opinion that adjustments could be effected by a liberal policy of defining "equity invested capital."

(*d*) The Treasury's answer—T. D. 5059—excluding reserves from equity invested capital.

[Copy]

IVINS, PHILLIPS, GRAVES & BARKER,
Washington, D. C., February 21, 1941.

Hon. J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

In re: Massachusetts Indemity Insurance Co.—Equity invested capital—Treatment of insurance reserves. Attention Mr. McLaughlin, Legislative and Regulations Division.

SIR: Several weeks ago Mr. Phillips and Mr. Barker, of our office, had a preliminary conference with your Mr. McLaughlin regarding the problem of the treatment of insurance reserves in the computation of equity-invested capital under the Second Revenue Act of 1940. At that time Mr. McLaughlin advised that he did not know whether or not the problem would be taken care of under the regulations which would presently issue from the Treasury Department. The mutually suggested procedure was that we should wait until the regulations issued, and then if they did not touch the problem, we should request a ruling on the matter and support the request for a ruling with a memorandum brief.

It is apparent from a study of the regulations as issued that the problems of insurance companies were not considered in the drafting of the regulations, and accordingly we request a ruling to the effect that the reserves of casualty insurance companies should be treated as equity-invested capital in the computation of excess-profits taxes. Memorandum brief in support of this position is enclosed herewith.

We also request that we be afforded an opportunity for an oral hearing on this matter.

Respectfully,

———— ————.

THE TREATMENT OF INSURANCE RESERVES OF A CASUALTY INSURANCE COMPANY UNDER THE EXCESS-PROFITS TAX ACT OF 1940

STATEMENT

The regulations issued by the Treasury Department dealing with the excess-profits-tax provisions of the Second Revenue Act of 1940 are silent with respect to the treatment of insurance reserves for either life or casualty insurance companies or for either stock or mutual insurance companies. Patently, because of the election privileges mentioned in section 712 of that act it becomes important that a correct ruling on this question be made prior to March 15, 1941.

It is the purpose of this memorandum to show that the reserves of casualty insurance companies should be treated as equity invested capital under the Second Revenue Act of 1940, section 718. Probably the most effective method of arriving at a correct interpretation of section 718 is an historical approach. What was the treatment of insurance reserves under the invested capital provisions of the 1917, 1918, and 1921 excess-profits tax acts and do these acts differ, insofar as our problem is concerned, from the present act?

The following pages present first the statutes and the history of the interpretations, followed by the argument by which we support our contention.

STATUTES

The pertinent provisions of the 1917 Revenue Act are contained in section 207, reading as follows:

"SEC. 207. That as used in this title the term 'invested capital' for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

"As used in this title 'invested capital' does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

"(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock

or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year; * * *"

Section 326 of the Revenue Act of 1918 reads as follows:

"SEC. 326. (a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

"(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

"(5) Intangible property bonda fide paid in for stock or shares on or after March 3, 1917, than an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; but

"(b) As used in this title the term 'invested capital' does not include borrowed capital.

"(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

"(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

"The average invested capital for the pre-war period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years."

Section 326 of the Revenue Act of 1921 reads as follows:

"SEC. 326. (a) That as used in this title the term 'invested capital' for any years means (except as provided in subdivision (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

"(2) Actual cash value of tangible property, other than cash, bona de paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the

business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued therefor, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

"(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

"(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; but

"(b) As used in this title the term 'invested capital' does not include borrowed capital.

"(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

"(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall be the same fractional part of such average invested capital."

The substance of the pertinent provisions of these statutes is identical, being:

Invested capital means:

1. Actual cash paid in (for stock or shares).[1]

2. Actual cash value of tangible property paid in other than cash, for stock or shares in such corporation—at the time of such payment.

3. Paid-in or earned surplus and undivided profits.

The pertinent provisions of section 718 of the present act defining invested capital are as follows:

"SEC. 718. EQUITY INVESTED CAPITAL.

* * * * * * *

(1) *Money paid in.*—Money previously paid in for stock, or as paid-in surplus, or *as a contribution to capital;*

(2) *Property paid in.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or *as a contribution to capital.* Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. * * *

" * * * * * * *

(4) *Earnings and profits at beginning of year.*—The accumulated earnings and profits as of the beginning of such taxable year; * * *"

The only difference in substance between the quoted provisions of the old laws and the parallel provision of the 1940 act is the amount of credit given for property paid in. Under the old laws the value at the time it was paid in was taken; under the current act the "unadjusted basis" is substituted in the second paragraph. In this memorandum the words "first paragraph," "second paragraph," and "third paragraph" refer to the three parts of the definition of invested capital (or equity invested capital) as outlined in substance above, even though the third paragraph ("earnings and profits" or "surplus and undivided profits") bears the number (4) in the 1940 act.

There are certain changes in phraseology between the old acts and that of 1940 which were not intended to change the fundamental purpose of Congress which was to tax "excess profits."

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[1] *LaBelle Iron Works* v. *United States* (256 U. S. 377), for 1917 act. Specifically mentioned in 1918 and 1921 acts.

The only difference between the first paragraph of the earlier acts and the first paragraph of the 1940 act is that "paid-in surplus" is transferred from the third paragraph of the earlier acts to the first paragraph of the 1940 act (a purely formal change) and the words "contribution to capital" are added to the 1940 act. As will be pointed out later, this additional phraseology in the 1940 act is significant.

There is obviously no difference in effect between—

(*a*) "Actual cash bona fide paid in for stock or shares" and

(*b*) "Money previously paid in for stock."

Thus there is no difference between the second paragraphs of the earlier acts and the 1940 act except the significant added phraseology of "contribution to capital."

The verbal changes[2] in the third paragraph do not indicate any change in the basic objectives of Congress. The earlier acts used the words "earned surplus and undivided profits" while the present act uses the words "accumulated earnings and profits." The stated reason for using the words "accumulated earnings and profits" rather than the words used in the earlier acts was that the present words have been used more frequently in other revenue acts and therefore may more generally be understood.[3] If there are any differences in phraseology it is submitted that the present wording is broader in meaning than the words used in the earlier acts. Certainly there is no difference between the phrases "undivided profits" and "accumulated profits." The only difference between "earned surplus" and "accumulated earnings" is that the latter (from a bookkeeping angle) may not yet have been credited to the surplus account.

REGULATIONS AND RULINGS

The early regulations regarding the treatment of insurance reserves for invested capital purposes were amended soon after they were issued. T. D. 3153 was issued April 9, 1921 (4 C. B. 398), amending article 870 of Regulations 45 (1918 act), to read as follows:

"ART. 870. *Insurance companies.*—The reserve funds of life insurance companies, the net additions to which are deductible from gross income under the provisions of section 234 of the statute, cannot be included in computing invested capital. The like reserve funds of insurance companies, other than life insurance companies, may be included in computing invested capital. See sections 325 and 326 (a) (3) and (b) and articles 569 and 814."

By A. R. R. 3202 (II-2 C. B. 275) the same regulation was made applicable to the 1917 Revenue Act. Article 869 of Regulations 62 (1921 act, promulgated February 15, 1922), read:

"ART. 869. *Insurance companies.*—The reserve funds of insurance companies (other than life) the net additions to which are deductible from gross income under the provisions of section 234 of the statute, may be included in computing invested capital. See sections 325 and 326 and articles 569 and 814."

These regulations for other than life insurance companies have never since been changed or modified. As to mutual life insurance companies, the regulations were changed in 1927 (T. D. 4053, VI-2 C. B. 292) to give effect to the decision of the Supreme Court in *Duffy* v. *Mutual Benefit Life Insurance Company*, referred to below. But the Bureau maintained its position to the effect that the reserves of stock life insurance companies were not to be included in invested capital (I. T. 2423, VII-2 C. B. 320). This Income Tax Unit was overruled by the decision in *Moncure* v. *Atlantic Life Insurance Company*, referred to below.

In 1921 the Bureau of Internal Revenue issued Bulletin II, Income Tax Rulings Peculiar to Insurance Companies. Paragraph 10 of this bulletin deals with the invested capital of a life insurance company, and paragraphs 11-13 dealt with invested capital of mutual life insurance companies. Paragraph 28 deals with the invested capital of stock fire insurance companies. Paragraphs 41-42 deal with the invested capital of stock casualty insurance companies. These read as follows:

"41. *Invested capital.*—The invested capital of a stock casualty insurance company comprises the following:

"(*a*) Gross assets at the close of the preceding year.

[2] See joint hearings before the Committee on Ways and Means and Committee on Finance, Excess Profits Taxation, 1940, p. 95.

[3] Ibid.

"(*b*) Plus: Excess of cost price of real estate and securities over book value. (The result will be the gross assets on the basis of actual cost.)

"(*c*) Minus:

"(1) Excess of market value of real estate and securities over book value as indicated by items 39 and 40 on page 4 of the annual statement, convention edition;

"(2) Excess of book value of real estate and securities over cost. (The result will be the gross assets on the basis of actual cost.)

"(*d*) Minus:

"(1) Estimated expenses of investigation and adjustment of unpaid claims;

"(2) Commissions, brokerage, and other charges due, or to become due, to agents or brokers;

"(3) Salaries, rents, expense bills, etc., due or accrued;

"(4) Estimated amount hereafter payable for taxes (exclusive of Federal income and profits taxes);

"(5 Amounts due, or to become due, for borrowed money;

"(6) Interest due or accrued;

"(7) Returned premiums and reinsurance.

"(*e*) Minus: Depreciation, computed on the cost of buildings from the date of acquisition to the beginning of the taxable year.

"(*f*) Minus: Inadmissible assets computed in accordance with section 326 (c).

"(*g*) Plus or minus: Changes in invested capital during the year, computed in accordance with the regulations applicable to corporations in general, as follows:

Additions:

"(1) By sale of capital stock for cash or other assets;

"(2) By payment of assessments or surplus by stockholders.

"Deductions:

"(3) By payment of cash dividends out of the earnings of previous years, or the first 60 days of the taxable year;

"(4) By payment of Federal income and profits taxes.

"42. *Computation of invested capital.*—In view of the fact that the various State laws differ in regard to the computation of the unpaid claims reserve of stock casualty insurance companies, the computation of invested capital as outlined above must be based upon the same annual statement upon which the net addition to reserve funds is computed."

DECISIONS

The only case in the Supreme Court is *Duffy* v. *Mutual Benefit Life Ins. Co.* (272 U. S. 613 (1926)), which held that the reserve of a mutual life insurance company should be included as invested capital under the Revenue Act of 1917.

This decision was followed and applied to stock life insurance companies under the 1917 act in *Moncure* v. *Atlantic Insurance Co.* (35 F. (2d) 360 (E. D. Va. 1929), affirmed 44 F. (2d) 167 (C. C. A. 4th, 1930), certiorari denied 283 U. S. 823 (1931)). The Government's petition for certiorari states that by agreement with the Association of Life Insurance Presidents, this was a test case. The brief in opposition to certiorari contains the following paragraph (p. 4):

"If the learned Solicitor General in his reference to an understanding between the General Counsel of the Bureau of Internal Revenue and the Association of Life Insurance Presidents, on pages 7 and 8 of the petition, intended to inform the court that this case was selected as a test case to determine a like question affecting other stock life insurance companies, respondent acquiesces. But if he intended to suggest it had been agreed that the allowance of the prayer of the petition for certiorari is essential to a final and authoritative conclusion, respondent must emphatically disagree. An equally final and authoritative conclusion will be reached by a denial of the prayer of the petition."

After this statement the Supreme Court denied certiorari. It would seem to be pretty close in effect to an actual Supreme Court decision.

In *Federal Life Ins. Co.* v. *Commissioner* (22 B. T. A. 132, (1931), the Board decided that the reserves of a stock life insurance company should be included as invested capital under the 1918 act. In reaching this result, they overruled the earlier decision in *Home Beneficial Association* v. *Commissioner of Internal Revenue* (15 B. T. A. 1319 (1929)).

It should be specifically noted that the Commissioner of Internal Revenue acquiesced in the decision of the Board in the *Federal Life Insurance Co. case, supra* (X–2 C. B. 23).

ARGUMENT

It will be seen that almost from the formative period of the regulations and rulings dealing with the treatment of insurance reserves under the earlier revenue acts the reserves of casualty companies have been considered to be a part of their invested capital. Furthermore, the present statutory words for computing taxable income of insurance companies other than life and mutual first came into existence in the 1921 act. Thus the treatment of reserves for income-tax purposes was and has been the same under the 1921 Revenue Act,[4] and the present act and no logical distinction as to the treatment of reserves for invested capital purposes between the earlier Excess-Profits Act and the present Excess-Profits Act can be made on the ground of any difference between the two applicable revenue acts in their treatment of the reserves for normal tax purposes.

Under these circumstances it should be noted that T. D. 3153, supra, governing the treatment of reserves for casualty companies and including such reserves in the invested capital of those companies, was in existence when the Revenue Act of 1921 was adopted. Under the doctrine of *Helvering* v. *Winmill* (306 U. S. 10), dealing with the reenactment of similar statutes in the light of existing rulings, the treatment of casualty company reserves as invested capital has been given legislative approval.

Even more important than the doctrine of reenactment[5] is the long-continued practice of the Treasury Department in treating the reserves of casualty insurance companies as invested capital. Even though the Bureau of Internal Revenue contested the right of life insurance companies to treat reserves as invested capital until 1931,[6] it consistently ruled otherwise with respect to other than life insurance companies. In fact the Bureau particularly emphasized its ruling in Bulletin H, supra, wherein it sets forth in detail the methods to be used by casualty insurance companies in computing their invested capital.

It is submitted, therefore, that because of the similarity of the invested capital provisions of the present act with the provisions of the earlier acts the reserves of a casualty insurance company should be included in its equity invested capital.

Other pertinent reasons exist why the reserves of a casualty insurance company should be included in its invested capital. It will be noted that in the *Duffy case*, supra, the Supreme Court paid particular attention to the inequities that would result in the administration of the law if a different result were reached. Based on this principle, the Court said:

"We cannot suppose that Congress intended such a result; * * *." The same argument would be even more patently applicable to our particular problem. Assume two stock casualty insurance companies A and B. A loses all its records in a fire or hurricane and cannot compute its equity invested capital. Consequently, it would be relegated to the application of section 723 and would include in its equity invested capital—

(*a*) Money.
(*b*) Adjusted basis of assets.

and would reduce this by its outstanding indebtedness. The reserves, not being debts (see *Duffy case*, supra, and sec. 719), would not be deducted from the sum of (*a*) and (*b*), so the assets which offset the reserves on the balance sheet would remain in equity invested capital. The effect is to compute equity invested capital in a manner similar to the computation of invested capital as set forth in Bulletin H, supra. Congress certainly never intended such disproportionate results as would result from denying the right of B to include its reserves in invested capital simply because it failed to enjoy the happenstance of a fire or hurricane. It is submitted that in the light of section 723 Congress intended section 718 to be interpreted in the same manner that Bulletin H interpreted the earlier revenue acts.

It should be noted that the Commissioner for over 10 years has acquiesced in the decision of the Supreme Court in the *Duffy case*, *supra*, (T. D. 4053 supra)

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[4] The principle of allowing additions to reserves as a deduction in computing taxable income existed under the 1918 act.

[5] See A Summary of the Regulation Problem, by Prof. Erwin N. Griswold, LIV Harvard Law Review, January 1941.

[6] *Federal Life Insurance Co.*, supra.

and for approximately 10 years has acquiesced in the decision of the fourth circuit in the *Atlantic Life Insurance Co. case, supra.* (Acquiescence in the *Federal Life Insurance Co. case, supra.*) Both those decisions primarily bottomed their opinion on the principle that insurance reserves should be included in invested capital under paragraphs 1 and 2 of the invested capital sections of the statute (money and property paid in, etc.) rather than under paragraph 3 of the statute[7] (surplus and profits). It would be reasonable to presume, therefore, that the Bureau rulings, dealing with other than life insurance companies, placed their reserves in invested capital under paragraphs 1 and 2 of the earlier acts. If this assumption is correct, and certainly it is logical, then it is submitted that the reserves of other than life insurance companies belong in equity invested capital under section 718 of the present act. Paragraphs 1 and 2 of the present act, so far as our problem is concerned, are no narrower than the original acts and if anything provide a broader statutory provision.

It is submitted that the present act should be considered as containing broader statutory provisions because paragraphs 1 and 2 contain the additional phraseology "contributions to capital."[8] Under the earlier acts cash or property turned over to a corporation by stockholders, not as a loan but as a contribution to capital, was always recognized as part of invested capital. If stock was issued for them they were included in paid-in capital; if no stock was issued for them they were included in paid-in surplus. (Regulations 45 and 62, arts. 813 and 837; A. R. R. 78, 2 C. B. 273.) However, contributions by persons other than stockholders was generally excluded under the earlier acts. (*Tampa Electric Co.*, 12 B. T. A. 1002; *Holton & Co.*, 10 B. T. A. 1317.) They were excluded in the cases of most all corporations until the *Duffy case, supra*, recognized that insurance companies, at least, were in a special category. In the *Duffy case*, the Court specifically spoke of life insurance reserves as contributions to capital. It said:

"True, the amount of the reserve is carried on the books as a liability, but only as the capital stock of a stock corporation is carried on its books as a liability. In both instances it is a form of bookkeeping to balance assets, which in the one case is contributed by the members and in the other by the stockholders."

It is admitted that the Supreme Court was speaking of a mutual company. But the Circuit Court of Appeals for the Fourth Circuit reasoned with respect to a stock company that the policyholders were in reality preferred stockholders and that both the stockholders and the policyholders had an associate interest in the reserves.[9] Certainly, the reserves are not debts. See *Duffy case, supra.* Cf. section 719. It would therefore seem reasonable to state that Congress by inserting the words "contributions to capital" in the 1940 act either wanted to correct the narrow interpretation resulting from the *Tampa* and *Holton decisions, supra*, or at least wanted to give legislative recognition to the *Duffy* and *Moncure cases, supra*, which recognized that reserves of insurance companies were contributions to capital.

It has been noted above that the Fourth Circuit Court of Appeals in the *Atlantic Life Insurance Co. case* also bottomed its decision on the principle that the reserves should be included in invested capital under the third paragraph of the invested-capital provisions as "earned surplus." As was said by the district court in that case:

"In the meantime, it (the reserve) is part and parcel of the assets used in the business of the company for purposes of profit, but retained to provide for future and contingent liabilities. Until liability occurs, it is surplus, because it represents the amount of value of present assets over present liabilities."

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[7] The fourth circuit rendered its decision in the alternative, i. e., both pars. 1 and 2 as well as par. 3.

[8] See pp. 5 and 6, supra.

[9] The fourth circuit said in the *Atlantic Life Insurance Co. case:*

"The amount paid in by policyholders and carried in the legal reserve of the company was certainly money paid in by them for shares in a common fund—a fund maintained for their benefit and invested for their advantage, as well as for the advantage of the company."

See also the language of the Circuit Court of Appeals for the Second Circuit in *New York Life Ins. Co.* v. *Bowers* (39 F. (2d) 556 at 559 (affirmed, 283 U. S. 242)). The court said:

"For it is possible to regard the policyholders even of a stock company as also associates in the enterprise, and perhaps that is the juster view."

We have previously pointed out that there is no distinction between "earned surplus and undivided profits" in the earlier acts and "accumulated earnings and profits" in the present act. In *Cummings* v. *Commissioner* (73 F. (2d) 477 (C. C. A., 1st), 1934), the Court said:

"If these funds, however derived, belonged to the company when received, they would go to increase its surplus, and it cannot be seriously argued that the surplus funds in the hands of the company over and above its stock liability are not the earnings or profits contemplated by the section."

The fact that these reserves have not been subjected to income tax does not negative this conclusion. From the point of view of contributions to capital it supports it, for contributions to capital are not taxed as income. Nor does the fact that the items in question have not borne income tax destroy the analogy to accumulated earnings and profits as a part of invested capital. There are many situations in which nontaxed amounts have been held to be nevertheless invested capital. An example of this is found in *Appeal of National Grocer Co.* (1 B. T. A. 688). The property of the taxpayer was taken by a railroad company. The price paid by the railroad company showed the taxpayer a net gain of $98,768. By reason of the "involuntary conversion" provisions of section 234 (a) (14) of the Revenue Act of 1921, $51,252.58 was allowed as a deduction and only $47,515.42 was taxed as income. The Board held that the entire $98,768 was properly part of earned surplus, saying:

"This sum of $98,768 was a gain or profit accruing to the taxpayer from dealings in property and, under the provisions of section 213 of the same revenue act, the taxpayer was required to report this gain as a part of its gross income for the calendar year 1917; and, except for the retroactive exemption contained in the Revenue Act of 1921, section 234 (a) (14), the full amount of this gain and profit would then have been taxable income. Congress, however, saw fit to provide, in the Revenue Act of 1921, that an ascertainable proportion of this gain, realized by the taxpayer under the conditions prescribed, should be deducted from gross income. In like manner Congress has provided for the exemption from taxation of gains and profits from other sources, among which are dividends received by one corporation from other domestic corporations; and it has also provided that certain gains and profits should be excluded from gross income, among which are amounts of interest received upon the obligations of States and municipal subdivisions thereof and certain obligations of the United States. All of these gains and profits, however, received by a corporation and exempt from income taxes, must necessarily find their way into and become a part of the surplus and undivided profits of such corporation, and we have yet to hear of anyone claiming that amount of interest upon municipal obligations, and dividends upon the stock of other corporations, either should be or could be eliminated from the sum of surplus and undivided profits which the law provides shall be included in invested capital.

"The surplus and undivided profits of a corporation at any given time is made up of all the realized gains, profits, and income of preceding years or periods and which remains after expenses and dividends are paid. (*Marks* v. *American Brewing Co.*, 52 South. 985). It thus conclusively appears that this sum of $51,252.58, having been a part of the realized gains and profits of this taxpayer for the calendar year 1917, although not included in its taxable net income, found its way into the company's general account of surplus and undivided profits, and section 326 of the Revenue Act of 1918 specifically provides that so much of this surplus and undivided profits account as remains in the possession of the corporation at the beginning of any taxable period shall be included in invested capital. It appears that there is no authority in any revenue act nor is there any accounting reason, to support the action of the Commissioner in eliminating this sum from the taxpayer's invested capital for the years 1918 and 1919."

The Commissioner acquiesced. (IV-1 Cumulative Bulletin 3).

Another analogy may be found in the receipt of a dividend by a corporation: Only 15 percent of the corporation dividend is taxed (formerly none of it was taxed), but the entire dividend is earnings and profits within the meaning of that term. Similarly, reserves of a casualty insurance company become taxable income only to the amount by which the reserve is decreased during the year, but would anyone doubt that if it violated the State law and declared a dividend which invaded its reserves the Commissioner would hesitate to tax it to the stockholders as a dividend declared out of "earnings and profits"?

CONCLUSION

We are dealing here with a rather unusual situation, as far as the excess-profits tax is concerned. The statute makes no specific reference to insurance companies; Congress was primarily occupied in drafting it with the problems of ordinary business companies. As to such companies, it may be that the words of the statute can be applied with a rather narrow literalness. It is plain, though, that any such purely literal construction would not carry out the real underlying intent of Congress if it is applied to insurance companies. There is no reason why it should be so applied. What Congress was trying to reach was extraordinary profits, profits above those which represent the fair return on the assets normally used in the business. The words used by Congress must be construed in the light of the nature of the business to which they are applied. In the case of insurance companies other than life or mutual, the reserves represent assets normally used in the business, paid in by active participants in the business whose position is very closely analogous to that of preferred stockholders. The fact that the reserves appear on the liability side of the balance sheet does not oppose this conclusion; it supports it. That is where capital and surplus do appear on the balance sheet. The reserves represent a segregation of those items with respect to the participation in the company by the policyholders.

The courts in the *Duffy* and *Atlantic Life Insurance cases* did not proceed upon a sterile literal interpretation of the narrow sense of the words used in the statute. They recognized that such an interpretation would not carry into effect the fundamental intention of Congress when it passed the act so far as these insurance companies were concerned. They recognized that the "Capital stock" item and the "Insurance reserve" item in the balance sheet were both expressions showing the source of funds "paid in" to the company and held as part of the assets which make possible the company's business operations. The assets derived from both sources are as essential to those operations as fixed assets are to a manufacturing plant. Both items in the balance sheet thus share essential characteristics of "equity invested capital" as developed in the statute. The attention of Congress was not directed to the peculiar problems of insurance companies when the statute was drafted. But there is certainly nothing in the statute to indicate in any way that Congress had any intention to be harsh or unfair in dealing with such companies. To apply the statute in a narrow literal way would lead to such a harsh and unfair result. Therefore we must seek the substance of the statute, its real purpose, as the courts did in the *Duffy* and the *Atlantic Life Insurance cases*, and as the Commissioner did when he promulgated Treasury Decision 3153 in 1921 (applied by the Bureau in Bull. H), and when he acquiesced in the *Federal Life Insurance case* in 1931.

The possibility has been suggested that section 722 was provided by Congress to take care of hard cases and might be applied to the returns of casualty insurance companies. But it seems unlikely that Congress intended that every casualty insurance company should be taxed under section 722. If it had that intention, it would probably have said so. Moreover, from the administrative point of view, it would seem unfortunate to throw all of those complicated cases into a section 722 proceeding, especially when it is clear that those companies do not have what is fundamentally "excess profits." It would be wiser to view the problem in the large; seek what Congress was really driving at; and reach an administrative ruling that will fully carry out the fundamental intention of Congress when the law is applied to casualty insurance companies.

Looked at from the point of view of substance, and the real purpose of Congress in enacting the excess-profits tax, there can be no doubt that the reserves in question should be treated as equity invested capital.

Respectfully submitted.

[Copy]

IVINS, PHILLIPS, GRAVES & BARKER,
Washington, D. C., March 6, 1941.

COMMISSIONER OF INTERNAL REVENUE,
Bureau of Internal Revenue, Washington, D. C.
(Attention P. J. Mitchell.)

In re Massachusetts Indemnity Insurance Co.

SIR: In connection with the question of including insurance reserves in equity invested capital, we desire to call your attention to the effect that H. R. 3531 has upon the question from the standpoint of general Bureau policy.

When section 722 was first put into the Second Revenue Act of 1940 it provided for adjustments for abnormalities arising out of either income or invested capital. In H. R. 3531, in the Senate committee report (Rept. No. 146, 77th Cong., 1st sess.), the committee says:

"In view of these compelling motives, the provisions of that act lay a tax upon that portion of the earnings of corporations determined to be excess profits. The tax rates provided, or even higher rates, are thoroughly justified if the income subject thereto is clearly of the type intended to be reached. At the same time, equitable considerations demand that every reasonable precaution be taken to prevent unfair application of the tax in abnormal cases. The weight of the burden imposed carries with it a commensurate need for restricting its application to the cases for which it was designed."

The Congress then set out, in H. R. 3531, to attempt to formulate some definite policies with respect to the application of section 722 of the Second Revenue Act of 1940. However, in working out these problems, it becomes apparent that the Congress has only provided for abnormalities which affect the base period earnings method of determining the excess-profits tax credit, and has not provided formulae adjusting for abnormalities in the equity invested capital method of determining the credit for excess profits tax purposes.

Investigation among the Members of Congress and their assistants who worked on the drafting of H. R. 3531 discloses that they realized that they would not have time to tackle all phases of abnormalities, but they have variously expressed the opinion that the Bureau, insofar as abnormalities of invested capital were concerned, could probably take care of such adjustments through a liberal policy of determining a correct definition of equity invested capital.

We therefore submit that in the light of this situation, our client who, solely because of the lack of time to properly evaluate the problem, has lost the right to use section 722 as a relief provision in determining its equity invested capital, should be entitled to a liberal ruling from the Bureau on the problem presented in the prior memorandum.

Respectfully,

TREASURY DECISION 5059, AMENDING SECTION 19.115–3 OF REGULATION 103, RELATING TO EARNINGS OF PROFITS, AND SECTIONS 40.718–1 AND 30.718–2 OF REGULATION 109, RELATING TO DETERMINATION OF DAILY EQUITY INVESTED CAPITAL

Paragraph 1. Regulations 103 (pt. 19, title 26, Code of Federal Regulations, 1940 Sup.) are amended by striking out the first sentence following the heading of section 19.115–3 as amended by Treasury Decision 5024, approved December 19, 1940 (C. B. 1940–2, 110), and inserting in lieu thereof a new paragraph as follows:

"In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance, a corporation keeping its books and filing its income tax returns under sections 41, 42, and 43 on the cash-receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income in the installment basis as provided in section 44 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 204 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 204 (b) (5) and which is segregated accordingly in the unearned premium reserve."

Paragraph 2. Regulations 109 (pt. 30, title 26, Code of Federal Regulations, 1941 Sup.) are as follows:

"(A) Section 30.718–1 is amended by inserting after the second sentence in the first paragraph a new sentence as follows:

"The terms 'money paid in' and 'property paid in' do not include amounts received as premiums by an insurance company subject to taxation under section 204.

"(B) Section 30.718–2 is amended by inserting after the third sentence in paragraph (a) a new sentence as follows:

"See, for instance, section 19.115–3 of Regulations 103, as amended, relating to the computation of earnings and profits in the case of a corporation computing net income on the cash, accrual, or installment basis, or in the case of an insurance company taxable under section 204."

(This Treasury decision is issued under the authority contained in section 62 of the Internal Revenue Code (53 Stat. 32, 26 U. S. C., Supp. V, 62) as made applicable by section 729 of such code, added by section 201 of the Second Revenue Act of 1940 (Public, No. 801, 76th Cong., 3d sess.); section 115 of such code (26 U. S. C., Supp. V, 115); and section 718 of such code as added by the Second Revenue Act of 1940.) (T. D. 5059; 1941-28-10778.)

The CHAIRMAN. Mr. Pach.

Will you give your name and state for whom you are appearing?

Mr. PACH. I am Vincent Pach, treasurer of the Bath Iron Works Corporation, and while my name is listed on the calendar to present this memorandum, I should like the privilege of having our accountant, Mr. Stoler, present it for me. He is here.

STATEMENT OF G. VINCENT PACH, BATH, MAINE, REPRESENTING BATH IRON WORKS CORPORATION, READ BY MICHAEL N. STOLER

Mr. STOLER. Mr. Chairman, this has to do with an apparent inequity in the excess-profits tax provision in computing the tax on long-term contractors. I should like to read from this memorandum.

This memorandum deals with what appears to be an inequity in the Second Revenue Act of 1940, as amended, which inequity it is hoped will be amended in the Revenue Act of 1941. The point in question deals with the earned-income base used by long-term contractors, as different from the base used by contractors who have reported their income on the percentage of completion basis.

1. A long-term contractor (contracts covering a construction period of 12 months or more) has the option, for Federal income-tax purposes, of either reporting his income at the time when the contract is closed out and the profit is definitely determined or else reporting the estimated profit annually, as earned (sec. 19-42-4, Regulations 103). Also under the regulations of the Commissioner of Internal Revenue, a method once adopted can be changed only after permission is secured from the Commissioner, as provided in sec. 19-41-2, Regulations 103.)

2. The foregoing has been in the regulations for many years and has proven equitable over the years. However, the inequity appears in the basis used in arriving at the base period net income for the years 1936-39 for excess profits tax purposes. (Sec. 30-721-1, Regulations 109.)

3. The second revenue act, as amended, affords some relief to a contractor reporting his earnings for income tax purposes on the completed contract basis, in that earnings arising prior to 1940 or subsequent to 1940 applicable to other years, are treated as abnormal income and are taxable at the excess-profits tax rates in effect during the years when the income was earned; thus, any abnormal income applicable to years prior to 1940 but received in 1940 would not be subject to excess profits tax.

But, in connection with base period net income which is the important factor to consider, section 721-3 of excess profits tax regulations 109, amended, reads as follows:

"Section 721 has no effect upon the computation of base period net income or of earnings and profits and therefore does not affect the computation of the excess profits credit.

Similarly, it has no application in the determination of taxes other than the excess profits tax imposed by subchapter E of chapter 2. Amounts attributed to future years are to be included in gross income for such years for excess profits tax purposes only.

4. Thus a contractor reporting on the percentage of completion basis has an advantage over a contractor who reported the earnings on the completed contract basis.

As an example, we can take two companies, both in the very same line of business and operating under the very same conditions. Company A had reported its earnings on the completed contract basis while Company B had reported its earnings on the percentage of completion basis. Further assuming that both companies have had contracts which took them approximately 3 years to complete, the average earnings basis for the two companies would be somewhat as follows:

	Company A	Company B		Company A	Company B
Net earnings—			Net earnings—Continued		
1935		$200,000	1939		$400,000
1936		200,000	1940	$1,200,000	400,000
1937	$600,000	200,000			
1938		400,000	Total	1,800,000	1,800,000

Thus, while both companies have approximately earned the same profit during the years 1935 to 1940, applying the earnings to the base years 1936 to 1939, we find that Company A has only an excess-profits credit of $150,000 ($600,000÷4) while Company B has an excess-profits credit of $400,000 (the average earnings for 1938 and 1939).

5. The Senate Finance Committee in its report on the Second Revenue Act of 1940, apparently realized the disadvantage to contractors who, in the past, had adopted the conservative basis of reporting on the completed contract basis, and stated in its report as follows:

> If it is determined that the income received in the taxable year is attributable to years in the base period, the amount of such income so attributable to such years will have the effect of increasing the base period net income and thus the credit under the average earnings method.

6. The regulations of the Commissioner of Internal Revenue, however, do not permit the inclusion of income in the base period earnings unless they were so reported in the tax returns for the base years. (See sec. 721 above.)

7. It is, therefore, suggested that contractors who have reported their earnings on the completed contract basis during the base years 1936 to 1939, inclusive, be permitted to arrive at an earnings base determined on the percentage of completion basis, as recommended by the Senate Finance Committee.

The reason we started with 1935 is that the contract may have been started at that point; both companies through 1940 have earned the same amount of money.

The CHAIRMAN. Any questions?

(No response.)

The CHAIRMAN. Thank you. Mr. Hook?

Mr. HOOK. I should like to have the privilege of reading this statements first, Senator, and then answering any questions which the committee may have.

The CHAIRMAN. Yes; you may proceed with it.

STATEMENT OF CHARLES R. HOOK, MIDDLETOWN, OHIO, REPRESENTING THE AMERICAN ROLLING MILL CO.

Mr. HOOK. My name is Charles R. Hook. My address is Middletown, Ohio, and I appear on behalf of the American Rolling Mill Co.

We submit to this committee that section 204 (2) of House bill 5417 should be eliminated entirely or at least amended to substitute the year 1941 for the year 1940.

Section 204 (3) of the House bill proposes to amend section 710 (c) 1 of the Internal Revenue Code, which defines the unused excess-profits credit, by adding at the end thereof a new sentence.

This new sentence provides that the excess-profits credit and the excess-profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to 1941. This means, briefly stated, that the excess-profits credit carry-over for 1940 is to be recomputed under the new 1941 law, and is not to be the amount originally computed under the 1940 law.

The original excess-profits tax law was approved October 8, 1940. At that time it was generally recognized that there were certain extreme hardship cases; as a result, the experts of the Treasury and of the Joint Committee on Internal Revenue Taxation were requested to make a further study of such hardship cases.

The excess-profits-tax amendments of March 7, 1941, were the result of such study, and were in the nature of relief provisions. Among such relief provisions was that portion of the new amendment which allowed a 2-year carry-over of any unused excess-profits credit. The committee reports and the discussion of the amendments on the floor of the House and the Senate contained many statements to the effect that, after the most careful consideration by the tax experts, this carry-over provision was conceived and recommended for passage.

You will find collected in appendix A of this statement a number of the statements made by the chairman of the Ways and Means Committee and the Finance Committee, and by members of such committees in explaining the amendments to the House and the Senate. It is sufficient here to quote only one of such statements, that is, that found in the report of the Senate Committee on Finance, reading as follows:

> The bill affords relief in the following situations:
> (1) It relieves the hardships which may be caused by the sharply fluctuating earnings of many types of companies, the activities of which are dependent upon business cycles, by allowing unused excess-profits credits to be carried over into the 2 succeeding taxable years, thereby tending to level off the unusual effects due to rise and fall of income. In addition, the allowance of such an excess-profits credit carry-over will be of substantial benefit to new corporations, and to old corporations undergoing a period of expansion.

And I particularly call your attention, gentlemen, to the last part of that sentence, "And to old corporations undergoing a period of expansion." Because that hits us right in the eye.

After the passage of the excess-profits tax amendments on March 7, 1941, the directors, officers, and advisers of the American Rolling Mill Co. surveyed the excess-profits tax provisions and came to the conclusion that if any principle had been established after the most careful consideration, it was that portion of the bill which provided for an excess-profits tax carry-over computed in the manner provided by the

1940 law as thus amended. Accordingly, the American Rolling Mill Co. determined that it had a substantial excess-profits tax credit carry-over from 1940 into 1941; and on the basis of such determination proceeded with the development and execution of certain parts of a large national-defense construction program.

Section 204 (e) if enacted into law, would completely eliminate such excess-profits credit carry-over. It wipes it out completely. The American Rolling Mill Co. would find itself in the position of having made substantial commitments on the basis of an excess-profits credit carry-over which the House bill now proposes completely to eliminate. That this proposal is inequitable and unfair, seems too clear for argument. In the determination of many corporate policies during 1941, the excess-profits credit carry-over computed under the 1940 law was a material determining factor.

Senator BROWN. You mean by that, as to a great many companies, as well as your own?

Mr. HOOK. Yes, indeed.

Senator BROWN. That they adopted policies because of the law that was passed?

Mr. HOOK. Unquestionably, Senator.

The proposed amendment results in further unfair discrimination. Corporations which were prosperous in 1940 computed their excess-profits credit under the 1940 law and obtained the full benefit thereof in determining 1940 excess-profits liability. Corporations which were not sufficiently prosperous to use up their entire credit, as computed under the 1940 law, now find that it is proposed entirely to take away a portion of that credit; that is, corporations not using up their entire credit in 1940, now find the unused portion thereof is to be reduced or, as in our case, entirely eliminated. This, it seems to us, unfairly favors the prosperous corporations and penalizes the less fortunate ones.

That the proposal contained in section 402 (e) is really discriminatory is shown by the fact that a corporation which did not need all its excess-profits tax credit in 1940 will pay a higher excess-profits tax for the 2 years of 1940 and 1941 in relation to its earnings than a corporation which could take advantage of and use up its entire excess-profits tax credit in 1940.

And that, gentlemen, I think is a pretty serious matter. I think that is evidently very discriminatory and I don't believe the House intended it should be. I can't believe it was given the consideration and thought that it deserved when this section was put in.

Approximately 5½ months have expired since the passage of the excess-profits tax amendments on March 7, 1941. Within such period, corporate policies as affected by tax considerations have become crystallized.

We submit it is unfair and discriminatory at this time to reduce the excess profits credit carry-over from 1940, which was a material factor in such policy determinations. We urge, on the contrary, that section 204 (e) should either be entirely eliminated, or that it should be amended so as to make its provisions applicable in a prospective manner only—not in a retroactive manner.

Senator TAFT. Mr. Hook, I have had several letters from other concerns. Have you had any communications from Cincinnati concerns?

Mr. HOOK. Yes; it happens they have been sent here to Washington. I did not know whether I would have time to introduce those. One is the Rapid Electrotype Co., of Cincinnati, whose invested capital is $880,375.35 which shows that it is not a big company. To them this is a very serious matter.

Let me read a portion of this and if you like, I will leave it for the record.

The CHAIRMAN. Yes; you may do that.

Mr. HOOK. It says:

In our particular case, our excess-profits credit computed under the invested capital method was $70,430.03, and our excess-profits net income for 1940 was $16,072.06, leaving an excess-profits credit carry-over of $54,357.97. For the year to date our excess-profits net income is approximately equal to our excess-profits credit, so that we may be compelled to pay an excess-profits tax for 1941 even though for the years 1940 and 1941 combined we will not have earned net income equal to the percentage of invested capital fixed by Congress in determining excess profits. This will work a hardship upon us, for it will retard our recovery from a long series of unprofitable years.

Senator TAFT. File that.

Mr. HOOK. Yes.

Senator TAFT. Have you another one?

Mr. HOOK. This is short, and I will read it. It was written to me under date of August 11, 1941, by the Sorg Paper Co., of Middletown, Ohio. It says:

Mr. C. R. HOOK,
American Rolling Mill Co.,
Middletown, Ohio.

DEAR MR. HOOK: Pursuant to our conversation, we hereby authorize you to act for and in our behalf with respect to securing a revision of section 204 (c) of the revenue bill of 1941.

This section of the act seems to us very unjust and places our company, as well as others, at a decided disadvantage because it reduces the benefits of the carry-over of unused credits from 1940, a year in which the earnings of many companies did not require the payment of excess-profits taxes.

Our company will be obliged to pay approximately $20,000 more income and excess-profits taxes should the above section of the revenue act become operative. While this amount from a percentage standpoint is only approximately 6½ percent, it is from a dollar-and-cent basis the equivalent of a quarter of a year's dividend on the preferred stock of our company. At the present time we are in arrears over $290,000 on preferred dividends.

The attached exhibits show how section 204 (c) adversely affects our company.

Yours very truly,

THE SORG PAPER COMPANY,
(Signed) J. A. AULL, Jr.,
Vice President and Treasurer.

Senator RADCLIFFE. Do you care to make on estimate by percentages or any other way what will be the effect of this on your own company?

Mr. HOOK. Yes; I can give you that exactly.

If you would like, while I am giving you these figures, here are some extra copies. I will be glad to pass them around.

Now, what you want is exactly the dollar-and-cent effect on our particular company if this provision, 204, remains in the bill?

Senator RADCLIFFE. Yes; I would like to see how it would work out, either by actual figures or percentages.

Mr. HOOK. I will give you exhibits A and B, and here is another exhibit which will show another phase of this situation.

On exhibit B, which you have there, Senator, you will notice that on the first set-up on the left we show the tax which would be paid for the 6 months and for the year, the year being based on the actual earnings for the 6 months, after giving effect to section 204 of the bill.

Now, on the right, we set it up showing what it would be if section 204 (e) were eliminated. In other words, in the first 6 months of 1941 we will pay, if this amendment stays in, $6,545,118.72, as against $5,979,736.52 if it were eliminated.

In other words, on an annual basis, multiplying the difference by 2 for the 6 months, it amounts to $1,130,764.42, which, in view of the large amounts of money we have borrowed ourselves—not from the Government but from financial institutions for these larger defense construction purposes—makes it, as you can see, a very considerable item.

Senator TAFT. How much money have you spent in expanding your plant?

Mr. HOOK. Well, I thought somebody would ask me that question so I had better have it with me.

Since August 1, 1940, up to and including August 1, 1941, we have borrowed in all $34,000,000. Now 3½ million dollars of that was to pay off a $2,000,000 first mortgage serial note which we guaranteed of a company we took over.

And a million and a half of bank loans paid off so it left a net of $30,500,000, all of which has gone into national-defense construction, or for working capital to support defense projects.

That statement is supported by the fact that we have had issued to us up to the present time necessity certificates which are only issued where the project is a national-defense one and considered necessary in the interest of national defense.

The total amount of these certificates approved, excluding land, is $22,922,402.80, so you can see, from what I say with respect to these larger amounts of money borrowed to go into essential and necessary defense projects what our problem is.

Senator TAFT. Those are all company projects; they are not loans from the R. F. C.?

Mr. HOOK. There is a $12,000,000 loan which is a straight R. F. C. loan for the Houston, Tex., plant. The twenty-two-million-odd dollars are loans made from two insurance companies, and the longest term on any one of these loans is 15 years; that is one, the balance are all 10 years.

Senator TAFT. Now you had a carry-over of something like $2,000,000 under the old law, and that $2,000,000 carry-over is now entirely eliminated?

Mr. HOOK. Yes; we had a carry-over of $2,692,296.24, and by applying the 1941 law to 1940 it completely eliminates it, and I will show you how, if you want these exhibits.

Senator CONNALLY. Have you a lot of national-defense contracts?

Mr. HOOK. You mean direct orders from the Government?

Senator CONNALLY. Direct or indirect.

Mr. HOOK. Yes; take, for instance, one of our plants is operating 80½ percent on defense orders.

Senator CONNALLY. You are making money on that, aren't you?

Mr. HOOK. I think we are making some money on that.

I am glad you asked that question because on another we have, for instance, one of our plants at Butler, Pa., and it is no secret—and I don't mind telling you so—where, because of this unusual situation, shortage of scrap and ceiling set on our prices, we are not even coming out on a works profit on a large part of our operations.

Senator CONNALLY. You figured that when you submitted the bids, didn't you?

Mr. HOOK. No; we didn't.

Senator CONNALLY. One reason you are going to make more money in 1941 than in 1940 is because of these war contracts, isn't it?

Mr. HOOK. Well, it is the total——

Senator CONNALLY. Well, is it or isn't it?

Mr. HOOK. Of course, defense has stimulated business.

Senator CONNALLY. But you want to carry over your 1940 credit as against this stimulated business?

Mr. HOOK. No; I am not arguing against the increased revenue to the Government.

Senator CONNALLY. But you want somebody else to pay it.

Mr. HOOK. No; I want an equitable arrangement whereby the inequities of the law will be changed.

Senator TAFT. You don't want the Government to go back on its word.

Mr. HOOK. Yes.

Senator CONNALLY. Well, the Government doesn't go back on its word because everybody who deals with the Government knows that laws will be passed——

Senator TAFT. The Government has no word, is that it?

Senator CONNALLY. That isn't it; when the Government passes a law that is not going back on its word.

The CHAIRMAN. What was your normal income tax?

Mr. HOOK. $2,128,996.96.

The CHAIRMAN. That was the normal tax paid for 1940?

Mr. HOOK. Yes.

The CHAIRMAN. You had a credit under the excess-profits tax which you would carry over but for the reversal of credit under this bill?

Mr. HOOK. That is right; we would have had a carry-over of $2,692,296.24.

The CHAIRMAN. And you don't have this credit now because of the reversal of the credit?

Mr. HOOK. That is right.

The CHAIRMAN. That is substantially what your situation is?

Mr. HOOK. Yes; the reduction in invested capital, of course——

The CHAIRMAN. Yes; yes.

Mr. HOOK. But here we have an exhibit, Senator, which shows exactly how that works out, the actual figures.

Senator GUFFEY. A few days ago I passed through Butler and by your plant and I didn't see any shortage of scrap in the pile there along the railroad for about a mile. How much scrap do you use?

Mr. HOOK. Well, that plant—we have to buy, normally, if we get our normal supply of pig iron, approximately 28,000 tons per month. Now, you saw a lot of scrap there, if you passed through there, that normally we would not use; we call it "hay." That is why it has increased our cost of operations.

Senator GUFFEY. What plant are you building in Texas?

Mr. HOOK. The Sheffield Steel Corporation of Texas, a wholly owned subsidiary of American Rolling Mill.

Senator GUFFEY. An open-hearth plant?

Mr. HOOK. Yes, open-hearth. We make rods, billets, bars, plates, and wire.

Senator GUFFEY. Where is it?

Mr. HOOK. At Houston, on the ship canal, just 10 miles out of the center of the city.

The CHAIRMAN. Any additional questions?

(No response.)

The CHAIRMAN. Put in the record any exhibits or letters that you have so that we may have them.

(The letter dated August 11, 1941, from the Rapid Electrotype Co., and telegram of August 16, 1941, from Rapid Electrotype Co., interoffice communication of August 19, 1941, from Mr. Kingsbury, exhibits attached to letter of August 11, 1941, from Sorg Paper Co., and exhibits A and B of American Rolling Mill Co., and appendix A, excerpts from the Congressional Record and the Congressional Committee Reports, referred to by Mr. Hook, are as follows:)

THE RAPID ELECTROTYPE CO.,
Cincinnati, Ohio, August 11, 1941.

Mr. CHARLES R. HOOK,
Mayflower Hotel,
Washington, D. C.

DEAR MR. HOOK: We understand that you are proposing to make a protest to a congressional committee against the proposed elimination of the excess-profits credit carry-over provision of the present excess-profits-tax law. As we are not in a position to make a visit to Washington or to employ counsel to represent us, we would ask you, and hereby authorize you, to make a similar protest in our behalf.

The excess-profits credit carry-over was enacted in the original law as a relief provision and was liberalized by the amendments passed in 1941. The excess-profits tax law was intended to tax profits in excess of 8 percent of invested capital or 95 percent of the average earnings over the 4 preceding years. Since

it was the intention of the law to tax only the excess profits, it seems only fair to permit companies whose net income was less than their excess-profits credit to carry such excess over to the following or the second succeeding year, and in this manner avoid hardship to companies whose income fluctuates sharply between years, or to new or old companies whose business is rapidly expanding.

The carry-over provisions of the present law afford much-needed relief in cases of this nature, and we protest very strongly against any attempt to eliminate the present provisions without substituting provisions which will afford similar relief.

In our particular case, our excess-profits credit, computed under the invested capital method, was $70,430.03 and our excess-profits net income for 1940 was $16,072.06, leaving an excess-profits credit carry-over of $54,357.97. For the year to date our excess-profits net income is approximately equal to our excess-profits credit so that we may be compelled to pay an excess-profits tax for 1941 even though for the years 1940 and 1941 combined we will not have earned net income equal to the percentage of invested capital fixed by Congress in determining excess profits. This will work a hardship upon us, for it will retard our recovery from a long series of unprofitable years.

All small business, which has found it increasingly hard to operate within the past few years, will be similarly affected. To this group as a whole the elimination of the excess-profits credit carry-over provision would be most unfair.

We would appreciate your presenting our protest to the proper officials and trust that your protest will receive favorable consideration.

Very truly yours,

THE RAPID ELECTROTYPE CO.,
C. E. CATTON,
Secretary-Treasurer.

[Telegram]

CINCINNATI, OHIO, *August 14, 1941.*

CHARLES R. HOOK,
Mayflower Hotel, Washington, D. C.:

Supplementing our letter August 11, invested capital our 1940 excess-profits tax return $880,375.35.

THE RAPID ELECTROTYPE CO.,
C. E. CATTON.

ARMCO,
Middletown, Ohio, August 19, 1941.

Mr. CHARLES R. HOOK, *President.*

Below is given summary of applications for necessity certificates which we have issued. All of these have been approved with the exception of the application covering the new jobbing mill at Ashland.

1. Hamilton plant, for blast furnace and related equipment to provide additional pig iron capacity:
Date of application: January 14, 1941.
Amount of application: $689,505, changed to $663,802.80 because we could not substantiate $25,702.20 on the furnace.
Approved and certificate issued February 20, 1941.
Certificate No. ND N-59.
2. Hamilton plant, for 25 coke ovens to increase its coke productive capacity:
Date of application, January 14, 1941.
Amount of application, $802,690.
Approved and certificate issued February 11, 1941.
Certificate No. ND-N-58.
3. Butler division for cold reversing mill.
Date of application, January 20, 1941.
Amount of application, $650,000.
Approved and certificate issued February 20, 1941.
Certificate No. ND-N-82.
4. Middletown division for 54-inch cold mill and accessories.

Date of application, January 20, 1941.
Amount of application, $3,626,000 (excluding land).
Approved and certificate issued February 20, 1941.
Certificate No. ND-N-83.
5. Ashland division for new blast furnace.
Date of application, March 18, 1941.
Amount of application, $5,530,000 (excluding land).
Approved and certificate issued May 2, 1941.
Certificate No. ND-N-321.
6. Sheffield Steel Corporation of Texas, for a complete steel plant:
Date of application: January 14, 1941.
Amount in total: $12,000,000 (excluding land $11,650,000).
Approved and certificate issued: April 11, 1941.
Certificate number: ND-N-47.
7. Ashland division for construction of jobbing mill:
Date of application: January 20, 1941.
Amount of appplication: $1,000,000.
Not approved as yet.
The total amount approved, excluding land, is $22,022,402.80.

Referring to our funded debt, the various issues and dates on which these issues were made are listed in the following table:

Cash received	Dated	Description	Amount
Aug. 1, 1940	July 1, 1940	10-year, 3-percent debentures, series A	$5,000,000
Apr. 1, 1941	Jan. 1, 1941	do	2,500,000
Dec. 4, 1940	Dec. 1, 1940	Series B to K, debentures $5,000,000 Paid Dec. 26, 1940, series B 500,000	4,500,000
Apr. 1, 1941		14-year 3⅜-percent debentures, series L	5,000,000
		Total	17,000,000
Aug. 1, 1941	Apr. 1, 1941	Series L debentures	5,000,000
		Total	22,000,000

The funds received from sale of the first block of series A, 10-year 3-percent debentures were used to pay off the first mortgage guaranteed serial notes, 4 percent, of Hamilton Coke & Iron on July 31, 1940, in the amount of $2,000,000, and bank loans in the amount of $1,500,000 paid on August 1, 1940.

C. L. KINGSBURY, *Controller.*

THE SORG PAPER CO.

Computation of estimated taxes for 1941, based on revenue bill of 1941, showing the effect of the provisions of section 204 (e) relating to recomputation of the credit carry-over from 1940

	Giving effect to the provisions of sec. 204 (e)		Before giving effect to the provisions of sec. 204 (e)	
Estimated invested capital for 1941		$5,500,000.00		$5,500,000.00
Estimated excess-profits net income		825,000.00		825,000.00
Credit on invested capital:				
8 percent on $5,000,000	$400,000.00		$400,000.00	
7 percent on $500,000	35,000.00		35,000.00	
Specific exemption	5,000.00		5,000.00	
Carry-over from 1940: Computed under 1941 act	156,067.25		212,577.53	
		596,067.25		652,577.53
Adjusted excess-profits net income		228,932.75		172,422.47
Excess profits tax:				
On $100,000.00 $100,000.00	41,500.00		41,500.00	
On $128,932.75 $72,422.47	64,466.38		36,211.23	
228,932.75 172,422.47	105,966.38		77,711.23	
Estimated excess profits net income		825,000.00		825,000.00
Less excess-profits tax		105,966.38		77,711.23
		719,033.62		747,288.77
Subject to income tax and surtax:				
30 percent of $719,033.62, less 1 percent on $25,000	215,460.09		----------	
30 percent of $747,288.77, less 1 percent on $25,000	----------		223,936.63	
Total estimated taxes	321,426.47		301,647.86	
Difference in credit carry-over from 1940:				
Income-tax deduction		56,453.99		
Reduction in credit on invested capital at 1 percent on the excess over $5,000,000		56.29		
		56,510.28		

THE AMERICAN ROLLING MILL CO.

Estimated credit on consolidated invested capital for 1941, computed under the provisions of H. R. 5417; also the estimated credit before giving effect to the provisions of section 204 (e) of the bill

Estimated invested capital for 1941 (equity and borrowed)		$127,067,780.32
Credit on invested capital for 1941:		
8 percent on $5,000,000 equals		400,000.00
7 percent on $122,067,780.32 equals		8,544,744.62
Specific exemption		5,000.00
Total credit under the 1941 bill after giving effect to the provisions of sec. 204 (e)		8,949,744.62
If it were not for the provisions of sec. 204 (e) of the bill, we would have the benefit of a carry-over credit from 1940 as follows:		
Credit on invested capital for 1940 at 8 percent on estimated invested capital of $115,285,802.67	$9,222,864.22	
Less: Tentative excess profits net income for 1940	6,530,567.98	
Credit carry-over to 1941 from 1940		2,692,296.24
Total credit under the 1941 bill before giving effect to the provisions of sec. 204 (e)		11,642,040.86

Sec. 204 (e) of the bill amends sec. 710 (c)(1) of the act as amended by the excess-profits tax amendments of 1941 by adding the following sentence: "For such purpose the excess-profits credit and the excess-profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941."

The above provision appears to nullify entirely the credit carry-over from 1940 of $2,692,296.24, as follows:

Credit on invested capital of $115,285,802.67 for 1940 computed under the reduced rates under the 1941 bill		$8,120,006.19
Tentative excess-profits net income for 1940 (as above)	$6,530,567.98	
Add: Income tax for 1940 not deductible under the bill	2,128,996.98	
Tentative excess-profits net income for 1940 for purpose of computation as provided by sec. 204 (e) of the bill		8,659,564.96
Estimated unused credit for 1940		None

THE AMERICAN ROLLING MILL CO.

Computation of consolidated income and excess-profits taxes for the first 6 months 1941 (estimated), based on revenue bill of 1941, H. R. 5417

	After giving effect to provisions of section 204 (e) of the bill		Before giving effect to provisions of section 204 (e) of the bill	
	Income	Tax	Income	Tax
Consolidated net income for first 6 months 1941	$11,570,296.93			
Less: Dividends not subject to excess-profits tax	153,958.70			
	11,416,338.23			
Placed on an annual basis, $11,416,338.23×12/6	22,832,676.46			
Add: 50 percent of estimated interest on borrowed capital for 1941	368,750.00			
Excess-profits net income	23,201,426.46		$23,201,426.46	
Deduct: Credit on invested capital	8,949,744.62		11,642,040.86	
Adjusted excess-profits net income (annual basis)	14,251,681.84		11,559,385.60	
Excess-profits tax:				
On $500,000.00 $500,000.00		$254,000.00		$254,000.00
On 13,751,681.84 11,059,385.60		8,251,009.10		6,635,631.36
14,251,681.84 11,559,385.60		8,505,009.10		6,889,631.36
Estimated tax at 10 percent under the special rule, sec. 201 of the bill, in certain cases where invested capital credit is used		400,000.00		400,000.00
		8,905,009.10		7,289,631.36
Income placed on an annual basis (as above)	22,832,676.46			
Add: 15 percent of dividends subject to income and defense taxes and to the new surtax	23,093.81			
	22,855,770.27		22,855,770.27	
Deduct: Excess-profits taxes	8,905,009.10		7,289,631.36	
Normal tax net income	13,950,761.17		15,566,138.91	
Income and defense taxes and surtax: Computed at 30% of $13,950,761.17 and $15,566,138.91		4,185,228.35		4,669,841.67
Total taxes (annual basis)		13,090,237.45		11,959,473.03
Total taxes for first 6 months 1941 (estimated)		6,545,118.72		5,979,736.52
NOTE.—The difference in tax on an annual basis as above is		1,130,764.42		
Proof:				
60 percent of the loss on the carry-over of $2,692,296.24 (see invested capital sheet) is	1,615,377.74			
Less: 30 percent of $1,615,377.74, representing the benefit of the deduction of excess-profits tax for normal taxes and surtaxes	484,613.32	1,130,764.42		

THE AMERICAN ROLLING MILL CO.

Illustrations of the disadvantage to the American Rolling Mill Co. in income and excess profits taxes for the 2-year period of 1940 and 1941 compared with hypothetical cases in which higher earnings are shown to have been made. Due to the provisions of sec. 204 (e) of the revenue bill the American Rolling Mill Co. loses entirely the benefit of a credit carry-over from 1940 of $2,692,296.24

	The American Rolling Mill Co. consolidated (1)		Case where earnings are equal to credit on invested capital in 1940, and same earnings as American Rolling Mill Co.'s in 1941 (2)		Case where earnings are in excess of invested capital credit in 1940 by $2,692,296.24 and less than American Rolling Mill Co.'s by same amount in 1941 (3)	
Taxes for 1940						
Invested capital under 1940 act	$115,285,802.67					
Credit on invested capital at 8 percent		$9,222,864.22		$9,222,864.22		$9,222,864.22
Income before deduction of income tax	8,659,564.96		$12,202,060.01		$15,744,555.06	
Less income tax	2,128,996.98		2,979,195.79		3,829,394.60	
Excess profits net income		6,530,567.98		9,222,864.22		11,915,160.46
Credit carry-over		2,692,296.24				
Excess profits net income						2,692,296.24
Excess profits tax:						
On $500,000 $204,000.00						
On $2,192,296.24 $1,096,148.12						1,300,148.12
Income tax (as above)		2,128,996.98		2,979,195.79		3,829,394.60
Total taxes, 1940		2,128,996.98		2,979,195.79		5,129,542.72
Taxes for 1941						
Invested capital	127,067,780.32					
Credit computed under 1941 bill		8,949,744.62		8,949,744.62		8,949,744.62
Excess profits net income		23,201,426.46		23,201,426.46		20,509,130.22
		14,251,681.84		14,251,681.84		11,559,385.60
Excess-profits tax		8,505,009.10		8,505,009.10		6,889,631.36
Tax at 10 percent under the special rule		400,000.00		400,000.00		400,000.00
		8,905,009.10		8,905,009.10		7,289,631.36

Income before deducting excess-profits tax	22,855,770.27		22,855,770.27		20,163,474.03	
Deduct excess-profits tax	8,905,009.10		8,905,009.10		7,289,631.36	
Income and defense and surtaxes (30 percent)	13,950,761.17		13,950,761.17		12,873,842.67	
Total taxes, 1941		4,185,228.35		4,185,228.35		3,862,152.80
Total taxes for 1940 and 1941		13,090,237.45		13,090,237.45		11,151,784.16
Total income for 1940 and 1941		15,219,234.43		16,069,433.24		16,281,326.88
		31,515,335.23		35,057,830.28		35,908,029.09
Percent of taxes to income for 1940 and 1941 [1]		48.29		45.84		45.34
Net income after taxes		16,296,100.80		18,988,397.04		19,626,702.21
Net income retained after taxes in excess of American Rolling Mill Co.'s				2,692,296.24		3,330,601.41

[1] 2.45 percent (by which (1) exceeds (2)) of American Rolling Mill Co.'s earnings for the 2-year period of $31,515,335.23 results in a higher tax to American Rolling Mill Co. of $772,125.71. 2.95 percent (by which (1) exceeds (3)) of American Rolling Mill Co.'s earnings for the 2-year period of $31,515,335.23 results in a higher tax to American Rolling Mill Co. of $929,702.39.

APPENDIX A.—*Excerpts from the Congressional Record and the Congressional Committee Reports*

SENATE RECORD EXCERPTS

In the Senate on March 3, 1941 (Record, p. 1674) Senator George stated with respect to H. R. 3531:

"I may say that the Senator from Nevada has taken, in my judgment, a very wise and liberal view of this amendatory tax measure. The amendment adopted by the Ways and Means Committee and recommended favorably by the Finance Committee simply remedies certain extreme hardship cases under the excess-profits tax act. It has been agreed to by the Treasury, it has full Treasury approval, it has the approval of the staff of the Joint Committee on Taxation * * *."

Senator Harrison stated (Record p. 1676):

"I may say that that matter was very important. In addition to allowing mining interests the right to spread the income over the development period, the bill allows a 2-year carry-over for unused credits, special relief for growing corporations and other relief for changes in the character of the business."

At page 1676 Senator George stated:

"Let me point out the fact that it is very helpful to mining companies—not that the Senator from Colorado is interested only in mining companies—in that it provides for a 2-year carry-over of any unused credit that a taxpayer may have, whether he is on the prior-earning basis or the invested-capital basis. That is very helpful. Suppose that during those 2 years a corporation has had a loss or did not earn anything, it had a basis, however, which would have given it a certain exemption from the excess-profits tax. Suppose then that in the 3 or 4 years of its operation it had a large profit. In the taxable year the amendment would give it the right to carry over 2 years of its unearned (unused) credit as against the profits of the year in which it had an abnormally large profit."

Senator Harrison (Record, p. 1677) stated:

"I will now discuss briefly the main aspects of the bill:

"Section 2. The bill provides for a 2-year carry-over of the unused excess-profits credit. The unused excess-profits credit for any taxable year is the amount by which the excess-profits credit for such taxable year exceeds the excess-profits income for such year. This provision will be extremely helpful to new corporations and to old corporations undergoing a period of expansion. It will be recalled that the Senate last year adopted a provision for a 2-year carry-over of the unused excess-profits credit for any taxable year beginning after December 31, 1939, in the case of a corporation 80 percent or more of whose gross income is derived from mining or processing minerals or from processing or otherwise preparing for market any seasonable fruit or vegetable or any fish or other marine animal life. In the conference this provision was eliminated and a substitute provided which allowed a 1 year carry-over in the case of a corporation, the normal tax net income for the year did not exceed $25,000. It was requested in the conference report that the Treasury and the staff of the Joint Committee on Internal Revenue Taxation were to study this limited carry-over with a view to its possible extension. As a result of this study the bill now provides for a 2-year carry-over for all corporations, regardless of the size of their net income."

The bill was passed (Record, p. 1680) and became law March 7, 1941 (Public Law 10, 77th Cong.).

SENATE COMMITTEE REPORT EXCERPT

Report No. 75 of the Senate Committee on Finance, Seventy-seventh Congress, first session, in outlining the relief to be afforded by H. R. 3531 stated among other things the following:

"The bill affords relief in the following situations:

"(1) It relieves the hardships which may be caused by the sharply fluctuating earnings of many types of companies, the activities of which are dependent upon business cycles, by allowing unused excess-profits credits to be carried over into the 2 succeeding taxable years, thereby tending to level off the unusual effects due

to rise and fall of income. In addition, the allowance of such an excess-profits credit carry-over will be of substantial benefit to new corporations, and to old corporations undergoing a period of expansion."

Report No. 146 of Ways and Means Committee, Seventy-seventh Congress, first session, contains a similar statement.

HOUSE RECORD EXCERPTS

On February 25, 1941, speaking of the 1940 act, Chairman Doughton stated:

"The conferees had great difficulty in reaching an agreement upon that bill. We could foresee that unpredictable issues would arise, but we did not know what their nature would be or how they would arise. So we provided for further study of the subject and the pending bill is the result of the study that has taken place between October and the present time." (Congressional Record, February 25, 1941, p. 1411.)

Speaking of H. R. 3531 (act of March 7, 1941), Chairman Doughton said:

"The present bill proposes no new tax, imposes no new burden on anyone; in other words, it does not raise additional revenue; if anything, it may actually reduce the revenue slightly, but even if it does, we feel it is thoroughly justified in order to give justice to the taxpayers, because the taxpayers, of course, are the ones who support this Government." (Same reference.)

Still speaking of H. R. 3531, Chairman Doughton also said:

"The bill therefore is not confined to a mere attempt to make section 722 furnish a complete answer to the problem. Many cases were found where the hardship caused by the present excess-profits tax could be remedied by the specific provisions, such as section 2, which gives a carry-over of 2 years of the amount of excess-profits credit not needed in the taxable year * * *."

Chairman Doughton also stated on the same occasion:

"The studies leading to this legislation were conducted by the Treasury staff under the supervision of Mr. Sullivan, Assistant Secretary of the Treasury and by the staff of the Joint Committee on Internal Revenue Taxation, under the direction of Mr. Colin Stam, Chief of Staff. The joint recognition of these experts were reduced to legislative language by the legislative counsel of the House.

"In all my experience with legislation pertaining to tax matters I have never known any committee, or any staff, to work more assiduously, continuously and steadily on a problem than was given to this bill in an effort to recommend amendments to carry out the original purpose of the bill. I am glad to say that the staffs worked together not only assiduously but harmoniously, and they are in perfect agreement as to the policy outlined in this bill. Their recommendations have been fully and thoroughly considered by our committee, and as a result this bill has been approved by the committee."

Still speaking of the bill 3531 Chairman Doughton continued (Record, p. 1413):

"I may say further that there is not a smell of partisanship to this bill anywhere. It comes here with a unanimous report and every member of the committee has been present, I believe at, at least, several of the sessions when the bill was under consideration and when it was fully explained. They have acquired full knowledge of the import of this measure and it has the unanimous support of the committee."

Mr. Treadway (Record, p. 1415) stated:

"The bill has the unanimous support of the Republican minority on the committee. It is not a tax bill but a relief bill; its object is to prevent hardships and inequalities under the so-called excess-profits tax. I want to say still further that the House must remember this is a bill prepared to carry out an assurance made in the reports on the original bill which became law in October 1940. We inserted in the conference report at that time the following language relating to the question of relief:

"'It is understood that the Treasury and members of the staff of the Joint Committee on Internal Revenue Taxation would give further study to the entire problem covered by this section and will report to the appropriate committees on the subject as soon as possible.'"

Mr. Cooper (Record, p. 1418) stated:

"This bill is for the purpose of affording additional relief in hardship cases where further study and consideration have revealed that more relief should be afforded. After about 3 months' additional study and work it is possible to bring this bill before the House today providing certain additional relief for so-called hardship cases under the excess-profits tax bill of last year.

"With the indulgence of the committee I would now like to enter into a brief explanation of the principal provisions of the pending bill.

"Under present law corporations with $25,000 or less normal tax net income are allowed a 1-year carry-over of unused excess-profits credit. Under the pending bill all corporations, regardless of size, are given a 2-year carry-over of unused excess-profits credit."

The CHAIRMAN. Mr. Jaretzki. Will you give your name to the reporter and state for whom you appear?

STATEMENT OF ALFRED JARETZKI, JR., REPRESENTING SULLIVAN & CROMWELL, NEW YORK, N. Y.

Mr. JARETZKI. My name is Alfred Jaretzki. I am a member of the law firm of Sullivan & Cromwell, New York, N. Y., and am appearing on behalf of a group of investment companies of the so-called closed-end type.

In brief, what we are asking for is, in view of this increased taxation, that we be relieved from the effect of double taxation on our stockholders.

At the present time, as a result of the application of the tax law to these investment companies, the shareholder is required to pay, directly or indirectly, taxes at rates far greater than would be applicable to him if he invested directly in the underlying securities.

The CHAIRMAN. Is this the old problem of the open-end companies?

Mr. JARETZKI. This is the problem of the closed-end companies.

The CHAIRMAN. It is the same problem?

Mr. JARETZKI. Yes; the same problem. The increased tax rates proposed only serve to accentuate this unfairness. My purpose is to ask that the proposed increase in rates be applied in such a manner as to rectify this unfair and burdensome situation; and I am certain that this can be done by a few very simple amendments of the bill.

This is no new problem, but it is only with the passage of the Investment Company Act of 1940, that there came a readiness to remedy the situation. Specifically, the Securities and Exchange Commission had been unwilling that relief be granted until the investment companies were subjected to Federal regulation.

The Senate Committee on Banking and Currency in reporting the Investment Company Act wrote:

* * * it appears that the nature of these companies in many respects, constituting a conduit for distribution of income to the smaller investor, is such that they should not be subjected to the same type of taxation as the ordinary business corporation. This has already been recognized in respect of certain classes of open-end companies which receive special tax treatment under existing Federal tax laws. The record before the committee indicates that the tax problem is acute with respect to closed-end companies of the type classified in this bill as "diversified." If this bill is passed, the committee believes that the tax problem of these companies should receive prompt consideration.

In line with the foregoing, diversified investment companies—those are the companies I am representing—were exempted from the

excess profits tax of 1940. But the problem of affording relief under general corporate taxes was postponed until 1941.

At that time we were told it was inappropriate to go into the general subject and it could be taken up in the next year's bill, which is the present bill.

The diversified investment company is designed to afford the small investor an opportunity to pool his resources with those of others for the purpose of obtaining a proper diversification of risk and the benefit of expert investment management. The studies of the Securities and Exchange Commission show that there are an estimated 1,500,000 security holders in investment companies of all types; that the average value of the common stock held per stockholder in 1935 amounted to only $1,774; and they show that approximately one-half of the common stockholders of investment companies hold stock with a value of $500 or less.

I point this out because it indicates it is the small investor that holds the stock of investment companies.

These studies indicate that the typical shareholder in investment companies is one whose personal income tax under the law as it now exists would range from 4.4 to 8.8 percent and whose tax under the present bill as passed by the House would range from 4.4 to 16.5 percent.

Now, under the existing method of taxation this individual is required to pay a high price in Federal taxes for the privilege of investing through an investment company, in comparison with the individual investing directly in the stocks of the underlying companies. The individual investor is taxed only once on the earnings on his investments, and is entitled to a reduced rate of tax in the case of long-term capital gains. The investment company stockholder, on the other hand, will first have to bear a corporate tax of 30 percent on the earnings on investments, apart from dividends which are only taxed in part, and again pay a tax when those earnings are distributed to him as a dividend; in addition neither the investment company nor the stockholder is entitled to any reduced rate of tax on long-term capital gains.

For example, if an individual whose effective personal income tax rate is 15 percent sold stock of an industrial company which he had held for more than 2 years at a profit of $1,000 he would pay a tax of $75 and would retain $925. If he had invested in the stock of an investment company and the company held similar stock and sold it for a similar gain of $1,000, the investment company would pay initially a Federal income tax of $300, leaving only $700 of the profit to be distributed to stockholders. When the company distributed the $700 as a dividend to the stockholder, he would pay a tax of 15 percent, or $105. Thus the stockholder in an investment company would bear a tax of $405 and retain only $595 out of the $1,000 profit as against a $75 tax and a $925 retention on the part of the direct investor.

The proposals which we advocate are designed to eliminate as far as possible the discrimination now existing against investment company stockholders by imposing upon the company and the stockholder a tax burden comparable to that now borne by a direct investor.

Senator DANAHER. What would be the same tax to an investor in an open-end company?

Mr. JARETZKI. He generally pays substantially the same tax as the individual who invests directly.

Because we have endeavored to propose changes which would have the merit of simplicity, the amendments would still leave the investment company stockholder at some tax disadvantage compared with the direct investor, but these, we believe, would be reduced to a minimum.

It is not possible to treat these companies exactly as open-end companies because there are other problems, but we attempt to make them approximately the same.

Briefly stated the amndments are as follows:

First, apply to investment companies the provision now in effect as to capital gains on securities held by individuals, namely that only 50 percent of a capital gain or loss on the sale of securities held for more than 24 months, or 66⅔ percent in the case of securities held between 18 and 24 months, be taken into account in computing net income of these companies.

Second, extend to diversified companies the principle as to credit for dividends applying to so-called mutual or open-end companies since the Revenue Act of 1936. Specifically, provide that if a diversified investment company distributes 90 percent or more of its ordinary net income, the corporate income tax shall be imposed upon the net income remaining after deducting dividends paid to stockholders.

In other words, the corporation would only pay a tax on so much of its income as it didn't distribute to its stockholders.

Senator CONNALLY. You mean, it would be exempt from the normal tax on the theory the stockholders would pay a tax on their dividends?

Mr. JARETZKI. Yes. These mutual companies——

Senator CONNALLY. Well you are not a mutual company.

Mr. JARETZKI. These so-called mutual companies—that designation does not mean they are nonprofit.

Senator CONNALLY. I realize that; I think there is a lot of fake in some of them.

Mr. JARETZKI. The point is that the open-end companies got this treatment in 1936; we haven't. It is perfectly true that the ordinary business corporation or industry corporation has this double taxation.

Senator CONNALLY. And the bank has it?

Mr. JARETZKI. Yes.

Senator CONNALLY. And you are competing with banks?

Mr. JARETZKI. No, sir. We are competing with the individual investor.

Senator CONNALLY. You are competing with banks and trust companies?

Mr. JARETZKI. No.

Senator CONNALLY. Well, you buy and sell securities?

Mr. JARETZKI. We are an investment company, investing in securities. The stockholder buys stock and in so doing he pools his individual funds with those of others, and by so doing, is able to get a wider diversification than otherwise he could.

Now, the whole question is whether this type of company can survive if it has to pay this tax. It is perfectly true that other companies do, but we believe the Securities and Exchange Commission have come to the conclusion that investment companies cannot survive if they must pay this tax.

The CHAIRMAN. Have they made any such announcement?

Mr. JARETZKI. No, sir.

The CHAIRMAN. The Security people appeared before this committee, I think last year, or was it the last year or the year before.

Mr. JARETZKI. Several years ago before the passage of the investment company act, the S. E. C. took the position they were opposed to any amelioration of our situation so long as we were unregulated.

The CHAIRMAN. They stated they were making a study to see if you were not entitled to comparable tax treatment.

Senator BROWN. That was last year.

The CHAIRMAN. And they did recommend an exemption of your type of company?

Mr. JARETZKI. They did; they naturally don't want to voluntarily appear and urge this thing but I feel, if they were asked, they would make such a recommendation.

The CHAIRMAN. The chief distinction with your type of company and the chief reason you cannot come under the law, is your stockholders have not the right to redeem their stock?

Mr. JARETZKI. That is right; that has disadvantages and advantages. These open-end companies where the stockholder has the right to redeem at any time at the liquidating value, that is an advantage, but the disadvantage which the Securities and Exchange Commission recognizes is that there is, under such a practice, a constant flow of liquidations and in order for the organization to survive, it must constantly continue to sell its stock and open-end companies are, therefore, in the business of distributing their own stock, whereas the closed-end companies are not.

And that has its disadvantages, and the records show, on investigation of the S. E. C., that there is no better performance record for instance, on the part of the open-end than on the part of the closed-end companies. They have stated that there is no reason why one type should be preferred at the expense of the other.

They have always taken that position, but were unwilling, until we were regulated by the Federal Government, to stand behind any tax advantages to investment companies as a group. Now we are subject to Federal regulation, and I know, because I have discussed with members of the Commission and members of their staff, they are prepared to support a proposal for tax relief, and I think, if asked to appear, they would support the changes I urge.

Senator CONNALLY. You mean exemption from the normal tax?

Mr. JARETZKI. Yes.

Senator CONNALLY. You think the S. E. C. would favor that?

Mr. JARETZKI. Yes.

Senator CONNALLY. Let me ask you this question: Your business is based on the theory that a number of individuals, by pooling their buying power and purchasing stock in these investment companies, thereby acquire a more diversified list of securities, or an interest in them than would be possible if purchasing directly?

Mr. JARETZKI. Yes; that is true.

Senator CONNALLY. Do you buy on the stock exchange or over the counter?

Mr. JARETZKI. Mostly on the stock exchange.

Senator CONNALLY. You operate on the exchange?

Mr. JARETZKI. Yes.

Senator CONNALLY. And what you make goes into your company and then is distributed out to your stockholders?

Mr. JARETZKI. Yes.

Senator CONNALLY. What difference is there between you and any other people who operate on the stock exchange?

Mr. JARETZKI. Well, if a person operates directly on the exchange, they would pay this tax amounting to $75, whereas operating through investment companies, they pay a tax of $405.

When I say "operate," I am using your language, but I do not mean "operate" in the normal sense; these are investment not trading companies.

Senator CONNALLY. You trade; you buy and sell?

Mr. JARETZKI. We buy and sell the same as any individual. He may buy some shares of United States Steel today and 1 year or 2 years or 3 years or 6 months later may decide he wishes to have something else. He doesn't trade in the sense of the person who buys and sells securities every day.

Senator CONNALLY. How does the trust or officers get compensated; you just pay the officers out of the net profit; you don't get any commissions?

Mr. JARETZKI. That is correct, sir.

In order that the provisions of the statute regarding capital gains may extend to the investor through an investment company as well as the direct investor, provision should also be made that after all other net income of the taxable year of an investment company has been distributed, any distribution out of net long-term capital gain realized by the company in the taxable year shall be taxed to the shareholders as long as long-term capital gain.

Third, exempt diversified investment companies from capital-stock tax and declared-value excess-profits tax. This combination of taxes has no sound or logical application to these companies. For, as applied to a company of this type, the tax depends largely upon the capital gains which the company may happen to realize, and in substance imposes upon the company the impossible task of predicting 3 years in advance what may happen to security prices and what occasion the company may have to change its investments during that period. Such a problem does not exist in the case of ordinary business corporations where the realization of capital gains rarely occurs in substantial amounts. This principle was recognized by Congress in 1940, when diversified investment companies were exempted from the operation of the excess-profits tax then enacted. The reasons for that exemption apply especially to this proposal.

Fourth, amend section 102, which imposes a surtax on companies improperly accumulating surplus, so as to exclude long-term capital gains from net income of a diversified investment company for purposes of that section. Sound policy frequently requires that these investment companies retain long-term capital gains realized during an advancing market in order to offset inevitable losses incurred in a falling market.

There is no danger that these public companies would be used for purposes of tax evasion, because no one would attempt to avoid surtaxes by organizing or participating in a public investment company in order to save a maximum individual tax of 22 percent on long-

term capital gains, while incurring a 30-percent corporate tax on such gains.

To summarize in a few words—the stockholders in these companies are fully prepared to bear their share of the added tax burden called for in the existing emergency, but strongly urge that the existing discrimination between them and the direct investor, and between them and the investor in the open-end companies, be removed so far as practicable.

I may add that I have discussed this matter over many months with representatives of the Securities and Exchange Commission and I am confident that the Commission, if its opinion were sought by this committee, would support the substance of the proposals I have made.

Senator CONNALLY. May I ask one question? Are you contending that the investment company should not pay any more than the individual investor?

Mr. JARETZKI. Not quite, sir. I am saying in effect that if the income passes through to the individual stockholder, the company should not pay a tax at all; the stockholder should pay the entire tax the same as if he was making a direct investment.

Senator CONNALLY. You say the ordinary man would pay $75 in that case?

Mr. JARETZKI. Yes.

Senator CONNALLY. And you want each of your stockholders to pay $75?

Mr. JARETZKI. Yes.

The CHAIRMAN. In other words, you want to be treated as an ordinary trust?

Mr. JARETZKI. That would be so.

Senator BAILEY. Shouldn't you make a distinction between your closed-end investment company and other companies which have capital gains? If you make that distinction, you will probably make your case good.

Will you make that distinction in the record? Here is an ordinary corporation that owns some stock and bonds that go up in value and they sell them and carry the proceeds, if any profits were realized, and sooner or later the stockholders get dividends the same as any other taxpayer; otherwise there are two tax payments, one by the corporation and the other by the individual. You are contending in your case that there are two taxes on one profit and it is incumbent on you to show the distinction between the closed-end investment trust, making a capital gain which you know is to the profit of the stockholder or certificate holder and the corporation which makes a capital gain in the customary way.

Now, you make your distinction and show wherein this is a trust, distinctively a trust, and my stock in the corporation is just an investment; then I think you have made a good point.

Mr. JARETZKI. Because of the limited time, I have neglected that point. You call my attention to an omission in my statement which I would like to clear up.

The CHAIRMAN. You may supplement your statement by putting in the record anything in writing you desire.

Mr. JARETZKI. Thank you.

The distinction is this, that, in the ordinary industrial company, a capital gain of the kind of which you speak is a rare event and therefore of not much importance; it doesn't happen every day. If the stockholder pays a second tax on that, it is not so serious, but, with an investment company, it is a continuous process, happening all the while. During years of declining prices he suffers these losses constantly.

Senator BAILEY. The investment trust holds in its portfolio shares in trust for those who participate in the trust by way of owning certificates or stock?

Mr. JARETZKI. Yes; that is right.

Senator BAILEY. A corporation doesn't do that; a corporation holds its stocks, bonds, and properties for the purposes of carrying on the general business, and stock and bonds are held only secondarily for the stockholders.

Now, you don't have any bonds?

Mr. JARETZKI. No, sir. Some companies do have an outstanding bond indebtedness, but that is not usual.

Senator BAILEY. Let us take another illustration: Suppose I am the guardian of five children and I have to invest their funds; I have a hundred thousand dollars. The tax is on the income of the children; the guardian would not pay it.

Mr. JARETZKI. That is right.

Senator BAILEY. Well, then, tell us your distinction.

Mr. JARETZKI. You have pointed to the substance of the distinction; technically, it is not exactly that. I was a little slow in picking up your thought, but you have the substance of the distinction in what you have just said.

Senator BAILEY. You pay, as matters now stand, two profits, two taxes on the assets of the trust company's stockholders.

Mr. JARETZKI. Put it another way: Individuals have the opportunity of becoming stockholders in United States Steel or some other industry enterprise in which they can only afford a few shares or diversifying by purchasing shares in an investment company; yet, if they purchase in the latter, although it is deemed to have benefits which are sound, if they have to bear this tax, they just cannot do it.

Senator BAILEY. But go back to me as guardian or trustee holding realty: I pay one tax; you don't expect my ward to pay a tax, too?

Mr. JARETZKI. That is true.

Senator BAILEY. That is why you should draw your distinction.

Mr. JARETZKI. Yes. May I adopt the Senator's suggestion and incorporate it in the record as though it were my own?

Senator CONNALLY. Mr. Chairman, in connection with this matter of investment companies, I want to ask a question or two.

You are a lawyer, are you not?

Mr. JARETZKI. Yes.

Senator CONNALLY. I have some letters here I want to put in the record about this kind of situation. Are you familiar with *Higgins* v. *The United States*, by Justice Reed, volume 61, Supreme Court Reports?

Mr. JARETZKI. Yes; I am familiar with that.

Senator CONNALLY. With *United States* v. *Pine*, by Mr. Justice Black, and also with *United States* v. *Helvering*, also in volume 61 of Federal Supreme Court Reports?

Mr. JARETZKI. Yes.

The CHAIRMAN. May I say to you, Senator Connally, that the Treasury is proposing in the bill dealing with administrative and technical matters to deal with that exact situation?

Do you want to put that in the record?

Senator CONNALLY. I can withhold it, but I want counsel, Mr. Stearn, to see it and give it some consideration. Under this statement, an executor is not allowed to deduct an expense of the estate from the income; whatever expenses he incurs in handling property for an estate are not deductible. It seems to me that is a very unjust thing—not allowed to deduct the expenses. A man on a farm, for instance, must report in full his income without deducting expenses.

It seems to me terrible injustice.

The CHAIRMAN. As I understand that decision, it is on the language of the statute, that the executor was not engaged in business; therefore, he could not deduct it at all.

Senator BAILEY. I was rather impressed by the statement of one of the witnesses that if we passed an act on a germane subject, imposing a new tax, for instance, on some food or drug sale, on which there had been a tax and former rulings and court decisions interpreting the same had been made by the Department or court, we would have been held to ratify or reaffirm that interpretation. I don't think it is the intent of Congress to make that assumption; but if it is, I think we should put some reservations in our bill.

The CHAIRMAN. Well, they apply that rule only in cases where the rule or regulation has been relatively of long standing.

Senator BAILEY. I think that would be all right; but where it is to be considered that we acquiesce in every one of these rulings, I don't think we have the information, in many instances, of what the regulation is.

The CHAIRMAN. It is on the theory of intent, the intent being not to disturb the existing interpretation.

Senator CONNALLY. Where a statute is reenacted, you assume, when you pass it the second time, you assume that you adopt the decisions of the court and administrators in their interpretation.

Senator BAILEY. That is on the theory we are familiar with all the regulations?

Senator CONNALLY. I am not quarreling with that statement of yours that there should be some reservation to that.

The CHAIRMAN. We will recess until 2 o'clock——

Senator CONNALLY. Under excess-profits taxes, I would like to have this letter from the Houston Post in the record.

THE HOUSTON POST,
Houston, Tex., August 21, 1941.

Hon. TOM CONNALLY,
Member, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR: I had planned to be in Washington during the hearings on the Revenue Act of 1941, as passed by the House of Representatives and now being considered by the Senate Finance Committee. Having been unavoidably

detained at Houston, I wish to present to the committee my opinion on that part of the act pertaining to the tax on excess profits and its effect on corporations who at this time find themselves heavily encumbered with debts with large annual amortization of this indebtedness contracted in prior years.

My suggestions as to revision in the law governing the tax on excess profits are as follows:

Under the present law only upon one-half of capital, as evidenced by borrowed money, are you allowed to earn 8 percent without being subject to the excess-profits tax. It seems to me, and in my experience with my own company, I am being discriminated against by being allowed to earn 8 percent on only one-half of the borrowed money before computing excess-profits taxes.

My company owes substantial debts contracted several years ago with large annual amortization payments over a period of 10 years. The provision above mentioned materially affects earnings available for the payment of these debts, and with the provision as now in the law I will have a very difficult problem in meeting the annual amortization payments and keep the company in sound financial condition. I see no reason why debts honestly made, and where there was a real need for making same in the operation of a business, that you should not be allowed to earn 8 percent on all such debts before computing excess-profits taxes.

I have another serious financial problem with my company which is brought about by the aggregate of normal taxes, excess-profits taxes, and amortization on debts being in excess of my net income, and it seems to me that some provision should be made in the law for a taxpayer who does not have sufficient earnings to pay his debt amortization, his normal income tax, and excess-profits tax, and I suggest that in such a case, where the normal income tax and the excess-profits tax, plus the contracted amortization on debts created prior to January 1, 1941, is greater than the taxable income, then a taxpayer shall be entitled to a credit upon excess-profits taxes to such extent that the aggregate of normal income taxes, excess-profits taxes, and fixed amortization will not be greater than the taxable income of the taxpayer.

I believe that many corporations will find themselves in this position, for in contracting debts several years ago no reasonable businessman anticipated that his income tax and excess-profits tax would constitute such a large part of his income, and I believe that many corporations today, under the high normal taxes and the excess-profits tax, will be paying out in the way of taxes such a large amount that they will not have enough income left out of earnings to meet fixed payments on their debts contracted in prior years.

If permissible, will you be good enough to place this letter in the record of committee meetings?

Yours very truly,

(Signed) W. P. HOBBY, *President.*

(The following statement was ordered incorporated in the record:)

STATEMENT OF FRED BRENCKMAN, WASHINGTON REPRESENTATIVE OF THE NATIONAL GRANGE

The National Grange recognizes the fact that our national-defense program calls for heavy increases in taxation. Such new taxes as may be imposed in this connection should be levied as fairly and equitably as possible. These levies should be of such a character as not to destroy our system of private enterprise upon which the security and well-being of the Nation so greatly depends in the emergency with which we are now confronted. On the other hand, no person should be allowed to make any inordinate profits, nor should taxes be levied for purely punitive purposes.

We believe that the House acted fairly and wisely in deciding not to increase the existing Federal tax of 1½ cents per gallon on gasoline, and we trust the Senate may agree with the House in this matter.

The highway user of the country are already paying their full and proportionate share of all general taxes. In addition to that, they are contributing in round figures about $2,000,000,000 a year in special highway taxes of various kinds, Federal, State, and local. This sum is approximately equal to 14 percent of the total revenues accruing to all the units of government in the United States. Roughly speaking, State and local taxes on highway transportation amount to $1,500,000,000, while the Federal Government is collecting about $500,000,000 a year from this source.

State taxes imposed on gasoline now average 4⅘ cents per gallon. The existing Federal levy of 1½ cents per gallon brings the total to 5⅘ cents. Adding another cent per gallon for Federal purposes would bring the average total to 6⅘ cents per gallon. At the present retail price of gasoline, this would represent a sales tax of more than 50 percent.

AGRICULTURAL AND MOTOR TRANSPORTATION

So far as agriculture is concerned, motor transportation under modern conditions is not a luxury but an absolute necessity. More than 1,000,000 motor trucks, or about one-fourth of the country's total, are owned and operated by farmers. A recent survey discloses the fact that with the abandonment of many branch lines of railroads that are no longer profitable, there are about 48,000 communities throughout the United States that are entirely dependent upon highway transportation.

The farmer must have his motor-vehicle facilities, and he does not feel that his use of the highways is a proper and adequate measure by which to determine his contribution toward the cost of national defense.

Some idea of the importance of the motor vehicle to the American farmer may be gained from the records of the United States Department of Agriculture, which show that approximately 27 percent of the butter, 39 percent of the eggs, 65 percent of the poultry, 40 percent of the fruit and vegetables, 62 percent of the cattle, 61 percent of the calves, 68 percent of the hogs, 29 percent of the sheep and lambs, and 50 percent of the mules and horses are now moved from farm to market by truck.

When the revenues derived from gasoline taxes are expended in improving and maintaining the highways, there can be no legitimate criticism. However, it must be kept in mind that much of the gasoline purchased by farmers is used for plowing, harrowing, threshing, filling silos, pumping water, operating spraying machinery, sawing wood, grinding feed, and for other purposes that do not involve any use of the highways. Many States properly refund the tax to farmers on gasoline used in such ways as have been enumerated. Other States do not make these refunds. So far as the Federal tax on gasoline is concerned, no refunds whatsoever are made. To increase the Federal gasoline tax would, therefore, result in increasing the farmer's cost of production.

The cost of transportation constitutes the biggest single service charge that agriculture has to pay. The imposition of an additional Federal tax of 1 cent per gallon on gasoline would make present excessive transportation costs on farm commodities just that much higher. This would be true of the more than 1,000,000 trucks operated by farmers themselves. It would likewise be true of common and contract carrier trucks that transport the products of the farm, and which haul supplies consumed on the farm.

The owners of common and contract-carrier trucks will naturally speak for themselves. But it is only fair to say with respect to them that they are engaged in a highly competitive business. The exhaustive study made by former Federal Coordinator of Transportation Joseph B. Eastman shows that highway users are paying their fair share of highway costs and more. The Eastman report, made public about 2 years ago, indicates that trucks as distinguished from passenger cars are paying more than their share of the cost of improving and maintaining our highways. Assuming the correctness of these findings, it would be just as logical to place a special tax for defense purposes on the coal consumed by the railroads as it would be to place a special tax for defense purposes on gasoline.

The intrusion of the Federal Government into the gasoline-tax field cannot be regarded as legitimate. Such appropriations as the Federal Government has made for highways can all be justified from the standpoint of national defense, to facilitate the transportation of the mails, and for other purposes benefiting all the people alike.

SOURCES OF HIGHWAY FUNDS

By far the major portion of the funds that have been expended for the improvement of our highways has come from State, county, and local sources. From 1917, when the Federal Aid Highway Act took effect, until 1939, the States expended $16,695,397,000 for roads. During the same period county and local expenditures for roads amounted to $12,980,000,000, making a total of $29,675,397,000.

During the years in question, Federal expenditures on highways, which were supervised by the Bureau of Public Roads, now the Public Roads Administration, amounted to $3,225,026,166. It should be noted that this includes the money spent for the elimination of grade crossings, forest roads and trails, and national-park highways.

In addition to this, from July 1935 to June 1940 the Works Progress Administration spent $2,931,738,000 on highways, roads, and streets.

Public Works Administration grants for streets and highways from July 1933 to June 1940 amounted to $641,133,429.

The total of all these Federal expenditures aggregated $6,797,897,595, of which $4,757,046,318 was for relief.

The primary purpose of the relief expenditures was to supply work for the unemployed. In fact, in appropriating emergency relief funds for roads, Congress expressly stipulated in awarding contracts in this connection that as much hand labor as possible should be employed.

In support of the proposition that the gasoline tax properly belongs to the States, it should be kept in mind that under the Federal Aid Highway Act, the funds appropriated by Congress all go for construction. The cost of maintaining these roads devolves upon the States.

Further than that, the States and their minor subdivisions have issued highway bonds in large amounts, and they are depending principally upon the revenues derived from the gasoline tax to pay off these bonds as they mature. As of January 1, 1938, the latest reliable figures available show that the total outstanding highway bonds of the States amounted to $1,931,370,000. Of this total, bonds valued at $466,387,000 were issued to reimburse counties for roads that were originally built from the proceeds of county bonds. County and local highway bonds outstanding as of January 1, 1940, have been roughly estimated at $1,000,000,000.

These figures prove conclusively that the gasoline tax belongs to the States. While everybody recognizes that the revenues of the Federal Government must be greatly increased to meet the costs of national defense, we cannot lose sight of the fact that our State and local governments must likewise be supported and maintained. That the tax policies pursued by the Federal Government during recent years constitute nothing less than a threat to the sovereignty and independence of the States, drying up the sources of revenue upon which they must depend to finance their activities, cannot be denied. The best hope of preserving our democracy lies in preserving the independence and sovereignty to the States, and this cannot be done by pursuing policies of taxation that will gradually to reduce the States to impotency and bankruptcy.

STATES MEMORIALIZE CONGRESS

The legislatures of half the States, fearing that the intrusion of the Federal Government into a sphere of taxation developed by the States to provide funds for road improvement may have serious consequences on State financing, have memorialized Congress to withdraw from the field of motor-fuel taxation. Congress should certainly heed the voice of the elected representatives of the States in this matter, because they speak for the majority of the people of the Nation.

In considering ways and means of raising by current taxation as large a proportion as possible of the funds needed to defray the cost of national defense, it appears to be necessary to broaden the tax base and to fairly and judiciously lower the exemption on incomes. As we have already indicated, no one should be allowed to make any undue profits, whether from defense contracts or in the regular line of business. We do not want another crop of millionaires such as was spawned by the First World War. Congress can take care of this situation by properly graduating the tax on personal incomes, the corporation income tax, and the excess-profits tax.

In view of the situation with which we are faced, the nondefense expenditures of the Government should be held to the lowest possible minimum, without sacrificing any really essential public service. It would be grossly improper and unfair to impose back-breaking taxes upon the people, with the Government squandering public funds to maintain supernumerary employees on the pay roll, or in promoting projects that are nonessential, and which do not contribute in any way whatsoever to the cause of national defense.

The CHAIRMAN. We will now recess until 2 o'clock.
(Whereupon, at 12:35 p. m., this hearing was recessed until 2 p. m.)

AFTERNOON SESSION

(Pursuant to adjournment, the hearing was reconvened at 2 p. m.)
The CHAIRMAN. The first witness this afternoon is Mr. Ralph Mulligan.

STATEMENT OF RALPH C. MULLIGAN, WASHINGTON, D. C., REPRESENTING THE NATIONAL COAL ASSOCIATION

Mr. MULLIGAN. Mr. Chairman and gentlemen, my name is Ralph C. Mulligan. I reside in Washington. I am appearing as counsel for the National Coal Association which comprises, either through direct membership or through the affiliation of district associations, most of the companies engaged in the mining of bituminous coal throughout the Nation; and may I say in that connection that bituminous coal mining is carried on in at least 26 States, that it is one of the Nation's great basic industries with operations that involve an annual turnover, including transport and distribution, of upward of $2,000,000,000.

The National Coal Association has been in existence about 25 years and is truly representative of the industry. Its principal office is in Washington—804 Southern Building.

I am here to present for the consideration of this committee, our views with respect to a provision of the House bill, the effect of which is to impose upon the corporate taxpayer under certain circumstances an additional 10-percent tax on part or possibly on all of its net profits in 1941 and thereafter.

I refer to title II, section 201 of H. R. 5417 which amends section 710 of the Internal Revenue Code. The paragraph to which we take exception is numbered (2) and is entitled "Special rule in certain cases where invested capital credit is used."

I shall be brief, having in mind that persuasive testimony on this point has been presented previously to this committee and that several witnesses from our industry are scheduled to follow.

Let me preface my discussion of this 10-percent penalty provision of the House bill applicable to corporations, which either from choice or from necessity, measure their net income by the yardstick of return on invested capital, with the declaration that the producers of bituminous coal recognize the impelling necessity for increased Federal tax levies as an aid in financing the gigantic national-defense program.

I have not been asked to come here to oppose or protest a stepping up of the taxes on the profits of business corporations or upon individual incomes so long as whatever upward revision Congress approves is equitable and not discriminatory in its application, and is not punitive in character, and does not defeat its ends by prostrating production.

This committee and the Congress may rest assured that those engaged in the production of bituminous coal are ready and willing to make necessitous sacrifices for the Nation's safety in the present emergency. They foresee very great sacrifices on the part of all business and every citizen.

If the producers of bituminous coal, after long years of unprofitable operations, of annual deficits running into hundreds of millions of dollars, are now enabled by dint of their own efforts or through the stabilization of prices which was the goal of the Coal Conservation Act of 1937, to operate on the black side of the ledger instead of the red-ink side, they will not grumble about the taxes on their profits provided the percentage of their profits which they are called upon to yield to the Government is no greater than is required of other and more favorably situated business enterprises.

Everyone who is conversant with the Government's fiscal picture recognizes the pressure that is upon this committee to explore every possible source of revenue and to leave no stone unturned.

But our argument in opposition to the 10-percent-penalty tax embedded in this so-called "Special rule in certain cases where invested-capital credit is used" rests upon the premise that fiscal exigencies of the Government, the legislative responsibilities of the Congress, and the task of this committee in an upward revision of the taxes upon corporate income and profits, affords no justification for resort to discriminatory or punitive taxation.

I am sure this committee desires to deal justly, and I am confident that if you reach the conclusion that this 10-percent-penalty provision is unjust and discriminatory, you will strike it out of the bill.

I am confident that an open-minded examination of this provision can lead to no other conclusion.

The discrimination would apply to all companies which, during the period 1935 to 1939, inclusive, showed earnings of less than 8 percent of invested capital. This was certainly the case with most of the companies engaged in the production of coal. They are among the conspicuous victims of this proposed "special rule."

In practical application, this proposed special tax reaches only corporations with no earnings or small earnings during the base period. It is to be imposed upon them solely because during the base period they were unable to show substantial earnings. It is to be imposed, even though the company this year fails to earn as much as 8 percent on its invested capital.

This penalty provision in reality has nothing to do with the taxation of excess profits—profits above 8 percent, or 7 percent on invested capital, which the pending bill purports to allow.

If any of the producers of bituminous coal succeed in making excess profits, let these profits be taxed on the same basis with every other business. But let's not tuck into the excess-profits-tax section of the bill a hidden joker at the expense of companies that are just now moving out of the red and into the black. Let me illustrate the working of this special rule.

Coal company A earns, say, 7 percent on its invested capital this year. Its earnings in previous years have been equally good when measured against its invested capital. It makes its tax return next March and pays whatever income tax the law imposes.

Coal company B earns, say, 7 percent on its invested capital this year. Its earnings in the base period 1938–39 were zero or a deficit. It makes its tax return next March and pays whatever income taxes the law imposes—and then, if this 10 percent penalty tax provision is enacted, company B will pay an additional 10 percent on its net profits this year.

We submit that this is discriminatory and discriminates against the weak and in favor of the strong. It puts an extra tax load on the company that is struggling for a come-back. A provision of this character will be particularly prejudicial to the producers of bituminous coal because so many of them are in this very category of companies that, after years of losses, are now struggling to make a come-back and now see a prospect of breaking even or making a moderate profit.

I shall not take the time of the committee nor encumber the record with any voluminous statistical data touching on the question of profit and loss in the bituminous coal industry during the past decade.

It will suffice to say that the published reports of the Internal Revenue Bureau show that in every year since 1930, for every corporation engaged in the mining of bituminous coal reporting a net income, at least two, and in some years three or more corporations in that industry reported deficits; that adding together the net income of those corporations engaged in the mining of bituminous coal as were fortunate enough to have any net income, the total in the years subsequent to 1930 ranged between a low of $5,000,000 plus in 1932 to a high of $23,000,000 plus in 1934; that adding together the deficits of those corporations engaged in the mining of coal as reported a deficit, the aggregate total in the 10-year period ranged from a high of $57,000,000 in 1931 to a low of $26,000,000 in 1937. Bear in mind these are loss figures.

But the most arresting figure is in the final result—the figure reached by offsetting the profits of the companies which showed a profit, against the deficits of the companies which showed a deficit, and making allowance for the Federal taxes paid by the profit-making companies. The figures show that for the bituminous coal industry taken as an entity, there was a loss rather than a profit, beginning with 1925 and in every year since.

The aggregate loss after taxes was $26,000,000 in 1925; it reached $51,000,000 in 1932; it was $32,000,000 in 1938; it was $8,000,000 in 1939.

Another approach to the question of profit or loss in the bituminous coal industry is the relationship between production cost per ton and mine realization per ton.

This is the approach of the Bituminous Coal Division and of the Department of the Interior.

According to the figures compiled by this agency, the production cost per ton exceeded mine realization right straight through from April 1937 to September 1940. The average loss per ton in the last 9 months of 1937 was 12 cents per ton; in 1938, 14 cents per ton; in 1939, 9 cents per ton; and in the first 9 months of 1940 was 5 cents per ton. I have omitted the third and fourth decimals.

I would like to have the committee understand that my purpose in introducing this record of losses of the bituminous coal industry in connection with this discussion of the discriminatory character of the 10 percent penalty provision is not intended as an appeal for sympathy, or a plea for special favor.

We are arguing against a provision which we believe to be fundamentally and obviously unjust and discriminatory. It just happens that because of the particularly unhappy experience of the producers

of bituminous coal in the matter of profit and loss, they will be the conspicuous victims if this provision remains in the bill and is enacted into law.

The loss record of the industry makes it clear why, in the case of three companies out of five, and I venture to guess five companies out of six, will have no choice as between the average-earnings yardstick and the invested-capital yardstick when it comes to measuring their 1941 net income. Most of them will have no average earnings in the base period worth talking about.

They must, of necessity in a majority of cases, measure their profits this year or next year on the basis of invested capital. When they do this, they are snared in this special rule and the 10 percent penalty tax.

That means that if the rates and the regulations contained in the House bill are enacted into law, the coal company that had no profits before but has a profit this year, pays a regular income tax of 22.1 percent; pays a surtax of 5 percent of the first $25,000 and 6 percent on the balance; and then pays an additional 10 percent penalty assessed against all that part of net taxable income as is not more than 8 percent of his invested capital.

That means that if the company makes a profit this year but had none during the base period, its Federal income tax will approximate 40 percent of its net income, even though the company has not one dime of excess profits as defined in the bill.

It is to be borne in mind also, that this special rule applicable to companies electing the invested capital yardstick and the resulting 10-percent penalty tax, does not apply to new corporations that may be expressly set up as part of the defense production. This is another aspect of the discriminatory character of this provision.

The attempted justification for this provision offered in the House committee report was the allegation that—

> Many corporations which are making added profits directly or indirectly attributable to Government expenditures for the national defense are paying no additional taxes upon such profits. It is felt that such corporations, benefiting so substantially from the defense expenditures, should make a larger contribution from their increased income even though their income for the taxable year is still less than the invested capital credit.

That is the quotation from the House committee report.

Addressing myself just to that for a moment, that contention has a superficial plausibility which the purpose of my argument here today is to unmask. I am seeking to demonstrate the essential vice of this penalty tax, and its discriminatory character. But whatever the conclusion of this committee on that score, let me underscore the fact that the war-profits angle—the "Benefiting substantially from defense expenditures" argument has scant application to the coal industry.

The 1941 mine output of bituminous coal may run 10 percent ahead of last year. The increased output is no doubt attributable to national-defense activity. But profit or loss in the coal industry does not depend primarily upon volume of output. This is shown by the loss figures previously cited. The industry operated at a loss even when mine output was increasing. Profit depends on mine-realization price in relation to production cost.

The Bituminous Coal Conservation Act of 1937 was debated and defended as necessary to put a floor under mine prices in our industry

and to insure the producers not a profit, but a minimum price structure that would equal the cost of production. The industry is now operating on that basis. It was the medicine which Congress prescribed for a sick industry. It happens that the application of this remedy coincides with the national-defense emergency.

It is true that the coal production is expanding. But the industry's profits, if any, are not a war profit and most assuredly are not an excess profit. To penalize the industry's recovery through a tax device that will take an extra 10 percent of any profits below an 8 percent return of any profits, is without a particle of justification.

I have read, may I say, a number of presentations on this subject, and a number of analyses on the application of this tax, including one that was prepared by the Tax Committee of the Congress that appears in the House report, but it seems to me that there is no better way to illustrate the essential injustice of this special rule than to picture the scene were this theory to be applied to the individual citizen.

Citizen Jones, with a little home and a little family, has had steady employment and steady income right along for the past half-dozen years. He makes his Federal tax return next March, takes whatever deduction the law gives him and pays tax on the remainder of his 1941 income at whatever rates the law imposes.

Citizen Smith has a home and family too, but in recent years has been without steady work and with little or no income. He has gone in debt, been supported by his relatives, perhaps he has been on relief. This year he has a good job. His net income this year is exactly the same as Citizen Jones (who has been working every year). He makes his tax return next March, takes his deduction and starts to pay his tax at the same rate and in the same amount as Jones.

But, at that point, the Federal tax collector tell him, "We want an extra 10 percent tax from you; if it wasn't for the war and national-defense activities, you would still be out of work or on relief." So he is to be required to pay not only the same income tax as his neighbor Jones (who has been luckier and had had a steady job all through the depression), but he must also kick in an extra 10 percent because he did not work before but is working now.

It is difficult to imagine any Government official proposing a tax so flagrantly unjust and discriminatory. Certainly no Senator or Member of the House would support any such proposition. Yet that is exactly the way this special rule works in the case of the corporate taxpayer.

Now, that concludes what I have in mind to say on the 10-percent penalty tax.

Now, to mention briefly two other matters of important concern to all corporate taxpayers. We renew the plea that corporations under common ownership have restored to them the right to make their Federal tax return for the purpose of the normal corporation income tax, on a consolidated basis. Congress has rightly recognized that for computing excess-profits tax it is fair that consolidated income of an affiliated group should be treated as a unit. There is no rational reason for taking a different position with respect to a consolidated return for normal and surtax purposes. We submit that a requirement for separate returns for companies under common ownership makes artificial and unjust distinctions and is merely another revenue raising device that ought not to be resorted to.

Now, with the prospective higher rate of tax on corporate incomes through the combination of normal and surtax rates, the injustice of a denial of the consolidated return privilege for corporations that together comprise a business unit, is greater than ever.

The other matter is with respect to the declared value in connection with the capital-stock tax. We strongly urge an amendment of the capital-stock provision so as to permit an annual declaration of value. The bill as it now stands, contrary to past legislative practice, does not even provide for a new or amended declaration of value although it proposes a 25-percent increase in the capital-stock tax.

The problem of calculating the future trend of corporate income is always difficult, and under existing conditions is virtually impossible.

We believe that under the uncertain conditions that now confront all business, an annual declaration of value is doubly desirable and under any conditions is no more than fair.

With the permission of the committee, I would like to supplement this statement for the record with two short memoranda, which I will file with the clerk within a day or two, covering two other subjects in the existing Revenue Act of prime concern to our industry but wholly unrelated to the topics I have discussed.

The CHAIRMAN. All right, Mr. Mulligan.

(The matter referred to is as follows:)

MEMORANDUM SUBMITTED TO THE SENATE COMMITTEE ON FINANCE BY THE NATIONAL COAL ASSOCIATION IN BEHALF OF THE PRODUCERS OF BITUMINOUS COAL, WITH RESPECT TO THE QUESTION OF DEPLETION ALLOWANCE

This memorandum is prompted by a paragraph included in the statement to the committee on August 8 by Secretary of the Treasury Morgenthau, in which he asserted that "concerns engaged in extracting certain of our national resources, notably oil, have been granted far greater allowances for depletion than can be justified on any reasonable basis of tax equity," and intimated that if the individual income-tax base was to be broadened "this privilege of tax escape (i. e., depletion allowance) should be simultaneously removed."

We submit that these two propositions are entirely unrelated. We maintain that, as respects the coal industry (for whom alone we are in a position to speak), the assertion as to "far greater allowances for depletion than can be justified on any reasonable basis of tax equity" is inapplicable and untrue. We oppose any change in the present statutory provisions respecting depletion except that with respect to the percentage depletion allowance which was first written into the Revenue Act of 1928 and extended to cover coal mining in the Revenue Act of 1932, we submit that in fairness to the taxpayer an opportunity should be accorded to him to make a new election as between cost depletion and percentage depletion.

In the case of the mining industries, one of the elements of cost that has to be taken into account in the determination of net income or profit is the value to be assigned to the mineral or metal extracted. The cost of extraction, in the case of coal the cost of mining the coal, the cost of its shipment, the expenses incident to its sale, are of relatively easy ascertainment. But the cost or value of the coal itself, as an element of the total sum to be subtracted from the sales price in arriving at the net profit (if any) is a variable item, always difficult of exact ascertainment.

Congress, in its original enactment of the income tax, freely conceded that in the case of the mining industries the cost or value of the metal or mineral itself was one of the items to be reckoned with in arriving at the final figure of net taxable income. This item was termed depletion. Every ton of coal taken out of the mine depleted the total in the mine (whatever that total might be).

There is nothing mysterious about this matter of depletion; nothing fanciful or imaginary about it. It is very obvious and very real. The complexities arise when it comes to figuring it, or to writing into the law a statutory yardstick of measurement that shall be equal and fair.

Cost depletion allowance.—Congress in dealing with this question of depletion in the earlier versions of the income-tax law, left it to the Treasury and the taxpayer to figure it out. The taxpayer was to be allowed to deduct annually a fair and reasonable amount on account of depletion to the extent sustained. The Treasury was the judge of what was fair and reasonable.

The formula devised for arriving at the precise amount to be allowed for depletion was first, for the taxpayer and the Treasury to come to an agreement on the figure to be set as the cost to the taxpayer of his entire coal property (or its market value as of March 1, 1913, in case of its prior acquisition); second, for the taxpayer and the Treasury to come to an agreement on an estimate of the total number of tons in the ground prospectively recoverable, and then to divide the first figure by the second to get a per-ton figure to be allowed as the per-ton depletion allowance. This method, as provided for in earlier revenue acts, and which is retained in the present revenue act, is commonly referred to as the "cost depletion allowance."

Depletion on fixed percentage basis.—Because Congress, the Treasury Department, and the mining industries alike perceived the difficulties in the cost depletion method when applied to mineral deposits an attempt was made to devise some other formula for figuring depletion. This was the origin of the so-called "percentage depletion allowance." It is a fixed yardstick instead of a variable yardstick.

The percentage depletion allowance is contained in the Revenue Act of 1936, section 114, paragraph (b), subsection (4). The earlier provisions respecting allowances for depreciation, depletion, and exhaustion were retained in the law, and many coal-mining companies have elected to continue to adhere to the cost depletion allowance plan as applied to their particular situation. Congress and the Treasury recognized that it might be a hardship, and perhaps a gross injustice to many mining taxpayers to cancel the depletion basis already in vogue and under which they had been operating for many years. A switchover to the percentage depletion allowance basis was, therefore, left optional with the taxpayer.

Percentage depletion for coal.—Depletion allowance in the case of coal mines is 5 percent of the gross income from the property during the taxable year, but with the limitation that in no event shall the authorized allowance exceed 50 percent of the net income (computed without allowance for depletion) from the property.

What does this mean and how does it work? It means, for example, that if a coal operator mines and markets a million tons of coal during the taxable year, but his operations have failed to yield any profit (without giving any consideration to the value of the coal itself that left his property), in other words, that his operations showed no net taxable income, without figuring any depletion allowance whatever, then the latter does not come into play at all. Both the taxpayer and the Treasury are out of luck. There was no net income, hence, no income tax. The percentage depletion allowance in no way resulted in depriving the Government of any tax revenue, in no way afforded the taxpayer an "escape" from a tax.

Coal operations wherein the price received for the coal fell short of (or were no more than) the expenses incurred in digging it out of the ground, and delivering to the purchaser, have been quite common during the past decade.

It is pertinent to note that a comprehensive study of costs in the bituminous coal industry, prepared and published by the Research and Statistical Division of the National Recovery Administration, embracing 180,000,000 tons produced in 1934, showed an average net income, after depletion, of less than 3 cents per ton. This might indicate an average net income of between 5 and 6 cents per ton before depletion.

Thus it will be seen that the percentage depletion allowance for coal—5 percent of the gross income, but not to exceed one-half of the net income—is an exact mathematical formula, susceptible of easy and accurate application and computation.

It will be seen that in no event is it exorbitant, for obviously an allowance of nothing, if the coal operations yield no profit, and an allowance of a few pennies per ton, if there be a profit, as the fair cost value of the coal in the ground is a very moderate proposition.

It will be seen that in no event does the percentage depletion allowance operate to wholly extinguish a tax liability that would otherwise occur. The allowance may not in any case exceed 50 percent of the net income. In other words, if the coal operator obtains only 2 cents per ton as his net before depletion, he can only deduct 1 cent for depletion. The other 1 cent is taxable.

It will be noted further that the 5-percent maximum which the Revenue Act establishes as percentage depletion allowance for coal is far less than is accorded to other natural-resource industries. The existing law allows a 15-percent deduction in the case of metal mines, 23 percent in the case of sulfur mines, and 27½ percent in the case of oil and gas wells.

We concede that the question of the rate of percentage with respect to any particular industry may be open to argument, but we submit that such an argument constitutes no objection to this method of determination of depletion.

We cannot speak as to whether the present rates of percentage depletion for other industries are in fact too large or too small. We do assert, in behalf of a large number of bituminous-coal producers, that the 5-percent rate of allowance in the case of coal has worked out reasonably well for all concerned.

Respectfully submitted.

NATIONAL COAL ASSOCIATION,
JOHN D. BATTLE, *Executive Secretary.*

STATEMENT SUBMITTED BY THE NATIONAL COAL ASSOCIATION, IN BEHALF OF THE BITUMINOUS COAL INDUSTRY, PROPOSING INCLUSION IN H. R. 5417 OF A PARAGRAPH AMENDING THE REVENUE ACT OF 1936 (SEC. 501 (F) (2), TITLE III) DEFINING THE WORD "COST" AS APPLYING TO THE COAL INDUSTRY TO BE COST OF THE COAL ON THE CARS AT THE TIPPLE

To accomplish this, I suggest, for your consideration, the following proposed amendment to be added as a new paragraph at the appropriate place in the new act:

"The term 'cost' as defined in title III, section 501 (f) (2), Revenue Act of 1936, is herewith extended in the case of coal operators subject to tax under said title II to mean cost of the coal on the cars at the tipple, exclusive of deductions for depreciation, depletion, Federal income and excise taxes, and administrative overhead expenses."

The use of cost arises through the necessity of setting up "average margin" and "margin" computations under title III, Revenue Act of 1936, for the purpose of determining whether or not the taxpayer was presumed to have shifted to others the refunds received of the excise tax illegally collected under the Bituminous Coal Conservation Act of 1935, in order to fix liability for unjust enrichment taxes.

By section 501 (f) (2), Revenue Act of 1936, the term "cost" is stated to mean "in the case of articles manufactured or produced by the taxpayer, the cost to the taxpayer of materials entering into the articles * * *." Under this section the Bureau of Internal Revenue has construed cost in the case of the coal operator to be the cost of the coal in the ground. Thus in the case of the owner-operator, cost is taken to be the unit of cost depletion and in the case of the lessee-operator to be the unit of royalty per ton. All labor, supplies, and other actual production costs necessary to place the coal on the cars at the tipple, the customary place of sale, are excluded.

The aforesaid unit of depletion and royalty costs are, in most cases, constant throughout the prior 6 years base, or average margin period, and the 6½-month tax or margin period. Therefore the resulting "average margin" and "margin" computations result in mere comparisons between the selling prices in the two periods. Such comparisons in no wise indicate whether or not the producer shifted the excise tax to the consumer. This can only be determined when the comparison is made between true profit margins. To do this, the direct production costs, as well as the material costs, must be taken into the computation of the margins.

When the Revenue Act of 1936 was drafted, the report of the Subcommittee on Ways and Means recommended that the presumption that the excise tax was shifted to others be established by comparison of the gross profits margins of the pretax and the tax periods. The final act as passed by the House did not adopt the rule. However, the report of the Senate Finance Committee on the act recommended "the inclusion of direct manufacturing costs, as well as material costs, in the application of this presumption."

Unfortunately the direct statement that direct manufacturing or production costs were to be included in "cost" was left out of the law as finally enacted.

With respect to the determination of the unjust enrichment tax liability of the coal operators this has resulted in continuous controversies. As a result, the Bureau of Internal Revenue has been able to settle and close but a small number of the pending unjust enrichment tax returns of the coal operators. Most of such cases so far closed have been settled by arbitrary compromises. Such settlements have been accepted by the taxpayers merely to bring their accounts current and be rid of a troublesome problem. A considerable number of cases have been appealed to the United States Board of Tax Appeals. To date only one of these cases, *Hart Coal Co.*, B. T. A. Docket No. 96267, has been disposed of. In that case the General Counsel of the Bureau of Internal Revenue, both in the trial before the Board and in his subsequent brief filed with the Board, approved and vigorously defended the principle of including the actual operating costs as "cost" in arriving at the margins required by the law. However, before a decision was rendered by the Board, the case was closed by stipulation showing "no deficiency." Immediately thereafter the General Counsel changed his position and has since refused to sanction the use of any "cost" other than the unit of depletion or royalty costs.

Consequently, the unjust enrichment taxes against the coal operators, due in 1936, remain unsettled in the great majority of cases. Those concerned with the administration of the act admit that the Bureau interpretation or construction of "cost" as used in the act when applied to the coal industry is inequitable. They admit the construction of the word "cost" here contended for when applied to the coal industry will give a more reasonable answer and allow the tax to be assessed against those operators rightly liable therefor. However, they feel they are without authority to apply such construction unless Congress amends the act.

It will not be necessary to apply the amendment to other industries, because they generally purchased, in the open market, the materials processed. Consequently, such industries are, under the Bureau construction of the act, permitted to include the full cost of materials as "cost" in determining the margins, and such margins are in effect profit margins.

Respectfully submitted.

NATIONAL COAL ASSOCIATION,
JOHN D. BATTLE, *Executive Secretary.*

STATEMENT OF LOUIS F. TANNER, REPRESENTING DAVIS-WILSON COAL CO., AND OTHERS, MORGANTOWN, W. VA.

Mr. TANNER. Mr. Chairman, members of the committee; my name is Louis F. Tanner. I reside at Morgantown, W. Va. I am a certified public accountant, and have been engaged in public practice for more than 20 years. I appear here today representing the following coal companies:

Davis-Wilson Coal Co., Morgantown, W. Va.
Christopher Mining Corporation, Morgantown, W. Va.
Cochran Coal & Coke Co., Morgantown, W. Va.
Preston County Coke Co., Morgantown, W. Va.

and many others.

During all this time we have aided our clients in connection with the preparation of their income-tax returns, and in order to properly serve them it was necessary to follow all of the various tax laws that have been enacted or amended since 1918.

I reviewed all of the tax bills before they were submitted by the committee to the Members of Congress, and at times have felt that certain inequities were written into them.

It has not been my policy to make any appearance or objection opposing legislation. However, at this time I feel it my duty to raise my voice in objection to one phase of the proposed legislation, namely: the special rule as set out in title II, Excess Profits Tax Act, section 201, amending section 710 (a) (2).

Our clients are small producers of bituminous coal, operating in northern West Virginia. It is needless for me to mention to this committee the importance of the bituminous-coal industry to the Nation, since it is, and should be, considered one of the major industries.

This industry has been a sick industry for more than 10 years, and the survivors have existed during the critical period only through their determination to survive.

In spite of these obvious facts, the industry has paid its proportionate share of income taxes as well as made its contributions to the welfare of the Nation:

1. It supplied coal to the Nation at a loss and at a price less than the cost of production.

2. It assisted in establishing and maintaining a higher standard of living.

3. It assisted and aided in increasing the national income by the payment of wages at a higher average than many other industries.

4. It has contributed heavily to the employee cause by large payments required under the Social Security Act, since approximately 65 percent of the cost of production of coal are paid out for wages.

Your committee is fully aware of the hardships that this industry has undergone. The present Bituminous Coal Act was passed by the Congress during 1937 for the prime purpose of establishing and regulating the price of coal so that the industry will get at least its cost of production.

The industry's capital has been badly impaired. It was not considered a good financial risk in banking circles for obtaining credit. Naturally, this condition affected the progress of the small producers. I might mention here that the smaller producers mine about 60 percent of all the coal produced in the Nation.

The industry has striven, particularly in the East, to adjust its operations on a more economic and profitable basis. Within the past 3 years a large part of the industry revolutionized its operation by the transition from a hand-loading operation to a mechanized operation and, as a result, it is just beginning to realize the fruits from this change which has materially reduced its operating costs, resulting in a reduction in its losses.

The industry within the past few years has changed its method of selling its product. It has expended considerable sums for the installation of facilities and equipment for preparation plants so that its product can be sold.

A contributing factor toward stabilization was the establishment of minimum prices under the Bituminous Coal Act of 1937. The prices thereunder did not become effective until October 1, 1940.

Therefore, any increased earnings in the coal industry are not attributable to governmental expenditures for national defense, but are primarily attributable to (*a*) the mechanization of mining which tended to reduce the operating costs, (*b*) the preparation and cleaning of the product which tended to increase the realization, and (*c*) the establishment of minimum prices under the Bituminous Coal Act.

Under the 1941 Revenue Act, you now propose to further increase the tax rates. It is not my aim to oppose any equitable taxation under

this proposed act, but I do feel that the reason given by the Ways and Means Committee in trying to impose a "special rule" as set out in title II, Excess Profits Tax Act, section 201, amending section 710 (a) (2), should not apply to the bituminous-coal industry.

A large percentage of the coal companies showed little or no earnings during the base period, whereas as a result of the economies due to mechanization, increased realization due to preparation, and the stabilization of prices, and not governmental expenditures for national defense, these companies may show some profit. The theory of taxation based upon the ability to pay would not be applicable by the imposition of a penalty tax such as proposed by the "special rule."

This is my thought in the matter, and I feel that this section should be eliminated from the bill in order to avoid an unjust discriminatory tax against the small coal producers.

The CHAIRMAN. Are there any questions?

(No response.)

The CHAIRMAN. Thank you for your appearance.

Mr. Caulfield.

STATEMENT OF J. F. CAULFIELD, REPRESENTING ELK HORN COAL CORPORATION, CINCINNATI, OHIO

Mr. CAULFIELD. The proposed tax bill will be discriminatory as it applies to the Elk Horn Coal Corporation, because the Elk Horn Coal Corporation had no net earnings during the base period 1936 to 1939, inclusive; hence, it would be subject to the special tax of 10 percent without any offsetting credits.

The Elk Horn Coal Corporation needs relief from such discriminatory taxation. The corporation is in receivership and it should be permitted to make use of such earnings as may accrue under present conditions to bolster up its working capital and to make settlement from time to time of a percentage of the sums due its creditors. Should the corporation be subject to discriminatory taxation, this process may be greatly slowed down or completely frustrated.

Such earnings as may accrue to the Elk Horn Coal Corporation under present conditions we feel will not be due primarily to activities brought about by defense preparations but will be due to two causes: (1) The setting of Government prices, which became effective October 1, 1940; (2) economies resulting from improvement of the properties brought about by the expenditure of large sums of money.

Theoretically, when reserve is set aside based upon a percentage of the cost of equipment and such reserve is built up over the estimated life of such equipment, the reserve equals the estimated cost of the equipment at a time when the equipment is worn out.

In practice it has been found that factors which interfere with the building up of adequate reserve are (1) obsolescence prior to the expiration of the estimated life of the equipment; (2) greatly increased costs of replacement of the equipment.

The Elk Horn Coal Corporation properties have been in operation since 1914. From time to time replacements of equipment have been made at higher and higher prices, and equipment which became obsolete had to be replaced by more modern equipment.

At the present time the receivers of the Elk Horn Coal Corporation plan an expenditure of approximately $300,000 to modernize and improve some of its plants.

The only way this money can be repaid to the lenders is through earnings. If these earnings are heavily taxed, and taxed in a discriminatory manner, the repayment of the loans to the borrowers will present a serious problem. The failure to make repayment of such loans will result in the loss of property which has been pledged as collateral on the loan.

The operating properties of the Elk Horn Coal Corporation comprise approximately 25,000 acres of its total holdings of over 200,000 acres. From time to time sales and leases have been made of parts of the undeveloped coal lands.

In 1939 the corporation was in a serious position because of the failure to pay certain unemployment and social-security taxes which became overdue to the extent of approximately $65,000. At that time the corporation found a buyer for coal properties, the sale of which produced approximately $300,000.

This enabled it to pay the social-security and unemployment taxes which were overdue, and it was also enabled to bring its payments on current purchases of materials, supplies, and equipment into more current position. It is not a healthy condition, however, where a corporation has to sell its assets to pay taxes and other obligations.

In the early years of the corporation's existence, approximately 85 percent of its high-grade byproduct and coking coal was shipped to steel companies. As the years went by, the various steel companies acquired their own mines. This gave the corporation the problem of finding other markets for its output. It was successful in doing so, but naturally its selling costs were greater as the number of its customers increased. Its coal now has wide distribution, as indicated by the statement attached hereto.

During the period when N. R. A. regulations prevailed, the company prospered. Wage rates became stable, the prices which were obtainable were adequate. Simultaneous with the effective date of N. R. A., a 2-year contract was signed with labor by the district in which the Elk Horn mines were located. The wages paid under this contract could be met at selling prices which were then set.

When the N. R. A. was declared unconstitutional, the selling prices of coal gradually fell, but the wages paid under the 2-year contract were not lowered, hence, the margin of profit gradually disappeared and eventually losses occurred.

During the short period when coal prices under the Guffey Coal Act were in effect from December 16, 1937, to February 25, 1938, the corporation prospered. When these prices were suspended, prices slumped but wages remained the same as before. In consequence, the company lost money.

The corporation management considered it advisable to make expenditures to modernize its equipment, improve the property, and consequently reduce its costs. It was hoped that costs might be reduced to a point where a profit might result, even at the lowered market prices. However, it was found to be difficult to raise funds

under the conditions which then affected the coal industry and, as month after month went by and losses mounted, the working capital of the corporation became depleted and the receivership of August 22, 1940 resulted.

It may be thought that a demand for coal for defense purposes will result in increased tonnage, thereby resulting in a lowered unit cost for overhead expense and a consequent increase in net earnings.

This is not likely to be the case, because the heavy demands upon the railroads for the movement of commodities other than coal have already resulted in car shortages.

The Elk Horn Coal Corporation production and net results of operations for the base period are given below.

The proposed law imposes a special tax of 10 percent upon the difference between the amount of current earnings less the average annual earnings during the base period and the earnings calculated after deduction of invested capital exemption. This basis of calculation penalizes the Elk Horn Coal Corportion because it had no earnings during the base period.

We respectfully request that the special tax of 10 percent be eliminated from the bill.

	Tons produced	Loss		Tons produced	Loss
1936	1,014,534.55	$324,115.46	1938	1,620,553.65	$710,872.10
1937	1,749,334.60	520,684.76	1939	1,675,619.70	925,735.32

Tonnage shipments by States, year 1937

State	Tons	State	Tons
Florida	206.95	Ohio	366,476.55
Illinois	333,988.97	Pennsylvania	514.80
Indiana	36,467.00	Virginia	216.95
Iowa	48,409.65	South Carolina	1,350.85
Kentucky	120,533.88	West Virginia	353.80
Massachusetts	1,057.65	Wisconsin	355,299.45
Michigan	371,314.70	Canada	94,555.45
Minnesota	4,608.80	Georgia	67.80
Missouri	382.35	North Carolina	535.10
Nebraska	346.45		
New York	12,561.80	Total	1,749,334.60

The CHAIRMAN. Are there any questions?

Senator GUFFEY. What is your output today, Mr. Caulfield, at Elkhorn?

Mr. CAULFIELD. The output today is approximately between 5,000 and 6,000 tons at our own mines.

Senator GUFFEY. Is that practically the capacity of your mine?

Mr. CAULFIELD. It is not quite the capacity. We expect to expend $300,000 to increase the capacity.

Senator GUFFEY. That is the capacity, the present output, with the equipment you have?

Mr. CAULFIELD. That is the capacity with the equipment we have; yes.

Senator GUFFEY. Are you making some money now?

Mr. CAULFIELD. We are making some money on a cash basis, and I think we will make some even after taking into consideration depreciation, depletion, and amortization, with steady production, and with the prices set under the Guffey Coal Act.

Senator GUFFEY. Have you made a settlement with your bondholders and banks for an extension?

Mr. CAULFIELD. We have paid about $160,000 of liens and preferred claims. We have about $50,000 of special claims which come prior to general creditors, and there are probably about $700,000 of general creditors' claims.

Senator GUFFEY. In what form is that? Bonds or notes?

Mr. CAULFIELD. Just open accounts. We have not made a special arrangement with them as yet.

Senator GUFFEY. Thank you very much.

The CHAIRMAN. Mr. Eichenawer.

STATEMENT OF O. K. PRICE, REPRESENTING PITTSBURGH COAL & UNION COLLIERIES CO. AND WESTERN PENNSYLVANIA COAL OPERATORS ASSOCIATION, PITTSBURGH, PA.

The CHAIRMAN. Will you give your name, please sir, and for whom you appear?

Mr. PRICE. My name is O. K. Price. I am appearing for Mr. Eichenawer. I am also appearing for the Western Pennsylvania Coal Operators Association, an association representing about 27,000,000 tons annual production; an association composed of about 105 operators representing that production, commercial production as distinguished from the captive production of the Pittsburgh district, which is about the same or a little more.

This presentation is made on behalf of the western Pennsylvania area; have for many years operated at a loss. This has depleted their working capital and consumed their capital assets. Their survival as industrial enterprises has been due to the sole fact that their operation has consisted in turning a capital asset in the form of a mineral deposit into cash even though at a loss. Probably a similarly distressing financial situation exists in other industries and individual enterprises but it has been a recognized fact that no single productive industry of comparable importance has endured a comparable adversity.

Under such advantages as are afforded by regulation imposed by the Bituminous Coal Act of 1937, which has recently been extended by the Congress, and the increased demand due to the present industrial activity the Bituminous Coal Industry to a small extent during the year 1940 and to a greater extent during the current year is emerging from the depression of former years and probably will enjoy more profitable operations than it has for approximately the past two decades, such profitable period, however, in the degree that it presently exists can only be regarded as temporary.

Recognizing the necessity of the Congress to raise ever-increasing revenues the industrial group herein represented wishes to respectfully

direct the attention of your committee to the effect of the application of certain features of the provisions of title II of the pending H. R. 5417, and particularly subsection (2) (B) of section 201 imposing a 10 percent additional tax upon increased earnings for the taxable year which are not subject to excess profit taxes otherwise under existing law. The reference to this provision in the House committee report on pages 25 and 26 is upon reading very plausible, but upon examination in application of the provision to the members of an industry such as is here represented shows that it is highly burdensome, discriminatory and destructive.

Due to their unprofitable operations over a long period of years and the depletion of their working capital and capital assets and well known competitive conditions existing in the industry the Bituminous Coal Producers of Western Pennsylvania have almost without exception had no, or no substantial earnings for many years—even preceding the years of the base period provided in the pending revenue act so that if they are under the provisions of the proposed act subjected to excess-profit taxes on an earnings basis substantially their entire current year's earnings will be taxed. This, as anticipated by the framers of the proposed act, will result in adoption by members of the industry of the invested capital basis for excess profit tax with the result that subsection (2) (B) of section 201 will automatically apply and subject such members of the industry to the 10 percent tax imposed by the section 201.

The application of the 10-percent excess-profits tax to this industrial group results in a burdensome, discriminatory, and destructive exaction, as we will now attempt to show.

(1) The burdensome feature of the tax can best be realized by contemplation of the staggering losses to which the industry has been subjected over a period of more than a decade. Time has not permitted a survey of the entire industrial group here represented, but figures as individually reported for income tax purposes obtained from members of such group, all of whom have been active producers for more than 20 years, representing more than 50 percent of the production of the entire membership, shows that during the decennial 1930–39 inclusive such members have in the aggregate realized total profits of but $228,271 and have sustained total losses of $34,801,934 or an aggregate net loss of $34,573,663. The industry is now confronted with a demand for capital for rehabilitation of plant and for extension thereof to meet the present defense demand for a prime necessity, and yet will be subject to an excess-profits tax under this provision on its current earnings, which it can only regard as temporary, and the same exaction will be repeated until the law is changed. It is to be remembered also that the invested capital base has been very much reduced by the operating losses referred to.

(2) The members of this industry which almost without exception have had constant losses over the past decade or longer and which will realize profits during the current year and perhaps some subsequent years will, under the pending bill, be currently paying a greater proportion of their earnings in Federal taxes than those of more

prosperous industries. Corporations that have been more prosperous during past years and which will pay upon a basis of earnings will escape the 10-percent tax while less prosperous corporations such as here represented and will thus constitute a tax on poverty rather than prosperity may be shown by a simple example of two corporations with like incomes and invested capital for the taxable year, the one with earnings over the base period, and probably previously, and the other without earnings over such period.

For this purpose corporation B cited as an example under the proposed law on page 25 of the House committee's report is used with and without base-period earnings.

	With base-period earnings	Without base-period earnings
1. Invested capital	$1,250,000	$1,250,000
2. Average base-period earnings	100,000	None
3. Net income, taxable year	130,000	130,000
4. Less credit—95 percent of line 2 plus specific exemption of $5,000	100,000	5,000
5. Adjusted excess-profits net income under sec. 713	30,000	125,000
6. Net income, taxable year	130,000	130,000
7. Less credit of 8 percent plus specific exemption of $5,000	105,000	105,000
8. Adjusted excess-profits net income under sec. 714	25,000	25,000
9. Excess of line 5 over line 8	5,000	100,000
Excess profits-tax under sec. 710 (a) (2) as proposed to be amended by sec. 201 of pending Revenue Act of 1941.		
10. Excess-profits tax on line 8	9,000	9,000
11. Tax at 10 percent on line 9	500	10,000
12. Total excess-profits tax	9,500	19,000
13. Net income, taxable year	130,000	130,000
14. Excess-profits tax, line 12	9,500	19,000
15. Adjusted net income	120,500	111,000
16. Normal and surtax	35,900	33,050
17. Total tax, line 12 plus line 16	45,400	52,050

It thus appears that the operation of the tax bill be highly discriminatory against corporations having small or no base period earnings.

(3) Without the opportunity to retain in their businesses a large part of current earnings the industrial group here represented will not be able to make the necessarily large capital expenditures for plant rehabilitation and extension without which the industry cannot continue. Any special tax exaction applicable particularly to corporations with small or no base period earnings will therefore be destructive and contrary to the "ability to pay" philosophy of taxation, and from a revenue producing standpoint can only result in diminishing returns.

It is therefore submitted that the proposed amendment to section 710 (a) of the existing revenue law relating to the Special Rule in Certain Cases Where Invested Capital Credit is Used, as set forth in section 201 of H. R. 5417, should be eliminated from the pending bill.

The CHAIRMAN. Do you wish to make a statement in addition to that?

Mr. PRICE. I have made no point of objection to the proposed revenue act, other than that which those who have preceded me have made, that is, the special 10-percent tax. I would like to emphasize that the western Pennsylvania operators have, perhaps, suffered more than any other group over the period of years which have preceded the present time.

I have tabulated a list of representative results from operations, or, rather, the net earnings of operators, representing more than 50 percent of the production of the association members, and it is impressive.

I make no special point, other than that this industry could not have survived the last 10 years if it had not been that it was turning a natural resource into cash, even though at a loss. It has only survived on that account. We have hopes for the future, and there is some justification for those hopes, under the stabilizing influence of the Guffey Act and some increased demand.

The CHAIRMAN. Are there any questions?

Senator GUFFEY. John Eichenawer did not come?

Mr. PRICE. He could not come.

Senator GUFFEY. I would like to ask him about the Pittsburgh Coal Co. I will not ask you about that.

Mr. PRICE. I would be glad to answer, because I represent it too.

The CHAIRMAN. Thank you for your appearance.

Mr. Beauvais and Mr. Freiberg.

I notice they are both listed here together.

STATEMENT OF L. A. FREIBERG, NEW YORK, N. Y., REPRESENTING NATIONAL HAIRDRESSERS AND COSMETOLOGISTS ASSOCIATION, INC.

Mr. FREIBERG. My name is L. A. Freiberg, representing the National Hairdressers and Cosmetologists Association, Inc. I am also speaking for Mr. Beauvais, so we can facilitate the hearings and not take too much time.

The CHAIRMAN. Yes.

Mr. FREIBERG. There seems to be an unfortunate listing on the calendar. We are not here on the proposed tax on electrical appliances, we are here in protest to section 2402 (b) of the proposed measure, which provides for a tax on cosmetics used in connection with the giving of beauty services, that tax to be based on a retail price for those cosmetics, and that price to be determined by the Commissioner.

We have learned from previous hearings of the committee that the attitude of the toilet goods and cosmetic industry with regard to special taxation on cosmetics has been gone into. While we generally want to state that it is our opinion that cosmetics have been a necessity in the life of the women of this country and should not be considered on any other basis from the standpoint of taxation, we want to confine our remarks here especially to section 2402 (b).

Cosmetology services and cosmetics are no longer luxuries since they have become a necessary part of every woman's dress.

The welfare of a nation is dependent to a great degree upon the morale of the women in the home. England's recent acknowledgment of the importance the use of cosmetics has played in this war is evidence of the position of the profession.

The National Hairdressers and Cosmetologists Association, and its affiliated membership of beauty-shop owners and operators throughout the United States believes that cosmetics should carry no greater taxation than any other necessities.

Further, this Association and its membership protests the imposition of a tax on cosmetic articles consumed in rendering cosmetology services.

The following objections are hereby made to the adoption of section 2402 (b) of H. R. 5417:

A. The provision is unfair in that it places a discriminatory tax upon the cosmetologist's tools since the use of cosmetic items is merely an incident to his work, revenue being derived almost entirely from the services rendered.

The services of the cosmetologist can be likened to those of the medical, dental, and nursing professions. These professions, in performing their services, also use certain cosmetic articles.

B. Beauty shops are not equipped to gather statistical information required to determine and record the exact amount of a pound or a pint of material used during a given period of time, since they do not employ clerical help.

According to the Bureau of Census figures for 1939, the average gross income for beauty shops of the United States is $2,789, which includes merchandise sold at retail. If forced to employ clerical help, many of them would have to discontinue business, thus increasing unemployment.

C. The provision is impractical in that it would lead to great confusion:

1. Many of the products used by the cosmetologist are prepared by him and used by him alone. Hence, there is no established retail sales valuation or price.

2. Other prepartions used by him are purchased for such use in bulk at wholesale prices and are not distributed at retail. How can any retail price be established upon which to base a retail sales tax?

3. The preparations so prepared and purchased come in bulk. It is impossible to determine, with any accuracy, the monthly consumption of these items as required under the proposal.

D. We object to one individual being given the authority to arbitrarily determine retail prices on products which are not normally retailed and for which no retail market exists.

At present a 10-percent excise tax is in effect on cosmetics, such being collected through the manufacturer. We believe that on bulk materials used in professional services, the only equitable way to collect a tax, if one is fair, is through the supplier to the beauty shop.

Our organization is willing to support a just tax program but believes, as pointed out above, that the imposition of the proposed cosmetic tax in the Federal emergency revenue bill is inequitable.

Senator BROWN. You think you can be reached by a manufacturers' sales tax?

Mr. FREIBERG. Yes; we do. It is estimated that the average beauty shop will spend about $200 per year at wholesale prices for the items which would become taxable under this provision. With 83,000 beauty shops in the United States, according to the census figures, these purchases will approximate only $16,600,000. Now, a 10-percent tax based on those figures would only be $1,666,000. If it is attempted to be collected from 83,000 beauty shops throughout the United States the Government, the Internal Revenue Department, the Treasury Department, and everyone concerned, we think, are soon going to find they will lose their hair, as I have, worrying about the hairdressers.

I am of the opinion, we are all of the opinion that the attempt to collect the tax from 83,000 beauty shops—this would also affect one hundred thousand-odd barber shops in the country, who would come under the measure, except their purchase of supplies would be even less than the beauty shops—we feel the amount of money that can possibly be realized would be greatly exceeded by the cost of collection, let alone the amount of trouble, both with the proprietors of the beauty shops and the barber shops.

The CHAIRMAN. The purchases are usually made from the manufacturers?

Mr. FREIBERG. Usually made through the wholesaler.

Senator BROWN. You think the tax should be on the supply houses other than the manufacturer and retailer?

Mr. FREIBERG. That is right. In other words, the present manufacturers' 10 percent excise tax on cosmetics, which now applies to all cosmetics used in beauty shops in giving their services, should remain as is now, and there should be no attempt to collect a tax based on the retail sales price for which there is no retail market. On the cosmetics which are sold through the beauty shop at retail, we are, of course, agreed to go along paying the same 10 percent retail tax on those cosmetics as any other agency of sale.

The CHAIRMAN. Are there any questions?

(No response.)

The CHAIRMAN. Thank you very much for your appearance.

Mr. Shaw.

STATEMENT OF T. T. SHAW, NEW YORK, N. Y., ON BEHALF OF THE BROOKLYN NATIONAL CORPORATION

Mr. SHAW. My name is T. T. Shaw. I am a member of the accounting firm of Arthur Young & Co., New York, N. Y. I am appearing on behalf of the Brooklyn National Corporation.

I wish to ask for the repeal retroactively to January 1, 1938, of section 505 (d) of the Internal Revenue Code. This section restricts the deduction of net capital losses to $2,000 in calculating personal holding company surtax.

This restriction was put into the law in 1937. The Ways and Means Committee at that time explained in its report that the reason for such restriction being placed on personal holding companies was to place them on the same basis as individuals who at that time were also re-

stricted to a deduction of $2,000 for net capital losses in their personal returns.

For years commencing on and after January 1, 1938, the $2,000 restriction was removed in the case of individuals but the restriction on personal holding companies was left in the law.

This seems clearly to have been an oversight. The restriction to $2,000 in the case of personal holding companies lost its purpose as soon as the same restriction was removed in the case of individuals. It is not, however, the fact that the provision has lost its purpose that is objectionable. It is the hardship and injustice which such a provision creates.

Where a personal holding company has taxable income of the current year but has net capital losses in excess of $2,000 (which it may deduct in calculating its normal income tax but not for the purpose of calculating its personal holding company surtax) and where such corporation has no accumulated earnings, it finds itself in such a position that it is impossible for it to avoid the prohibitive personal holding company surtax no matter what action it takes.

If it makes distributions to its stockholders, such distributions are considered to be at least in part a return of capital and the dividends paid credit is restricted to that portion of the distribution which is deemed to have been made out of earnings.

Even if the company distributed all of its assets, it still could not avoid the personal holding company surtax. Removal of the $2,000 limitation on the deduction for net capital losses would remove this hardship.

Since some personal holding companies have suffered during 1938, 1939, and 1940 through the existence of this $2,000 limitation in the law, I suggest that it be repealed retroactively to January 1, 1938.

There seems little doubt that Congress never intended the provision to operate the way it does. It is nothing less than a trap which personal holding companies, who have the combined misfortune to have no accumulated earnings and to suffer capital losses in excess of $2,000, find themselves in.

I understand the Treasury officials recognize that and admit the injustice of the provision and would be agreeable to having it removed. Its retention in the law will undoubtely cause much litigation and expense for taxpayers.

Only a week or two ago, the second-circuit court handed down a decision dealing generally with this question. The case referred to is that of *Pembroke Realty & Securities Corporation* v. *Commissioner of Internal Revenue.*

The case was decided in favor of the taxpayer, which was found not to be liable for the personal holding company surtax.

Judge Swan, in his opinion, made the following significant remarks:

> To us it appears beyond question that the Congress did not intend to impose a penalty tax upon a corporation which in fact distributed all its current earnings to shareholders. The purpose was to induce such distribution, and the tax was laid on "undistributed income." Had Pembroke's capital not been impaired, its distribution of current income would indisputably have been a "dividend," and the corporation would not have been subject to a surtax. It is incredible, in the light of the purpose of the legislation, that a different result was intended in the case of a corporation whose capital happened to be impaired * * *.

It is within the power of the courts to declare that a thing which is within the letter of the statute is not governed by the statue because not within its spirit or the intention of its makers.

In the interests of fairness to taxpayers and to avoid needless litigation and expense, I believe that section 505 (d) should be repealed and its repeal made retroactive to the date when the $2,000 restriction was removed in the case of individuals, namely, taxable years commencing on and after January 1, 1938.

Now, to repeat, the restriction on personal holding companies really has no purpose. However, it is not just the existence of the provision that is objectionable, but it is the way it works.

Perhaps you are familiar with it and have had illustrations given you already.

Let us take a simple case of a personal holding company that had an income of $100,000 in 1940, from dividends and interest, say, but it also had capital losses of $100,000 in 1940, long-term capital losses. For normal tax purposes, it would have no tax at all, because its true income would be zero.

However, for personal holding companies' surtax purposes, the law says you can deduct only $2,000 of those capital losses, and you have to pay the prohibitive tax of 75 percent on $98,000 of your nonexistent income.

Now, with a company that has been placed in that situation, if the company has no accumulated earnings on profits, as that term is understood in the income tax law, there is nothing it can do than pay the prohibitive tax, because if it makes distributions to its stockholders, such distributions are considered to be a return of capital. It seems to me that, on the face of it, is vidiculous, and it should certainly be taken out of the law.

The CHAIRMAN. Have you talked to the Treasury people about it?

Mr. SHAW. Yes; I have, Senator, and they feel, too, that it is unfair. They say, "Well, what can we do about it? It is there in the law. We just have to collect the tax if you are liable for it."

I have not spoken to any of the higher-ups; I have never been able to get in touch with them.

I cannot see how any fair-minded person would want to uphold a provision like that.

Now, in the case I referred to, where Judge Swan rendered the opinion, the corporation was ruled not to be liable in that case. So if we went to the trouble and expense of taking the case to the circuit court we could probably avoid the tax, like this company did, but if we could do that by a simple change in the law, it seems to me the situation would be cured.

The CHAIRMAN. Your matter will be given consideration, and I understand is being given some consideration in the bill dealing with the technical miscellaneous provisions of the tax act.

Mr. SHAW. Unfortunately, the company I have in mind has been hurt for the past 2 years because of the existence of this provision. While it made a distribution to the stockholders, they are considered to be a distribution of capital and it does not do the corporation any good. I think if the provision is repealed it in fairness should be repealed retroactively to 1938, when the $2,000 limitation was removed in the case of individuals. Commencing January 1, 1938,

that restriction of $2,000, which this personal holding company provision was put in to be comparable with, has been removed from the law, and so I think in fairness it should be removed retroactively to 1938.

The CHAIRMAN. I think you are entitled to some relief, but we have to be pretty careful to safeguard it, else the holding companies would accumulate a loss on stocks that you have referred to.

Mr. SHAW. We should, of course, prevent abuses, if possible.

The CHAIRMAN. It seems to me there is some merit in your contention.

Mr. SHAW. This company I have in mind acquired most of its securities at the height of the market in 1929, which depreciated to such an extent since that time that practically everything it sells it incurs a loss on. Of course, it has to dispose of its securities from time to time. It would incur capital losses at those times. When it finds itself with capital losses, and it has no accumulated earnings, it is faced with the 75-percent tax, unless it goes to the circuit court. I feel confident that if we go to the trouble and expense of doing that we can avoid paying the tax.

Senator BROWN. It is a matter of interpretation of the law. I thought what Senator George meant was whether or not you would take up the matter of some change in the legislation now or later?

Mr. SHAW. We wrote to the Commissioner several weeks ago, pointing out the inequity of the thing, and asking that the provision of the law be repealed retroactively, but we have not had any reply yet.

I have been to the Internal Revenue Building, I have seen whoever it was possible to see there, and put the thing to them. They admitted to me that it is inequitable, and should not be the law, they felt, but they say, "What can we do about it?"

Senator BROWN. It seems to me where you should take it up is with the Treasury Department, with Mr. Sullivan. They advise us from time to time in regard to legislation. You cannot get an interpretation out of them other than you have gotten, but you might put the problem to them and see if they can suggest something to cover it by legislation.

Senator LA FOLLETTE. It is my understanding that the matter is under consideration in connection with the second bill.

Senator BROWN. I think you have got a good case.

Mr. SHAW. If anyone can justify, on any theory, that provision being in the law, then I would be very glad to hear them. If there is any justification for it, let us leave it in the law.

The CHAIRMAN. We have your point.

Mr. SHAW. Thank you very much.

The CHAIRMAN. Mr. Ahrens.

STATEMENT OF BERT C. AHRENS, NEW YORK, N. Y., EXECUTIVE SECRETARY, EDUCATIONAL BUYERS ASSOCIATION

Mr. AHRENS. Mr. Chairman and members of the committee. My name is Bert C. Ahrens. Representing the Educational Buyers' Association, I speak in behalf of 380 members who are the purchasing officials of 380 colleges, universities, and hospitals, located in all parts

of the Nation, large ones and small ones, renowned and little known, tax-supported and endowed, whose object in belonging to the association primarily is to promote efficient procurement of supplies for their institutions.

Much as I would like to tell you of the success of the association in helping the member procurement officer better his professional ability and in creating opportunities for him to stretch his institutional dollar, I accede to your chairman's plea for brevity, and offer a copy of the Proceedings of the Twenty-first Annual Convention of the Educational Buyers' Association for your examination, that you may, if you desire, get an idea of the type of activity we carry on and judge for yourselves as to our success in promoting efficient procurement for our member institutions.

I wish to point out that the price of goods consumed by educational and similar institutions is vital to them and that they have helped themselves to find out how to pay the least for the best in the various quality ranges. They have examined every cost factor and have succeeded in bringing many of them to a point fair to themselves and the producer.

The tax factor is not susceptible to any other approach than this and I find myself beginning with the others in this room.

Axes ground in these hearings usually are, it is popularly believed, applied to the grindstone by the profit motive.

That motive these days unquestionably is coupled with a genuine desire to help you gentlemen in your efforts to do the best you can for the welfare of our country.

But the educational institutions do not have and never have had the profit motive. They serve the people in a very vital way and are in effect public institutions.

Past legislation has recognized that fact. Municipalities and States in the main exempt educational and eleemosynary institutions from sales taxes, as well as from taxes on their plants.

The Congress exempted them in H. R. 8148 from the application of the Robinson-Patman Act, as follows:

Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled, That nothing in the Act approved June 19, 1936 (Public, Numbered 692, Seventy-fourth Congress, second session), known as the Robinson-Patman Antidiscrimination Act, shall apply to purchases of their supplies for their own use by schools, colleges, universities, public libraries, churches, hospitals, and charitable institutions not operated for profit.

Business very properly should have a profit motive. Labor is worthy of its hire and agricultural production must be encouraged.

But taxing the educational and public-health systems of the Nation in times when cost factors are growing larger despite dogged efforts to control them, adds a burden to a public enterprise heretofore in normal times not carried. The purchasing power of the institutional dollar shrinks with other dollars in a rising cost period but there is no way for the institution to get more of them as does business, labor, and agriculture.

Endowments are not increasing and few students would pay increased tuition, in fact, there are fewer students by reason of the Selective Service Act, opportunities for high earnings, and so forth.

Now, as I said before I am begging, but while the prospect that our educational institutions will be poorer should have your consideration,

I more humbly beg of you that you do not destroy the precedent of exemption from taxation for the eleemosynary institutions of this country the work of which is unselfish and for the public good and keeps pace with, yes, leads the way in social, scientific, and even commercial progress, and makes important contributions to military development.

I am, in effect, talking for the endowed institutions, for the bill you are considering exempts the State institutions through the State exemption.

Does it not seem, considering this, that the act is discriminatory in this regard? Since the function of both State and endowed institution are the same the theory and system of State exemption might well be applied to all eleemosynary institutions.

In his report on the bill Chairman Doughton of the Committee on Ways and Means of the House of Representatives stated:

> Your committee's principal aim in this bill, however, as in all tax legislation, is the procurement of revenue.

Take the State institution consumption out of the consumption of all nonprofit institutions and you have reduced the anticipated revenue from this source considerably, since the ratio for tax-supported colleges to endowed is 32 to 68 percent.

Let us look at the prospective revenue from one class of item a great proportion of the sales of which is made to educational laboratories.

The distribution of the 1940 sales of one representative manufacturer of optical goods is as follows:

	Percent
To the Federal Government	12
To State and municipal governments	12
To hospitals	2
To educational laboratories	37
To medical students	23
To doctors	2
To industrial laboratories and individuals	12

There will be no revenue from the purchases of the Federal, State, and municipal governments which take 24 percent of the sales.

Of the 37 percent which goes to educational laboratories some is tax free since some purchasers are tax-supported institutions.

Estimated as being 60 percent of this 37 percent, tax supported, and so tax free, educational institutions add 22 percent to the aforementioned 24 percent and we have 46 percent of the total sales not available for tax revenue, leaving 54 percent available under the bill, still the bulk of which in the interest of the public welfare the Congress should not want to tax.

In order then to reach the doctors and the industrial laboratory and individual purchases, used in profit-making enterprise, the bill will miss entirely taxing 46 percent of the sales, will tax 40 percent of the sales to consumers which in the general interest should not be taxed, and so leaves the desired object of the tax, that is, the sales to doctors, industrial and individual laboratories, a mere 14 percent of the total sales of this class of merchandise.

It is estimated that the potential yield from optical goods used in education, scientific research, and public-health control is in the neighborhood of $250,000.

It is strongly urged, therefore, that paragraph (9) section 3406 of part V of the bill be stricken out in the interests of the Nation's medical students, hospitals, and educational laboratories the encouragement and assistance to which should be part of the government policy always and particularly at this time.

The general exemption from the application of the bill should certainly be accorded educational and the eleemosynary institutions so that this well-founded policy be not disturbed and particularly in these days when civilian morale and behind-the-line national strength dare not be weakened.

(The data used in the discussion of optical goods was provided by Mr. John Roberts, president of the Scientific Apparatus Makers of America.)

The CHAIRMAN. Thank you for your appearance.

(Letters by Mr. Roberts are as follows:)

MISSOURI VALLEY ASSOCIATES,
Chicago, Ill., August 20, 1941.

Hon. WALTER F. GEORGE,
Chairman of the Senate Finance Committee, Washington, D. C.

MY DEAR SENATOR GEORGE: I wish to present, on behalf of the medium-sized privately endowed college, a protest against the sales tax on optical instruments as specified in section 3406, paragraph 9, revenue bill, 1941.

From my experience, I believe that of the items in paragraph 9 (omitting the military instruments, such as fire-control optical instruments, searchlight mirrors and reflectors), approximately 70 percent will be used by the Government departments, educational institutions, hospitals, medical and dental students. Also, knowing the small profits in the industry, it will be necessary to pass the tax on to educational institutions, hospitals, and students, as the Government, State, and municipal purchases are exempt. I am inclined to think that the original framers of this bill were of the opinion that a larger proportion of such instruments were used in industry or as luxury items. However, the latter, such as opera glasses, prism binoculars, etc., are provided for under section 2400.

It is needless to state to this committee the desperate financial situation of many time-honored educational institutions that have contributed some of the best brains of the present and past in all walks of life in this country. Several members of your own committee are graduates of privately endowed colleges, and many of your colleagues come from the same type of institution. These institutions are faced with diminishing returns from their endowments and an increasing expense account, and in the near future at least they will not receive from their friends as large contributions for the support of their institutions. At present the majority are operating with an annual deficit that has been met by contributions from alumni, who now will not be as able to continue.

As a graduate and trustee of an institution in my native State of Missouri, namely, Missouri Valley College, at Marshall, I wish to ask the careful consideration of the committee in eliminating this additional tax on education, for the small amount of revenue that will be forfeited will be negligible when compared with the advantages received. If these institutions, through economical conditions or taxation, are forced to close their doors, additional burdens will be placed upon State or tax-supported institutions, which, in turn, will increase the burden and taxation upon everyone. I also am sure that the committee will agree that it is not to the best interests of the country to have only tax-supported institutions.

Very truly yours,

JOHN M. ROBERTS, *President.*

CHICAGO, ILL., *August 22, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

MY DEAR SENATOR GEORGE: I wish to supplement the brief of Mr. Ahrens of the Educational Buyers Association, on section 552, paragraph 9, entitled "Optical Instruments," by the following additional information:

1. *Amount of tax involved.*—For the year 1940 the sales of the optical instruments as specified in the above section and paragraph were $4,500,000. Of this total 48 percent was to the Federal Government, State, and municipal, and State-supported institutions, chiefly educational ,who under section 2406 are exempt from this taxation. Therefore, only $2,340,000 remain to be taxable. This would give a revenue of $234,000 at the 10-percent rate. These sales should be further investigated and broken down as follows:

Fifteen percent, or $675,000 sold to endowed educational institutions that are not tax supported.

Twenty-three percent or $1,035,000 was spent by students in professional schools such as medical, dental, and so forth. It is manifestly unfair to tax the privately endowed nonprofit institution and allow the State-supported (doing the same work) exemption. In the case of the young professional student, he is hard put to in order to secure his education without having to pay an educational tax on his equipment.

If we combine the above classifications we have:

Sales to privately endowed institutions	$675,000
Sales to professional students	1,035,000
Total sales to non-profit and non-tax-supported consumers	1,710,000

With these deductions there would remain sales amounting to $630,000 to profit earning and individual consumers carrying a tax of $63,000. This would be the total tax, if we exclude all nonprofit consumers. The above figures are reliable to my best knowledge and information.

2. This tax is discriminatory in that it applies only to the optical instruments used for scientific work and omits all other forms of such instruments—the luxury or individually used optical instruments (such as, opera glasses, marine glasses, field glasses, and binoculars) are taxed under section 2400, entitled "Jewelry," etc.

3. The tax would be hard to administer, for the following reasons:

(*a*) Some institutions are partially supported by taxation; the major part of their income is from endowment or student fees.

(*b*) In other instances certain departments only are tax supported.

(*c*) Some include in tuition the total cost of the student's equipment. In this case it would be hard to separate the taxable items.

(*d*) The cost of administration would be a very high percentage of the return.

Our association respectfully requests that due consideration be given to the above claims.

Submitted by

JOHN M. ROBERTS,
President, Scientific Apparatus Makers Association.

The CHAIRMAN. Mr. Satterthwaite.

STATEMENT OF WILLIAM F. SATTERTHWAITE, SALES ENGINEER, GENERAL DRY BATTERIES, INC., CLEVELAND, OHIO

Mr. SATTERTHWAITE. Mr. Chairman and members of the committee, my name is William F. Satterthwaite, representing the General Dry Batteries, Inc., of Cleveland, Ohio. We have plants in Cleveland, Ohio; Dubuque, Iowa; Baltimore, Md.; and also in Nogales, Ariz.

It is the purpose of my statement to bring to your attention the hardships which are worked upon our company by the capital-stock tax and its associated excess-profits tax under the new circumstances arising from the shortage of critical metals. This shortage has arisen from our national-defense efforts. We have requested the opportunity

of presenting this problem because we believe it works an undue hardship which is contrary to your intentions. We also ask relief as suggested at the end of this brief in the sincere belief that it conforms to your objectives.

The present revenue act and the proposed Revenue Act of 1941 require that each corporation declare a capital value for the purposes of the capital-stock tax and the declared value excess-profits tax.

This declared value is effective for 3 years, with the adjustments as required by the revenue act, and is the basis of the capital-stock tax and the declared value excess-profits tax.

Under normal conditions it is possible to make a reasonable estimate of expected earnings for the 3-year period but we are not working under normal conditions.

We manufacture dry batteries which consist of zinc, manganese dioxide, carbon, ammonium chloride—or sal-ammoniac—brass, and copper. There are also other ingredients used in small quantities but these are the ones which present the major part of our problem.

In the case of zinc, we do not know from month to month how much we will be allowed to receive due to the fact that zinc is under priority which varies from month to month. We also do not know to what extent we can obtain the other necessary ingredients to maintain production. If we cannot obtain any one of these necessary materials we are forced to shut down.

Therefore, it is impossible for us to estimate our earnings. Such an estimate is the basis of declared value and, therefore, we are at a loss as to what value to declare. This uncertainty is entirely beyond our control and will force us to either pay an unduly high capital-stock tax or declared value excess-profits tax.

The capital-stock tax requires a declaration of value once every 3 years. This year is a new declaration year and, therefore, it is the basis for the tax for the next 3 years as contemplated at the present time. The bill provides for adjustment to the initial declared value to compensate for structural changes which will affect the earnings.

Our problem is not with that particular phase of the problem. The declared value forms the basis on which the capital-stock tax is determined at the rate of $1.25 per $1,000 as proposed in the current bill.

The declared value excess-profits tax uses the declared value as the basis and imposes a tax on earnings in excess of 10 percent of the declared value.

In order to minimize these two taxes, the taxpayer endeavors to estimate the earnings as accurately as is practicable for the 3-year period and then to multiply this by 10 so that the expected earnings will not be subject to heavy excess-profits taxes.

At the same time the earnings should be estimated low enough so that the capital-stock tax itself is not excessive. Consequently the corporation in the past has endeavored to estimate its earnings accurately enough to pay equitable taxes.

The country is putting forth major efforts to defend itself against any possible aggressors and this effort constitutes a large task. The task is so great that unexpectedly large quantities of certain materials are required with the result that shortages in civilian needs are becoming very acute.

The shortage in zinc is forcing a reduction in our production which we cannot reasonably estimate for even 3 months.

While we have endeavored to protect ourselves with our zinc supplier on a contract made in 1938, this supplier has been required by the present emergency to contribute a proportion of all zinc to a pool necessary for defense. This contribution has forced a reduction in the amount of zinc which we can obtain under this contract and, therefore, we find ourselves encountering a major zinc deficiency.

Copper and brass have just come under the full allocation program and, therefore, we find ourselves facing further difficulties along the lines of metallic shortages.

Every dry cell requires a brass cap on the carbon pencil to make suitable electrical contact. Each assembled battery of two or more cells used in radio and similar work requires copper wires connecting the cells in series or in parallel.

We anticipate that before the year is ended that this shortage in copper and brass will affect us drastically.

We are further warned that shortages in other ingredients used in dry batteries probably will materialize before the end of the year. Therefore, we are placed in a position wherein we are entirely unable to estimate our earnings for as much as 3 months not to mention 3 years.

We believe it to be our patriotic duty to cooperate with the Government in every defense measure and we do so willingly. However, we do believe that under the circumstances, the capital-stock tax and its associated excess-profits tax has an element of unfairness and works an undue hardship upon us and other companies in the same position.

In conclusion we ask you to consider carefully the problem as discussed above and to modify the current revenue bill of 1941 to eliminate the inequities brought into existence by the metal shortages and the priorities. We ask that this bill be modified in two ways:

First, for the duration of this emergency and so long as priorities are in existence on the metals necessary to the construction of our product, that each year be allowed as a new declaration year.

Secondly, we urge that the declaration be made and based upon the earnings of the preceding year. In this way the inequity of the excess-profits tax or an unduly high capital-stock tax is eliminated and yet the capital-stock tax is retained as if the taxpayer had made a good estimate of his earnings.

We thank you for your careful consideration and favorable action.

I thank you for your attention.

The CHAIRMAN. We thank you, sir, for your appearance.

Mr. Graffis.

STATEMENT OF HERBERT GRAFFIS, EDITOR OF GOLFDOM, CHICAGO, ILL.

Mr. GRAFFIS. My name is Herb Graffis. I am editor of Golfdom, a business magazine of golf and represent the National Golf Foundation, a nonprofit organization.

Like everybody else here, we want a pass. The misconceptions about golf puts us behind the 8-ball. It is reputed to be the rich man's game.

Right now about five-sixths of the 3,126,000 golfers are either children of high-school age and the youth of college age or adults who play on the public golf courses. The Treasury Department has been through this excise tax experience with golf and with the other sporting goods before, and has found, so I understand, that the net has been virtually nothing.

This time it will be less, if possible, for the simple reason, they will just quit playing. The national problem now is to get people active, the kids and the adults. In the sporting goods business, we have long since learned that the most used piece of sporting equipment is the seat of the pants. The draft statistics unfortunately bear that out. We find, as you gentlemen have found, that most of the physical disabilities of the draftees are bad feet; I think they are just a few points back of bad teeth. The only people who walk any more are the mailmen, pickets, and golfers.

The golfer walks about 4 miles exercising his lungs profusely, and comes in and drinks four times what he spends in golfing equipment. Those are actual figures, gentlemen.

Due to the statements that have been made in the last Presidential election about the country golf set, we realize that we are somewhat handicapped until you gentlemen recall that the country golf set were able to throw around more conversation than voting weight, and the five-sixths of the golfers, who use this game as recreation, respectfully suggest that they be joined with the very large group that also prays for exemption.

I have filed a digest with the clerk. The figures are all there. We have, in this matter, the same serious purpose and high hope that some of you gentlemen have about your scores.

Thank you.

The CHAIRMAN. Thank you.

(Mr. Graffis submitted the following memorandum for the record:)

MEMORANDUM FILED BY HERB GRAFFIS, EDITOR OF GOLFDOM, THE BUSINESS JOURNAL OF GOLF

GOLFDOM,
Chicago, Ill., August 22, 1941.

RE: SPORTING-GOODS TAX

There are 2,162,000 active golfers in the United States of whom only 533,000 (approximately 24 percent) are members of private golf clubs having annual dues of $10 or more. The 76 percent play on public courses. In addition, there are almost 1,000,000 high-school and college boys and girls receiving golf instruction and playing in individual and scheduled team matches.

The old belief that golf is a rich man's game is blasted by the fact that golf now is the outdoor game the man, woman, and youngster in modest income brackets finds most attractive for actual participation. It is not a luxury sport. It is popular physical conditioning for people of both sexes from the ages of 13 to almost 80.

Latest available Department of Commerce Census of Manufacturer figures show for 1939 the value of golf goods to be $15,644,612. These figures probably are quite generous. For instance: The number of clubs was given as 2,855,837. The number of shafts was given as 3,218,002. The factor of breakage in steel shafts is negligible. With 362,165 more shafts than clubs reported as 1939's manufacture and the 1940 spring clearance sale of 1939 unsold clubs being extensive, there is circumstantial evidence to indicate that the $15,644,612 figure gives an overly bright picture of the extent of the golf business.

Although even a 10-percent tax on this annual volume of golf business, according to Treasury officials' past experience, would not be a revenue-raising procedure warranted by the net income, the tax effect on golf play and golf business would be serious enough to be especially undesirable in these times.

Golf already has been self-damaged by delusions of grandeur inspired by gulps of locker-room Scotch and a failure to do its figuring until the scorecard calls for pay-off. That is why the "country club set" of which you heard during the latest national campaign did not sling much weight around. That conception of the "country club set" is a picture of the vanishing American. That is why so many of the once proud private clubs have been foreclosed, and now, in not unusual cases are being played by any of the public who can lay from 25 cents to $1 on the line for a day's playing privileges.

That excess of optimism in golf has given the low-income adult and the youngsters a break. Golf-goods manufacturers, for the greater part, are the offspring of companies that wanted an outlet for certain byproducts or an off-season use of equipment and factory personnel. These manufacturers, some of whom were overly optimistic about the promise of growth in golf, and some of whom over-guessed the existing market, have been in strenuous competition for such business as is available.

Therefore, prices for golf goods have been kept lower than actual cost of manufacture and distribution warrant. It is one of those lovely instances in which the man and woman whose income barely covers living expenses get a great break.

Now, with the certain prospect of continued sharp increases in costs of such materials and labor as may be available, there looms a virtual certainty that the game will lose many whose physical and temperamental status is important to national defense. Golf already has many of its newer crop in the Army, Navy, and air forces. They were in good physical shape. They are not out of the golf market, and quite a few of them are wondering why golf driving ranges aren't among the Army recreational facilities.

The American recreation picture has changed tremendously since the emergency in 1917. This time the increased wages in defense industries are not going for wide striped silk shirts or patent-leather shoes. The representative American now is recreation minded. His and her attention to his own physical condition and that of the children has been sharpened by draft examination physical findings.

But it is not easy to get the average American physically active. Even the kids are getting sedentary. The most used piece of athletic equipment in the United States is the seat of the pants, as one very quickly learns when seeing such figures as 90,000 attendance at basketball games; 7,500,000 at the football games of 64 representative universities; 1,500,000 at national pro-league football games, around 26,000,000 at major- and minor-league baseball games. Grand entertainment, of course, and great physical culture for those who play them.

But try to get the good citizens of any age to condition themselves physically in a game that requires about a 4-mile walk in an afternoon, and you have a national physical-fitness problem pop up at you. Only mailmen, pickets, and golfers do much walking any more.

The Army learned that more than a year ago during maneuvers of National Guard troops. Many of the lads couldn't stand the road work.

There were approximately 61,220,000 rounds of golf played in the United States last year on the Nation's 5,209 golf courses. Not over 1,300 of these courses are strictly private—playable only by members and their guests. There are 711 courses publicly owned where anyone who pays the fees ranging from nothing cash to $1.50 a round can play, 1,210 privately owned courses open to the public, and of the 2,080 nine-hole so-called private courses, it is my conviction, based on extensive experience, any reasonably personable man or woman could play on payment of fees for a round.

Work Projects Administration projects have included 204 public golf courses newly constructed and 298 reconstructed or improved. The golf course, public and private, increases taxable values in its vicinity, and in the case of the public recreation facilities that usually take in enough income to more than pay for its maintenance and operation.

A significant indication of the part golf is playing in bettering the American's physical condition is the club rental plan started at Cincinnati's public courses and now at New Orleans, Houston, Dallas, Fort Worth, St. Louis, and other cities. For 15 cents a youngster or a man or woman can rent a set of four of five clubs

and get three used balls. A charge of a dime a ball is made for each one not returned. This plan has been so successful that in Cincinnati alone last year more than 20,000 rental set fees were taken in.

The average annual expenditure of the golfer for clubs, balls, and bags is only about $15, thus flatly contradicting the "rich men's game" charge. But the game now is enlisting those to whom the $15 charge for a recreation of many years' playing span is too great. This rental plan is but one activity. Golfers have contributed thousands of used clubs to be used in teaching the nearly 1,000,000 high-school and college youngsters. Increase in golf equipment prices will nip this crop in the bud. Further indication of golf's extensive and growing appeal to the class of youngsters and adults greatly in need of low-cost pleasant outdoor physical condition is in the golf practice range business. Practice range owners in numerous cities from New England to the Gulf coast have told me that as many as 30 percent of their patrons never have been on golf courses, but are getting ready for the day when they can afford clubs, balls, and green fees.

Industrial and commercial league golf teams are becoming one of the most popular sports activities of spontaneous or company organized recreation programs, due to the adequate but not strenuous nature of the exercise and the handicapping feature of golf, which allows the duffer and the proficient player to compete on a fair and interesting basis.

I recall reading an Associated Press story quoting Dr. George W. Calver, congressional physician, as advising Senators and Representatives to "walk at least an hour every day and get in nine holes of golf if possible." He was quoted as saying that the almost continuous session of 3 years has overworked and overstrained national legislators. He was reported as having said that the public should be interested in Congressmen getting some relaxation to balance their legislative worries.

The authoritative advice also may be applied to the general public of a considerable age reach whose physical condition and general temperament plainly could stand improvement. The extensive potential employment of golf for more of the average people of both sexes and a wide age range definitely is a factor in this country's national defense. The representative ordinary adult golfer is of a class that pays taxes without yowling or complaining of his pain. He asks mainly a break for the kids. He therefore respectfully submits that the meager (if any) net income of an excise tax on golf equipment would tend to beat the Government out of what it wants and must have, first, a healthy working, earning, and fighting condition of its youngsters and of its taxpayers.

The CHAIRMAN. Mr. Spargo and Mr. Blakelock. Are you gentlemen going to get together?

STATEMENT OF GEORGE E. SPARGO, DEPARTMENT OF PARKS, CITY OF NEW YORK, N. Y.

Mr. SPARGO. I am George E. Spargo, executive officer of the department of parks, city of New York, and while we, too, would like a free pass on something, it is only on those things that are actually recreational facilities of the city of New York which we would like to have you consider.

The facilities that would be most affected by the proposal you have before you are our swimming pools. There are 17 pools, all operated free in the morning for children under 14. We charge 10 cents for children in the afternoon and evening and 20 cents for adults. That is barely enough to cover the maintenance cost of these pools throughout the city. I think perhaps the most concise way for me to give this to you is to read the letter Mr. Moses sent to Senator George, but not the memorandum, which we would appreciate having incorporated in the record. We can file copies of the memorandum with you, and that will give you the rest of the story.

It says:

THE CITY OF NEW YORK, DEPARTMENT OF PARKS,
New York City, August 19, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR: I wish to call your attention to the defective wording of section 541 of H. R. 5417 known as the Revenue Act of 1941 which is now under consideration by your committee.

This section provides for a new basis for computing admission taxes by establishing a "tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place. * * *"

The words "admission to any place" are also used in section 1700 of the old revenue act. Under a recent ruling these words have been construed to include charges made for the use of publicly operated swimming pools and other recreation facilities. With similar reasoning this wording could also be construed to apply to charges made for the use of hotel rooms, pay toilets, bridge and other traffic facilities, parking fields and a host of other facilities never intended by Congress when this provision was adopted.

We have been unable to get anywhere in our efforts to adjust this matter with the Internal Revenue Bureau which is insisting on the collection of taxes from the users of publicly constructed and operated swimming pools and threatening to send public officials to jail if they do not comply.

This is a problem of general application throughout the United States affecting every recreation facility operated by a State or municipality for the health and welfare of the people where a small charge is made to help defray the costs of maintenance and operation.

Specifically the city of New York has constructed with public funds and has in operation 17 outdoor swimming pools. The charge made to the users of these pools is 10 cents for children and 20 cents for adults. To add a tax to these charges because of the ruling of the Bureau of Internal Revenue will bring in very little tax revenue and will do an immense amount of harm.

An amendment has been proposed which has the approval of the United States Conference of Mayors and a number of States. A copy of this amendment is enclosed herewith. It clarifies the law in regard to publicly operated recreation facilities but makes a distinction between spectators, who pay admissions to witness a contest, performance, or exhibition, and the users of public recreation facilities who pay a charge to help maintain such facilities.

I am also enclosing a memorandum which more fully discusses the proposed amendment.

I respectfully urge your committee to support this amendment.

Very truly yours,

ROBERT MOSES, *Commissioner.*

(The memorandum discussing proposed amendment referred to in Mr. Moses' letter to Senator George of August 19, 1941, is as follows:)

MEMORANDUM ON THE QUESTION OF FEDERAL TAXATION OF ADMISSION TO BATHE IN POOLS, BEACHES, BATHS, AND RECREATIONAL FACILITIES OF THE STATE OF NEW YORK AND ITS MUNICIPALITIES

The people of the State of New York, by many acts of the legislature, approved by the Governor, have adopted a program of recreation to promote the health and welfare of the people of the State. On several occasions the people have directly approved this program by voting affirmatively on bond issues to provide funds to finance the program. The various municipalities of the State have followed the lead of the State administrations in providing like recreational facilities for their own citizens. The Federal Government has made large sums available in the form of loans, outright grants, Work Projects Administration, Civilian Conservation Corps, National Youth Administration, and other funds for like purposes. In New York City alone 17 outdoor swimming pools have been constructed.

The policy of Federal, State and municipal governments has been to provide funds from various sources for the acquisition of necessary lands and to construct buildings and equip them for recreational use. In the initial stages moneys are also supplied for maintenance and operation, but more and more the

policy has developed to make modest charges for the use of recreational facilities wherever possible so that the cost of maintenance and operation may be paid by the people using the facilities and not out of general funds. The policy is not to collect for the use of facilities more money than is actually needed for maintenance and operation. As a matter of fact, in almost no cases do the charges pay the entire costs of carrying on these projects. Resort is still made to the appropriation of funds to make to make up the difference between the actual costs of maintenance and operation and the amounts that can be collected.

In all cases the charges are adjusted to meet the ability to pay of the users of the facilities. Administrators in charge of recreational areas have always to keep in mind that the real purpose is to improve the health and general welfare of the people. The charges are adjusted whenever it is found that they are proving too much of a handicap and attendance is falling off. On the other hand, the administrator must always keep in mind that the public policy is to meet the recurring charges for maintenance and operation out of receipts instead of resorting to the tax roll.

Recently, the delicately adjusted control of this State and city policy has been thrown out of balance by demands of the Federal Internal Revenue Bureau that State and municipal agencies collect from users of recreational facilities an admission tax to be turned over to the Government. This demand is contrary to the theory which has been sustained by the highest court in this country, that the Federal Government has no power to tax a State. The answer of the taxing authorities to this broad argument is that the tax is not levied on the State but on the users of the facilities and therefore the question of one sovereign taxing another is not involved. This is specious reasoning. The fact is that the State and city charge as much as can be collected without discouraging the use of recreational facilities. Any tax that is added to what the State and city charge will simply cut down the use, which as a matter of policy, the State is encouraging, If the tax is not added to the present charges then it must be paid out of the charges collected and will be that much less money to pay the cost of maintenance and operation.

It would seem that Congress is enacting the admissions-tax section of the revenue act had in mind this fundamental theory and considered it so well accepted that it was not necessary to make an exception to the law.

There is no need to argue over the wording of the act or to go into a long dissertation on the right of one government to tax another. The fact is that this policy of recreation has been adopted by a number of States for the general welfare of the people and it should not be burdened by placing a tax on it. The best way to clarify the question is to amend the new tax bill which is now before the United States Senate and specifically state that users of recreational facilities conducted by the State or any of its municipalities will be exempt from this tax.

A distinction should be made in the case of facilities that are essentially entertainments, exhibitions, or performances rather than for the recreation of the people, such as shows and athletic events where people go to enjoy the entertainments or diversions rather than to participate in them. For this reason an amendment to specifically exempt users of public recreation facilities from paying a tax should also clarify the wording of the present tax act by specifically excepting from this exemption taxes levied on admissions of spectators to shows, exhibitions, performances, or athletic contests conducted by a State or municipality. In other words, there should be a distinction made between spectators who pay admissions and users of public facilities who pay a charge to help maintain such facilities.

REVENUE ACT OF 1941, H. R. 5417, PAGES 53-54

PART IV—CHANGES IN BASIS OF COMPUTING TAX

SEC. 541.—ADMISSIONS TAX.

(C) No tax shall be levied or collected under this section in respect of any fees, charges, or admissions collected as a prerequisite to the use of healthful recreational facilities supplied pursuant to public policy, all the proceeds of which inure exclusively to a State or any political subdivision thereof, or to any public corporation created by special Act of the legislature of a State for a public purpose, no part of the net earnings of which inure to the benefit of any private stockholders or individual, provided that this exemption shall not apply to fees, charges, or admissions collected from spectators at exhibitions, performances, or contests.

(Change designation of present paragraph C to D.)

Mr. SPARGO. To give you an idea of what some of these facilities look like, I would like also to leave with you pictures of the pools in operation and also some of the other recreational facilities in operation.

I would like to say that last year there were approximately 1½ million paid admissions to these pools and the same number of free children in the morning. Mr. Blakelock is from the Long Island State park commission, which in turn is part of the State park system in New York State, and they have a similar problem there.

We do not ask, as you notice from Mr. Moses' letter, that you give any consideration to spectator events that we put on. For example, we have an amphitheater where we put on a water carnival and show once a week. The tax on admissions to those special events, of course, we expect to pay; it is the recreational or health-building facilities on which we would like to be relieved of paying a tax and we assume you will want to continue to tax those other events where admissions are charged. You will be doing an immense amount of good if the tax on these active recreation facilities is left out of the bill.

The CHAIRMAN. Mr. Blakelock, do you wish to make a statement?

Mr. BLAKELOCK. No; Mr. Spargo has covered the subject. The situation in the State parks is the same as in the city parks and, for that matter, throughout the country where municipalities are operating such facilities.

The CHAIRMAN. We have here a letter with reference to section 3465 and section 3466 of the 1941 revenue bill which I would like to invite the Treasury's attention to, and would like to incorporate it in the record.

It is from Mr. Kenneth Hogate, who calls attention specifically to the "ticker service" that is covered by this amendment to sections 3465 and 3466. I would like to have that entered in the record and like to have the Treasury see it and make a special note of that in view of the statements made.

The letter follows:

DOW, JONES & COMPANY, INC.,
New York City, August 21, 1941.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate.

Re sections 3465 and 3466 of 1941 revenue bill.

DEAR SENATOR GEORGE: An attempt would probably have to be made to construe the tax imposed on news ticker services, section 3465, subsection 2 (p. 55, lines 2 and 3), as now worded, as applying to the Dow, Jones news service, although that service clearly and undeniably constitutes the public press function of disseminating news. Any such attempt would unquestionably be expensive and embarrassing, because the present language of the bill jeopardizes Dow, Jones' recognized press standing of 40 years.

Section 3466 especially excludes the press from the provisions of the previous section. We are not asking for any special exemption and accept any tax levied on the press. Rather than appear at the hearings on what is really a noncontroversial matter, I take the liberty of writing to you, with the respectful request that this letter be entered as part of the committee's records so that it will be before the members of the committee when you reach discussion of these sections of the bill.

I am sending copy of this letter to the Honorable John L. Sullivan, Assistant Secretary of the Treasury, in the belief that changes which will clearly bring the Dow, Jones news service out from under this cloud of doubt will not be resisted by the Treasury.

May I suggest that the necessary changes could easily be made? They involve only deletion of the words "news ticker services" in section 3465 and defining "the public press" in section 3466 in such a way as expressly to include every method by which press news may be disseminated to the public through the medium of the written word.

If further information is desired, I shall be most happy to hear from you. I refrain from going into detail simply to conserve your committee's time and because the facts are not in question anywhere.

With kind regards and highest respect,

Very sincerely yours,

(Signed) KENNETH C. HOGATE.

The CHAIRMAN. Are there any other witnesses here, who desire to be heard this afternoon, who are on the calendar for tomorrow?

Mr. SELLEW. I would be pleased to.

The CHAIRMAN. We would be glad to hear you. Are you on the calendar for tomorrow?

Mr. SELLEW. Yes.

The CHAIRMAN. If you will come around and give your name, we will be glad to hear you now; it will shorten the work tomorrow.

STATEMENT OF DAVID M. SELLEW, GENERAL MANAGER, AUBURN RUBBER CORPORATION, AUBURN, IND.

Mr. SELLEW. Mr. Chairman and members of the committee: My name is David M. Sellew, and I am the general manager of the Auburn Rubber Corporation of Auburn, Ind. We manufacture a line of rubber toys and rubber soles and heels for shoes. Approximately two-thirds of our production consists of rubber toys which sell on the market at a retail price of 10 cents or less. These are samples of our products.

As such a manufacturer, my company comes within the category of a small manufacturer and is affected by section 3406 of the revenue bill of 1941, passed by the House of Representatives and under which a new excise tax is imposed on rubber articles as follows:

Articles of which rubber is the component material of chief weight, 10 percent. The tax imposed under the paragraph shall not be applicable to footwear, articles designed especially for hospital or surgical use, or articles taxable under any other provision of the chapter.

In making these comments, I am assuming that the purpose of this bill is, first, for the purpose of raising revenue and, second, for the purpose of inducing a reduction in the use of crude rubber in order that a greater supply of crude rubber may be available for national-defense purposes.

Objections to this bill have been expressed by the Rubber Manufacturers Association, the Toy Manufacturers Association, and other witnesses who stressed the seriousness of discriminating in this manner against the rubber industry and the difficulties and hardships that will be caused by the ambiguous wording of the bill. These objections are, in my opinion, true statements of fact.

However, I desire to place my objections upon two special grounds, neither of which have been covered, so far as I know, by the evidence of any other witness.

First, as heretofore stated to you, the bulk of our manufactured articles consists of rubber toys, heels, stick-on soles, etc., which sell at retail for 10 cents or less. In an article selling for more than this

amount it is possible that this additional tax could be absorbed by the manufacturer, the wholesaler, or the retailer; but in an article selling for 10 cents or less the margin of profit to the manufacturer, wholesaler, or retailer is so small that the absorbing of such a tax would be impossible. These article have sold, by custom of the trade, in 5- and 10-cent stores for 10 cents, and an attempt to raise this price above the 10-cent level would encounter so much sales resistance from the public that the result would be a definite reduction in the sale of such toys and other articles; and such reduction, in my opinion, would so seriously affect the trade as would tend to drive out of business small manufacturers such as my concern. The result of this would be that it would throw out of employment our 500 employees and would prevent the Government from collecting, by way of income tax and other Federal taxes, such amounts as we are now paying and do pay when in operation. Therefore it would appear that the effect of this additional excise tax upon the manufacturer of articles that sell at 10 cents or less would be to defeat the purpose of the act and destroy more revenue from the standpoint of Federal income tax than would be received from the excise tax.

Therefore, it would seem to me, from the standpoint of revenue, this section should be amended to exempt therefrom any articles designed to sell at retail for 10 cents or less.

Second, I desire to call your attention to the fact that the act as passed by the House of Representatives placed a 10-percent excise tax on articles of which rubber is the component material of chief weight, without any reference as to whether the article is manufactured, either wholly or in part, from crude rubber.

In order to conserve the crude-rubber supply and reduce the amount of crude rubber which would be used by the manufacturers of domestic articles, it would seem to me advisable to make some incentive for the manufacturer to reduce the amount of crude rubber which he does use or will use in the manufacture of the article which he fabricates, and it would, therefore, seem to me that it would be a wise provision to exempt from the provision of such excise tax all rubber articles which do not contain more than 10 percent of crude rubber, or such other percentage as Congress might deem advisable.

Such provision would then induce the manufacturer to produce his product from reclaimed and scrap rubber as far as it would be possible to do so and refrain from the use of any more crude rubber than would be absolutely essential to the manufacturing of his product.

In addition, may I call your attention to the fact that such an amendment of this act would permit the manufacturer who does not at this time use more than 10 percent of crude rubber in the manufacture of his product to continue to manufacture on the same basis that he is now operating, and in this way continue to furnish employment and earnings which would be available for the purpose of Federal group income tax and such other revenue as might be available to the Federal Government for their use in paying the expenses of government and the defense program.

In conclusion, may I repeat that this tax, when imposed on 5- and 10-cent merchandise, will remove much of it from selling counters, which will naturally mean no revenue from this tax on this type of product and a reduction in other revenue to the Government from

manufacturers producing this type of product. Again, if no relief is provided for the manufacturer who uses small percentages of crude rubber in his products, many of them, including my company, will be forced to curtail their operations drastically, and this curtailment will add very little to the Government stock pile because of the small amounts of crude rubber used by them even in normal times.

The CHAIRMAN. Well, sir; thank you very much.

I think that exhausts the witnesses for today. We will recess until 10 o'clock tomorrow.

(The following letters, memoranda, and statements filed with the committee were ordered inserted in the record:)

ARKANSAS PHARMACEUTICAL ASSOCIATION,
Little Rock, Ark., August 7, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: My name is Irl Brite, secretary-manager of the Arkansas Pharmaceutical Association, and I reside in Little Rock, Ark.

I thank you gentlemen of this committee for the privilege of submitting to you a brief statement in opposition to an increase in the excise tax on gasoline.

I would like to point out that it is not the desire of representatives of my organization or any other loyal Arkansan to shirk his just share of the national-defense burden. All of us realize that the emergency must be met and the cost shall fall upon all of us. However, we feel that the expenditures for national defense should be borne equally by all citizens, and we also feel that it is the wish of your committee to see that an equitable distribution of taxes are levied. In view of the fact that the operators of motor vehicles are now paying a large share of the expenditures for national defense, we believe that any increase in the Federal gasoline tax at this time would further bring about a disproportionate share of the burden upon highway users. While the Federal Government is in no wise responsible for Arkansas' high gasoline tax of 6½ cents per gallon, it is, nevertheless, a burden and especially so with the present Federal gasoline tax of 1½ cents per gallon, making a total tax of 8 cents per gallon on all gasoline consumed in this State.

We will thank the members of your committee to give this matter deliberate, considerate consideration before increasing the excise tax on gasoline.

Sincerely yours,

IRL BRITE, *Secretary.*

ALABAMA INDEPENDENT SERVICE STATION ASSOCIATION, INC.,
Montgomery, Ala., August 12, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate,
Washington, D. C.

DEAR SENATOR GEORGE: I am enclosing herewith a statement in opposition to the proposal to include an additional gasoline tax in the tax bill now being considered by your committee.

It will be appreciated if you will refer it to the committee and place it in the records of the committee hearing.

Very truly yours,

ALABAMA INDEPENDENT SERVICE STATION ASSOCIATION, INC.,
By L. L. LANE, *President.*

Encl.

To the Chairman and Members, Senate Finance Committee:

GENTLEMEN: I would like to appear personally before you gentlemen to oppose the suggested increase of 1 cent per gallon in the Federal gasoline tax, but I cannot leave my service station long enough to come to Washington, and haven't the money necessary to make the trip. For those reasons the following information is given in this form for your consideration and for the committee record.

It has always been our belief that since the States had created the gasoline tax, as a type of tax for road purposes, and since the use of gasoline tax revenues for general governmental purposes definitely constitutes "double" taxation on a group of citizens, most of whom are less able to pay special and double taxes, the Federal Government should never have gone into this tax field. We have constantly fought to retain this particular tax solely to the use of the States for road purposes. The logic in this policy is borne out by the fact that the motorist has already made an outstanding contribution to national defense by way of the finest highway system in the world.

The Federal Government is now on the verge of destroying that which has made it possible for the motorist to do the road-building job that has been done. If the Federal Government continues to infringe upon this tax field and overload the motorist, the gasoline tax, as a type of tax, will ultimately break down, and with it our highway system will go to pot. The present total gasoline tax in Alabama is a 68-percent retail sales tax.

Last year when the Federal gasoline tax was increased 50 percent for national defense along with lesser increases on other commodities it was not opposed because "quick" money was recognized as essential and we were in accord with the need for preparedness. However, we see in this newest proposal extreme danger to ourselves as businessmen, and to our national defense efforts as well. We find ourselves asking the question, "Why is it even considered?" There are adequate immediate and future supplies of petroleum products for every need. Gasoline is not the only commodity that could be taxed heavily enough to bring in large amounts of money.

The service station operators of Alabama and others too, I am sure, are ready and willing to accept their fair share of the tax load. However, our ability to do so rests in the success of our business, the sole means of our income. If the Federal gasoline tax and the State general sales tax were the only taxes on our principal product, we would have no complaint nor cause for concern.

Unfortunately, this is not the case. Every item of merchandise sold by us bears from two to four separate and distinct sales taxes ranging from 4½ percent on parts and accessories to 67 percent on gasoline. We now work 1⅓ days out of every 3 for Federal, State, county, and city governments collecting taxes, without pay of course, on our merchandise. In addition to that we pay State, county, and city privilege taxes from 2 to 20 times greater than those on any other business. We have always paid our own way and expect to continue if permitted to do so.

About half of our customers have just so much money to spend with us for petroleum products. We know this because we are personally acquainted with them. We know that any additional tax will cause them to cut down on the use of our products. There are many customers who never buy more than 1, 2, or 3 gallons of gasoline at a time, and most of them use their cars for pick-up trucks in their work.

These are the same good American citizens who have already during peace time, contributed millions of dollars to national defense by way of highways and bridges already built, and who are also already contributing millions of dollars to the Federal and local governments in special motor taxes being used for general purposes.

Very truly yours,

ALABAMA INDEPENDENT SERVICE STATION ASSOCIATION, INC.,
L. L. LANE, *President.*

UNITED STATES SENATE,
COMMITTEE ON MILITARY AFFAIRS,
August 12, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: At the direction of Senator Lodge, I am submitting the enclosed telegram from Lt. Gov. Horace T. Cahill, at present Acting Governor of the Commonwealth of Massachusetts, for such action as you may deem proper.

Very sincerely yours,

T. W. WHITE, *Secretary.*

[Telegram]

BOSTON, MASS., *August 11, 1941.*

HON. HENRY C. LODGE,
United States Senate, Washington, D. C.:

Strongly protest contemplated 1-cent increase Federal gasoline tax. Will impose additional burden on 7½ millions of Massachusetts motorists and invade field of taxation which Senate Finance Committee, in its report of May 10, 1933, said should be reserved to the States.

Respectfully,

HORACE T. CAHILL, *Lieutenant Governor,*
Acting Governor of Massachusetts.

[Telegram]

HELENA, MONT.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, Senate of the United States,
Washington, D. C.:

Reference is made to Federal revenue bill passed by House and now before your committee. My attention has been directed to recommendation by Treasury Department that bill be amended include 1-cent increase Federal excise tax gasoline. Proposed tax gasoline counting 1940 increase will bring total increase to 150 percent over 1939. Large percentage gasoline tax this State paid by farmers and essential transportation and believe this applies Nation-wide. Gasoline tax long ago removed from luxury and nonessential classification. Additional gasoline tax would further increase heavy burden now borne by lower income groups on a real necessity. Gasoline tax levy is major source of State highway income and I am fearful that further increase Federal tax bill will jeopardize State income for highway construction and maintenance purposes not to mention heavy taxation now borne by highway transportation, the disparity of taxation of consumers of gasoline, and other factors. My opinion is that proposed increase gasoline tax for national defense may have undesired effect not to mention effect on farming and agricultural production which we all consider vital to national defense. Speaking for Montana and endeavoring to look to the best interests of its citizens and with due consideration to necessary national-defense efforts I desire to enter my protest against amendment of the bill to include further increase of Federal excise tax on gasoline. I shall appreciate it if you will bring this protest to attention of your committee and file same as part of the record of hearings before it.

SAM C. FORD, *Governor of Montana.*

[Telegram]

HELENA, MONT., *August 14, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Finance Committee of Senate, Washington, D. C.:

I wish to go on record heartily endorsing in full night letter sent your honorable body by Gov. Sam C. Ford on 13th instant opposing any further increase in Federal gasoline excise tax.

SAM W. MITCHELL, *Secretary of State.*

[Telegram]

HELENA, MONT., *August 14, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.:

Relative revenue measure passed by House now before your honorable body for consideration. This commission has given due consideration to proposal Treasury Department to increase Federal gasoline tax and wishes to go on record as unalterably opposed thereto and endorsing in full telegram to you 13th instant by Gov. Sam C. Ford of this State.

HIGHWAY COMMISSION OF MONTANA,
By H. W. HOLMES, *State Highway Engineer.*

[Telegram]

HELENA, MONT., *August 14, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, Senate of the United States, Washington, D. C.:

Refer to Federal revenue bill passed by House and now before your committee. Understand Treasury Department has recommended that bill be amended to include 1 cent increase Federal excise tax gasoline. As one familiar with conditions in Montana, I urge that your committee refuse to approve amendment referred to since a further increase in gasoline prices will not only injure all the people of this State, but will hinder our highway construction as well. I sincerely believe that in the public interest no further tax be placed on gasoline because this will reflect in the price here and will present a burden too heavy for most of our people to bear.

JOHN W. BONNER, *Attorney General.*

ARKANSAS WHOLESALE GROCERS ASSOCIATION, INC.,
Little Rock, Ark., August 8, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: My name is William L. Humphries, secretary-treasurer of the Arkansas Wholesale Grocers Association, Inc., Little Rock, Ark. I respectfully ask permission to present the views of our organization with reference to the proposal to increase the Federal gasoline tax 1 cent per gallon.

Our organization is fully cognizant of the fact that taxes must be raised to defray expenses of the national-defense program, and there is no intention of questioning the sincerity of these endeavors to finance the defense program through increases in existing taxes or the addition of new levies, but at the same time it is appreciated likewise that the Congress intends fully that there should be an equitable distribution of the cost of defense among the different taxpaying groups.

United States Government figures show that more than one-half of the owners and operators of motor vehicles, the chief consumers of gasoline, earn less than $30 per week. Despite their limited ability to pay, these consumers are now contributing more than 14 percent of all the taxes collected by Federal, State, and local units of government.

The existing disparity in taxation of consumers of gasoline was intensified when the Federal gasoline tax was increased in 1940 one-half cent per gallon, or 50 percent, while taxes on other commodities in this same revenue measure were increased only 10 to 16 percent, except distilled spirits, toilet preparations, and cabaret admissions.

In view of the fact that the operators of motor vehicles are already paying more than their share of taxes for national-defense purposes, we feel that the taxes should be evened up on other commodities before any additional taxes are added to gasoline.

The operators of motor vehicles in Arkansas are deeply appreciative of the action taken by the House Ways and Means Committee by rejecting the proposal to increase the Federal excise tax on gasoline. We sincerely trust that if this matter is brought to the attention of your committee that it likewise will take similar action.

Respectfully yours,

ARKANSAS WHOLESALE GROCERS ASSOCIATION, INC.,
WM. L. HUMPHRIES, *Secretary-Treasurer.*

MOTOR VEHICLE ASSOCIATION OF ALABAMA, INC.,
Birmingham, Ala., August 11, 1941.

To the Chairman and Members, Senate Finance Committee, Washington, D. C.

GENTLEMEN: Being unable to appear before your committee personally, I am taking this means of presenting the opposition of the Motor Vehicle Association of Alabama to any additional gasoline taxes, to be included in the record.

The trucking industry is already contributing heavily in taxes to the Federal, State, and local Governments and is the only form of transportation that has not requested and secured governmental subsidies in one form or another. Any additional gasoline tax would constitute a special tax on motor transportation, while some of the other forms of transportation would go untaxed.

Trucks constitute one of the most vital factors of national defense but, at the same time, they have been the objects of vicious and destructive regulatory legislation and restrictive taxation, practically all of which has been sponsored by competing forms of transportation. Most of this legislation, in spite of all efforts of motor transportation and its shippers, is still in effect, and we are trying to operate against overwhelming odds already. The laws and taxes adversely affecting this industry have been publicly recognized as serious bottlenecks to national defense. Any additional tax on our operations will tend to make it more difficult to handle our part in the national-defense program.

Our organization is composed not only of for-hire carriers but of private carriers as well, including farmers, lumbermen, various wholesale businesses, fruit and berry growers, and others. These truck owners unquestionably will be required to contribute heavily to Federal-tax revenues by way of other general taxes. They expect to do so, and we are glad to contribute their share to national defense but are in no position to contribute twice while others contribute once.

While the importance of the trucking industry in national defense has been emphasized almost constantly by governmental authorities, it is pointed out by the United States Department of Agriculture that farmers are most affected by the gasoline taxes. The trucks in Alabama last year, together with other motor-vehicle owners, paid 40 percent of all State-collected taxes. They also paid about 20 percent of all taxes collected by municipalities. It would appear that the motor-vehicle owners are already carrying much more than their share of the tax loads of all branches of government. It is to be remembered that the motor-vehicle owner and industry operating trucks first pay all general taxes and then, in addition, pay special levies merely because they operate motor vehicles. The Federal gasoline tax definitely constitutes double taxation on a select group of businesses and citizens.

When thinking of national defense, preparedness, and even war, it is agreed by everyone that roads and bridges are probably the most vital necessity of all, especially in this modernized day and age. In considering new taxes for these purposes, should we not remember that the motor-vehicle owner of the United States has already contributed billions upon billions of dollars to our national defense by way of the finest highway system in the world? He will continue to contribute unless he is prevented from doing so by unfair and discriminating taxation.

Very truly yours,

MOTOR VEHICLE ASSOCIATION OF ALABAMA,
J. R. ODEN, *Executive Vice President.*

UNITED STATES SENATE,
COMMITTEE ON EDUCATION AND LABOR,
August 18, 1941.

Mr. FELTON M. JOHNSTON,
Clerk to the Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SIR: Upon appeal of some people from my State, I request that the attached argument against gasoline taxes be included in the committee hearings on that proposal.

Respectfully submitted.

JOSEPH ROSIER.

WHY FURTHER INCREASE IN THE FEDERAL GASOLINE TAX SHOULD NOT ALSO BE ADDED TO THE REVENUE BILL OF 1941

The provisions of the revenue bill of 1941 as approved by the House of Representatives do not embody any increase in the prevailing Federal gasoline tax rate of 1½ cents a gallon. Instead, car owners were asked to assume their new share of additional defense costs in the form of increased excise tax rates on other automotive commodities and a new annual use tax of $5 for each vehicle.

The Federal gasoline tax rate increase was not omitted from the House revenue bill because the revenue possibilities of such a tax increase were overlooked. A concrete proposal to raise the Federal gasoline tax rate from 1½ to 2½ cents a gallon was considered by the House Ways and Means Committee during the extensive hearings on the revenue bill conducted by the committee.

A STATE TAX FIELD

On the basis of the testimony presented at these hearings the House Ways and Means Committee concluded that any further increase in the Federal gasoline tax would be unsound and unjust. In its reluctance to increase further the Federal gasoline tax the committee was conscious of the fact that the gasoline tax traditionally has been a road tax imposed by the States to finance what is still primarily a State function, road construction and maintenance.

Using revenue from the gasoline-tax and other highway-user levies, income from bond issues, and funds provided by the Federal Government's program of highway aid, the States have invested billions of dollars in extensive systems of highways. The House Ways and Means Committee realized that this investment would be jeopardized if the income of the State highway departments, which are so dependent on the yield from the State gasoline tax, should be undermined by excessive duplicating Federal gasoline taxes. Roads must be properly maintained or they deteriorate rapidly.

The States are dependent on their gasoline revenue not only to protect the investment in roads but also to honor their highway debt. Nearly $120,000,000 is required annually from the State gasoline tax revenues alone to pay the principal and interest on State highway obligations. The credit of the States is dependent on the faithful payment of these charges each year. The House Ways and Means Committee was informed by State officials that the continued discharge of these obligations, however, would be seriously threatened by Federal usurpation of the gasoline-tax field.

Convincing testimony was presented to the committee to show that the gasoline tax now is the greatest single source of State tax revenue. In 1940 State gasoline taxes yielded $864,000,000, a sum representing 26 percent of total State tax collections, exclusive of pay-roll social-security assessments. No other one tax produced a greater percentage. Two States, Nebraska and Georgia, derived at least 50 percent of their tax revenue from the levy on gasoline.

FEDERAL TAX IS DUPLICATIVE AND EXCESSIVE

The Ways and Means Committee also recalled that in 1932, when the States already had come to rely heavily on the gasoline tax as a source of revenue, the Federal Government also enacted a duplicating gasoline tax at a 1-cent-per-gallon rate. This tax, unlike the State gasoline taxes which were designed as a special charge against the motorists for the use of the highways, was enacted as a general revenue measure. The committee was aware of the fact that the Revenue Act of 1940 had increased the Federal gasoline tax rate from 1 to 1½ cents per gallon, an increase of 50 percent. This 50-percent increase was the most substantial of the increases then imposed on everyday necessities.

Up to the time of the increase in the Federal gasoline-tax rate for defense purposes, the consumers of gasoline had paid into the Federal Treasury nearly $1,500,000,000 in taxes on that commodity to aid the Government in a period of distress. With the new ½-cent-per-gallon increase in rate, these consumers of gasoline have been asked to pay annually $112,000,000 in addition to $224,000,000 in general emergency gasoline taxes they had been paying. This fact the House Ways and Means Committee appreciated.

NOT A FAIR TAX

The committee knew, too, that a tax on gasoline is a tax on the consumer of gasoline—whether it be called a manufacturers' excise tax or a retail sales tax—for the tax is included as a cost in the price the consumer must pay. Any proposal to increase the Federal gasoline tax, therefore, would need to be considered primarily in terms of the consumer from whose pocket the tax eventually is paid.

To bear a fair share of the cost of general government is the responsibility of every citizen. This is particularly true of the cost of the national-defense program.

But it was pointed out to the Ways and Means Committee that the annual payment made toward the cost of general government by an individual in the form of Federal gasoline taxes is measured by the amount of gasoline he consumes. Some individuals consume more than others because they live farther from their place of employment or because as farmers or salesmen they must consume gasoline to make a living. Accordingly their Federal gasoline-tax payments for the support of general government are greater.

These considerations have become particularly significant because the shortage of housing and labor in centers working on defense projects is requiring the assembly of skilled industrial workers from wide areas. The transportation of these workers to their jobs has been facilitated by the private automobile to a degree possible by no other means. Consequently, through no choice of their own, workers are known to be driving back and forth to work each day on a round trip taking 4 hours.

The House Ways and Means Committee concluded that it would be unjust to increase the gasoline tax and penalize those who thus must sacrifice a substantial portion of their own time in getting back and forth to their defense work by automobile. In addition to making such sacrifices in personal time, they would be called upon to pay a greater share of the defense costs simply because they had to travel farther to get to their jobs.

This fact was considered important because, as average citizens, motorists pay all the general taxes levied by the Federal Government. In addition, as highway users they alone pay the special automotive taxes. As a result, motorists now are contributing in excess of $500,000,000 more each year to the Federal Government than other citizens of the country who do not operate motor vehicles. Furthermore, reliable studies by Federal governmental agencies disclosed that the average motorist earns between $20 and $30 weekly. Special automotive taxes now cost the average motorist more than $50 annually. The country's motorists, therefore, were shown to spend about 2 weeks' wages just to meet their annual automotive tax bill.

BILL ALREADY ADJUSTED TO MAKE MOTORISTS PAY FAIR SHARE

In view of these very fundamental and important considerations, the House Ways and Means Committee, therefore, decided that it would be unfair and unsound to increase further the Federal gasoline tax. In line with the objective to compel each individual and group to assume its fair share of the new additional defense-tax burden, however, the new revenue bill as approved by the committee contained provisions for increases in the Federal excise-tax rates on automotive chassis, parts, and accessories, inner tubes, and tires. In addition, an annual "use" tax of $5 per vehicle was imposed on all car owners.

The increased Federal automotive taxes will exact from motorists about $135,600,000 each year, and the annual use tax will cost them more than $150,000,000. Combined, these new taxes on car ownership and use will cost the Nation's motorists about $286,000,000. This represents a most substantial share of the new tax bill, and the revenue will come from one separate and distinct group—the car owners. Of course, car owners—as general citizens—also are subjected to all the other new general emergency taxes. Their new $286,000,000 extra tax payment is collected from them in addition to all other taxes simply because they own cars.

To impose also an increase in the Federal gasoline-tax rate would impose on car owners a disproportionate share of the new defense costs and would disrupt the carefully balanced revenue bill as offered by the House Ways and Means Committee and finally approved by the House of Representatives.

MOBILE, ALA., *August 15, 1941.*

Hon. WALTER F. GEORGE,
Washington, D. C.

Honorable Chairman and Members Senate Finance Committee:

HONORABLE SIR: I attach brief covering some of the objections voiced by members of board of directors, Mobile division, Alabama Motorists Association, concerning proposed increased Federal gasoline tax.

We are very much concerned about this matter and we ask your consideration and support, as in our opinion further taxes on gasoline, even though it is the patriotic duty of everyone to cooperate during times of distress, is not justified after taking in consideration the heavy taxes that already exist on this commodity.

Very truly yours,

G. FRANK JONES,
Chairman, Board of Directors,
Mobile Division of Alabama Motorists Association.

Honorable Chairman and Members Senate Finance Committee:

GENTLEMEN: In view of our inability to have a representative appear personally, we wish to take this means of calling to your attention a few facts that should have a bearing on the proposed additional gasoline tax.

The gasoline tax, as a type of tax, was created and is justified for road purposes only. The motor-vehicle owner pays all other taxes for general purposes the same as does the non-motor-vehicle owner and then, in addition, pays the special sales tax on gasoline to operate his motor vehicle. To tax gasoline for purposes of a general nature constitutes double taxation on the motor-vehicle owner.

This cannot be justified on the grounds that the motor-vehicle owners are rich. The large majority of our motor-vehicle owners have incomes of less than $30 per week, and only a very small percentage are considered wealthy. The farmer and the workingman are the principal ones who pay this tax. One example is the fact that about 1,000 workers living in Birmingham are daily driving 50 miles to and 50 miles from the powder plant now being constructed at Childersburg, Ala.

Even before the Federal Government first stepped into the gasoline-tax field, the States had already monopolized this tax source for the construction and maintenance of roads and bridges. The State and local gasoline-tax rates in Alabama now reach a total of almost 7 cents per gallon and the existing Federal tax brings this to 8½ cents.

This constitutes a retail sales tax of around 68 percent already.

The motor-vehicle owner is already paying far more than his share of taxes. Last year in Alabama motor-vehicle owners paid to the Federal, State, and local governments a total of $27,576,000 in special gasoline, oil, and automotive taxes. Of this amount, $8,296,000, or 31 percent, went to general governmental functions.

Last year 40.1 percent of every tax dollar collected by the State of Alabama came from the pockets of the motor-vehicle owners, about 11 percent of our population.

STATE-HIGHWAY REVENUES

A most important factor to be considered is the effect of continued increases in the Federal tax on the State-highway revenues.

The State of Alabama and our 67 counties have an immense amount of highway bonds outstanding for the next 10 years. Present revenues are sufficient only to retire these debts, maintain present roads, add to match Federal-aid funds with difficulty. National-defense-road needs are placing additional expenses on our highway department.

Additional Federal gasoline taxes will tend to further handicap our local efforts to construct and maintain an adequate highway system. After the present defense work stops, the effect of increased Federal gasoline taxes will become highly destructive, because it is a matter of record that the higher the tax goes the fewer are the gallons of gasoline consumed. The result will be that our State-highway revenues will fall.

The motor-vehicle owner as a group has already done more for national defense than any other group of citizens. He has already delivered in peacetimes the finest highway system in the world, and no one can deny the value of such system to national-defense efforts or to war purposes.

We sincerely believe that, since there are adequate supplies of petroleum immediately available for all present and future requirements, an additional gasoline tax would be detrimental to national defense rather than helpful.

Very truly yours,

ALABAMA MOTORISTS ASSOCIATION, MOBILE DIVISION,
G. FRANK JONES, *Chairman, Board of Directors.*

LITTLE ROCK, ARK., *August 11, 1941.*

CHAIRMAN AND MEMBERS,
SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: I understand that the Treasury Department has recently recommended an increase in Federal gasoline taxes of 1 cent per gallon. We are already paying 1½ cents per gallon Federal tax, and should this increase become effective it would make us pay a total tax of 2½ cents per gallon.

I feel, as do many others, that imposing at this time an additional tax on gasoline would be detrimental rather than helpful not only to my State but to the Nation. In my State the burden would fall more heavily upon the farmers than anyone else, because Arkansas is an agricultural State. I feel now, as I have always felt, that the farmers have to carry too much of a burden, as things now stand, without making the load heavier at this particular time.

I am not unmindful of the fact that we must raise a great amount of money in order to meet the huge expenditures that are necessary in connection with our defense program, but I feel that there are other fields of taxation which can stand this burden more easily than the farmers of our country.

I sincerely hope that your honorable committee will vigorously oppose the recommendation of the Treasury Department that an increase of 1 cent per gallon be placed on gasoline.

Very truly yours,

JACK HOLT, *Attorney General.*

Gentlemen, as chairman of the Minnesota Highway Users Conference, I should like to present certain vital statistics and information relative to the proposed increase in the Federal gasoline tax now under consideration by your committee. At the outset, I wish to state that our organization is in no way attempting to avoid its fair and just share of taxation for national defense, but at the same time we would like to bring to your attention certain facts in connection with the further increased taxes on highway transportation. We fully realize that the defense movement must be financed by new and increased taxes, but at the same time it is fully appreciated that this body intends that there should be equitable distribution of the costs of defense among the different taxpaying groups throughout the country.

Despite their modest economic circumstances, owners and operators of motor vehicles as the chief consumers of gasoline are the most heavily taxed group in the country. More than half of them have an income of less than $20 per week and only 12 percent an income of more than $60 per week, according to reports issued by the Department of Commerce and the National Resources Committee. Despite their limited ability to pay, these consumers are contributing currently more than 14 percent of all the taxes collected by Federal, State, and local governments. In total, they are required to contribute each year nearly $2 000,000,000 in special levies upon automotive equipment and its operation. Of this sum, a billion and one-half is paid to the States and their localities; the remaining one-half billion goes to the Federal Government. In addition to these specialized levies, they also must pay the same taxes as other citizens for the general maintenance and upkeep of all the Government.

Gasoline is no longer a luxury; hence it is unwise to place it in that category. The vast majority of motorcar users, as pointed out, are in the lower-income classes; hence the inequity of levying a 75-percent additional Federal tax on this group.

In Minnesota our State collects upward of $20,000,000 a year in gasoline taxes. In addition to that, the Federal levy approximates $8,000,000. These two taxes constitute a 40-percent sales tax on the gasoline sold in our State. Our three largest counties, containing our three biggest cities, contribute one-third of the gasoline-tax revenues. In other words, two-thirds of our State's gasoline taxes are paid by smaller communities and the rural areas. As you already know, the farmers are not exempt from the gasoline tax; therefore this additional levy would increase the cost of gasoline to 66 percent of our consumers who reside in rural areas. In addition to that, a large portion of the tax paid by our three cities is also paid by low-income groups, i. e., those earning less than $30 per week.

Current proposals, therefore, for an increase in the Federal gasoline tax in all fairness must take into account the existence of present State gasoline taxes which were levied, of course, prior to the imposition of the Federal tax. Minnesota now taxes gasoline at 4 cents per gallon, in addition to the 1½-cent Federal levy, which brings the total to 5½ cents. An increase of the Federal tax to 2½ cents, as provided, would increase the over-all tax to 6½ cents, or the equivalent of a sales tax of 52 percent based on the current retail price. From July 1932 to July 1940, the date on which the Federal gasoline tax was increased for defense purposes, consumers of gasoline have paid into the Federal treasury nearly a billion and one-half dollars to aid the Government in a period of distress. As a result of the ½-cent-per-gallon increase enacted in 1940, these consumers were required to pay some $112,000,000 more per year.

There has been much discussion of the indispensability to the defense program of certain basic and vital materials but little attention has been paid to gasoline, which seems to be equally indispensable. Without it, most of the defense workers would be unable to reach the factories and many of the finished defense materials could not be transported away from the factory by truck. In many instances the private automobile offers the only possible means of transportation to and from defense work, and this is equally true in the transportation of farm products to the various agricultural markets. Local highway programs would also suffer since the forced curtailment of the operation of motor vehicles through taxation would have the effect of reducing this revenue by a comparable amount. Obviously, any marked reduction in available revenue would cause a serious disruption of the financial resources available for highways. Furthermore, State highway programs alone would not suffer. Of the revenue collected from the motorists, some $246,000,000 annually is being distributed now to counties for expenditures upon roads under the jurisdiction of those units. Restriction upon operation of automobiles through taxation would effect a reduction in the amount of money which the counties now obtain from such funds and a similar reduction in sums accruing to other local governmental units. Such action certainly could not be reconciled with current efforts by Federal authorities to encourage State and local officials to undertake the elimination of bottlenecks in the highway system which are considered detrimental tc national defense.

These are but a few of the arguments we submit in brief for your consideration before adding a further tax to gasoline. It is an essential commodity used by over 30,000,000 motor-vehicle operators in this Nation today. It is vitally important that serious consideration be given to this.

STATE OF ARKANSAS,
DEPARTMENT OF STATE,
Little Rock, August 9, 1941.

CHAIRMAN AND MEMBERS SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: My name is C. G. Hall, secretary of state, Little Rock, Ark. At the outset I want to express to the committee my appreciation for the courtesy of allowing me to make a brief statement in opposition to an increase in the Federal gasoline tax at this time.

Being a native of this State and having a personal acquaintance with men and women in all walks of life, I can truthfully say that no Arkansan would evade paying his just share of the cost of national-defense expenditures. Our citizenship has always done its part in any emergency, and during the war days of 1918, as well as in the present crisis, our young men volunteered their services in great numbers. I feel, along with my fellow Arkansans, that the motor-vehicle operators are now paying their fair share, if not more, of the money being raised for national-defense purposes. In this State, alone, with the second lowest per-capita income in the United States, at the present rate of 1½ cents, the Federal gasoline tax is producing an annual revenue of approximately $3,000,000. Any further increase in this excise tax at this time would place an unreasonable and excessive burden upon our highway users.

Respectfully yours,

C. G. HALL, *Secretary of State.*

ARKANSAS HIGHWAY USERS CONFERENCE,
Little Rock, Ark., August 11, 1941.

CHAIRMAN AND MEMBERS, SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: My name is William F. Scarborough, secretary-treasurer of the Arkansas Highway Users Conference. This organization's membership is comprised of the following groups:

Arkansas Automobile Club
Arkansas Automobile Dealers Association
Arkansas Bakers Association
Arkansas Bottlers Association
Arkansas Dairymen's Association
Arkansas Farm Bureau Federation
Arkansas Farmers Union
Arkansas Ice Cream Manufacturers Association
Arkansas Pharmaceutical Association
Arkansas Roadside Council
Arkansas Wholesale Grocers Association
Associated Motor Carriers of Arkansas
Oil Dealers' Association of Arkansas
State Grange
United Commercial Travelers

We, as an organization representing many groups interested in highway transportation, do not want to appear unpatriotic in carrying our part of the burden for the payment of national-defense expenditures. We do feel, however, that the highway users are already paying a disproportionate share of special levies for defense purposes in addition to an extremely heavy burden of automotive taxes which were levied prior to the emergency.

We accepted an increase in the Federal gasoline tax in July 1940 willingly and without expressing any opposition thereto. We felt then, and still feel, that motor vehicle operators should pay their fair share of taxes unecessary for the proper and adequate defense of our Nation. When the 50-percent increase in the Federal gasoline tax was enacted last year increases in other commodities approximated 10 to 15 percent. We feel and believe that your committee, upon proper investigation, will be convinced that the highway users of today are paying at least their fair share, if not more, of national-defense taxes.

We respectfully urge that the Federal gasoline tax not be increased at this time.

Respectfully submitted.

W. F. SCARBOROUGH, *Secretary-Treasurer.*

INDEPENDENT BUS AND TRUCKERS' ASSOCIATION,
Little Rock, Ark., August 7, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: My name is Willis V. Lewis, secretary-treasurer of the Independent Bus and Truckers' Association, Little Rock. I respectfully ask permission to present the views of our organization with reference to the proposal to increase the Federal gasoline tax 1 cent per gallon.

We are all aware of the fact that our national-defense program calls for heavy increases in taxation. As the Independent Bus and Truckers' Association sees it, such new taxes as may be imposed should be levied as fairly and equitably as possible. These levies should be of such a character as not to destroy our system of private enterprise, upon which the security and well-being of the Nation so greatly depends in the emergency with which we are confronted. On the other hand, no person should be allowed to make any inordinate profits, nor should taxes be levied purely for punitive purposes.

The highway users of the country are already paying their full and proportionate share of all taxes. In addition to that, they are contributing, in round figures, about $2,000,000,000 per year in special highway taxes of various kinds—Federal, State, and local. This sum is equal to approximately 14 percent of the total revenues accruing to all the units of government in the United States. State and local taxes on highway transportation amount to about $1,500,000,000 a year, while the Federal Government is collecting approximately $500,000,000 a year from this source.

With a State gasoline tax of 6½ cents per gallon added to the present 1½ cents, or a total tax of 8 cents, Arkansas motor-vehicle operators today are paying more than a 50-percent sales tax upon an essential commodity.

We respectfully urge your committee to disapprove the proposal to increase the Federal gasoline tax.

Respectfully submitted.

INDEPENDENT BUS AND TRUCKERS' ASSOCIATION,
WILLIS V. LEWIS, *Secretary-treasurer.*

THE TRAVELERS PROTECTIVE ASSOCIATION OF AMERICA,
Atlanta, Ga., July 23, 1941.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Re: Federal gasoline tax.

DEAR SENATOR: Because of the well-recognized principle that everyone should do his part in meeting our country's problems, we are addressing this letter to you regarding proposals to increase the Federal gasoline tax. We are fully aware that the excessive expenditures of our Federal Government will probably call for more taxes unless substantial curtailment is made in these expenditures. At the same time it should be remembered that any tax increase levied now will undoubtedly remain in effect for many years hence, and it would seem advisable to broaden the application of any additional taxes.

Taxes on motor-vehicle operation are already far beyond the bounds of reason. The fact that people continue the use of motor cars and trucks, notwithstanding the outrageous and unreasonable cost of special motor-vehicle taxes, shows how necessary is the motor vehicle in our present-day life. It would be well for us to realize the value of motor-vehicle transportation now; England and France permitted special interests to hamper the progress of motor-vehicle development with disastrous results. To quote Frederick C. Horner, member, United States Civil Defense Commission to England:

"It is no secret that transportation is a major problem in England. Over there, as over here, the railroads have been telling the public that they had plenty of equipment to take care of any emergency. Today the English railroads are still saying, 'We can take it.' They can, of course, but with no promise of delivery."

Our own transportation experiences during the World War should be a warning.

Many of our people must use motor cars and trucks in earning a living. The levying of additional special taxes in motor-vehicle operation would be an unreasonable extra burden on these people who are already forced to pay outrageous special taxes on the use of their motor cars and trucks.

The traveling man, of whom about 70,000 are included in our organization, is already paying too much in special taxes on the operation of his motorcar. This applies also to others who must use the motor vehicle in making a living. To increase this tax, now outrageously high, would seem preposterous, but we understand such proposals are being made.

We have no desire to question the sincerity of efforts to finance our national activities, but we would be unfaithful to our trust if we did not rise in protest against proposals to single out the motorcar owner for additional special taxation.

The Federal gasoline tax was put on as a "temporary emergency" tax, admittedly wrong and unfair at the time, has been reenacted from time to time, increased 50 percent last year, and now proposals are made to increase it, because it is easy to collect. Surely you can find a fairer method of raising revenue.

Gasoline is overtaxed now.

Sincerely yours,

WILBER E. BROWN.

P. S.—Please have this letter included in the record of the hearings of the Senate Finance Committee on the tax bill.

S. H. KRESS & Co.,
New York, August 15, 1941.

Senator WALTER F. GEORGE,
Chairman, Finance Committee, Senate Office Building,
Washington, D. C.

DEAR SENATOR GEORGE: We went to Washington to consider presenting to your committee the situation as to how the new revenue bill affects our business and thousands of others similarly situated.

After being at the hearing yesterday, I realized the tremendous burden placed on your committee and appreciate the sincerity with which you all are considering this immense problem. Instead of asking for a personal hearing, decided that it would be to the best interests of all to submit, in writing, our observations on provisions which we think are both inadvisable and discriminatory.

We hope that your committee will give the same consideration to these suggestions as if we used your time in making a personal presentation, and request that you place the attached on record with your committee.

This is the result of a conference with a member of your committee, Senator Clyde L. Herring, of Iowa, who is a personal friend of many years and knows the effect of these provisions upon our industry.

Yours sincerely,

S. H. KRESS & Co.,
By R. H. KRESS, *President.*

1941 FEDERAL TAX LAW (H. R. 5417, REVENUE BILL

Title 2—Excess-profits tax: Section 201 (a) applies the fixed percentage rates on the fixed dollar amount, which is an unfair application with respect to different corporations and/or industries.

By classifying the taxable brackets on the percentage of income, its application would be the same for all corporations regardless of whether or not their business is affected directly by the defense program; we suggest the following schedule as an example:

	Percent tax
First 10 percent of excess-profits taxable income	35
Next 15 percent of excess-profits taxable income	40
Next 15 percent of excess-profits taxable income	45
Next 15 percent of excess-profits taxable income	50
Next 20 percent of excess-profits taxable income	55
Balance 25 percent of excess-profits taxable income	60

Section 713 (b) base period—excess-profits credit based on income: Consider adding to make this "average of any 3 years of the 4 years." Several of the Senators stated as having previously been brought to the committee's attention as to this discriminatory feature applying to a large number of corporations who may have had one bad year due to conditions beyond their control.

Section 714—excess-profits credit based on invested capital: Why apply a 7-percent rate on the balance of capital above $5,000,000, as it only allows $10,000 additional taxable income on each million dollars of excess, and causes further confusion?

The normal Federal income tax should be first applied against corporation profits before the application of the excess profits, and the Government should collect an equal amount of tax. As the 60 percent fixed excess-profits-tax rate under section 201 on the higher-bracket percentage of the excess-profits taxable income will take care of the larger part of the profit accruing to all corporations.

Chapter 19: Retailers' excise taxes are an abomination, whether levied by Federal, State, or municipal governments because of the tremendous costs of collecting and reporting; as proposed there will be excise taxes applying on special items in our industry on dry goods, jewelry, hardware, notions, soda and lunch, and toilet goods.

For our stores 85 percent of the items sell for 25 cents or less; 56 percent are 10 cents or less. How would this tax be applied and collected without a wasteful cost to retail stores, and the Internal Revenue Department in checking same up? The bill calls for 10 percent on the majority of the items, so how could the retail store add ½ to a 5 cents sale to the customer, and 2½ to a 25-cent sale, etc., without causing definitely dissatisfied customers? It must be remembered that most States and several cities already levy sales taxes and other taxes which must be collected as a separate item.

Then again, how will the honest retailer keep the record of such collections? One hundred percent of our sales are recorded through cash registers.

Instead of a retail excise tax this should be a manufacturers' excise tax and the rates adjusted to yield the necessary income.

Inventory declines: Provision should be made for the time when the crash causes a drastic drop in market prices.

As Senator Connally suggested, a revision last year to be incorporated in section 604 (a) (2), similar to section 214 (a) of the Revenue Act of 1918, this data has been submitted to him directly to be brought to the attention of the committee.

Copy to Senator Walter F. George.

AUGUST 15, 1941.

Senator TOM CONNALLY,
Senate Office Building, Washington, D. C.

DEAR SENATOR CONNALLY: I enclose a copy of communication today sent to your chairman, Senator Walter F. George.

This is in accordance with our conversation and, on account of the time which you could give being limited, I feel sure that this brief statement will be more comprehensive than what we could have covered verbally.

Complying with your request, attached are two double-spaced copies of the following:

Section 604 (a) (2) of the Connally amendment proposed but not enacted as a part of the Revenue Act of 1940.
Section 214 (a) of the Revenue Act of 1918.
Excerpt from Dominion of Canada Excess Profits Tax, section 6 (1) (b).

In 1920 our corporation suffered an inventory loss of over $1,250,000, which was likewise reflected in our 1921 earnings, as that merchandise inventory panic lasted for 2 years.

The Government should prepare for such contingencies, which will occur at almost any time during the immediate future years; the present uncertainty of business operation was demonstrated last week when several hundred thousand hosiery-mill operators were thrown out of work as 10,000 hosiery mills closed August 2, caused by silk being placed on the defense-priority list.

As prices rise, inventories rise, particularly because of the uncertainty of deliveries. Inventory losses always accompany deflation of inflated prices and inventories.

Yours sincerely,

R. H. KRESS.

SECTION 604 (a) (2) OF THE CONNALLY AMENDMENT PROPOSED BUT NOT ENACTED AS A PART OF THE REVENUE ACT OF 1940

CONNALLY AMENDMENT

This act was subsequently amended and the following paragraph was deleted in the amendment:

(2) *Loss in inventory.*—(A) At the time of filing return for the last taxable year under this title a taxpayer may, notwithstanding any other provision of law, file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 6 per centum per annum from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the tax imposed by this title the amount of such loss shall be deducted from the net income.

(B) If no such claim is filed, but is shown to the satisfaction of the Commissioner that during the period of 1 year after the date upon which the last return under this title is due the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the last taxable year under this title and the tax imposed by this title for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 322.

SECTION 214 (A) OF THE REVENUE ACT OF 1918

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

(12) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 percent per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the tax imposed by this title the amount of such loss shall be deducted from the net income.

(b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918, and the tax imposed by this title for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

EXCERPT FROM DOMINION OF CANADA EXCESS-PROFITS TAX LAW, SECTION 6 (1) (B)

(16-107) *Reserve against future inventory losses.*—Such reasonable provision as a reserve against future depreciation in inventory values as the Minister, in his discretion, may allow having regard to a basic quantity of stock in trade necessary for the business as indicated by the quantity on hand at the end of the fiscal period of the taxpayer ending in one thousand nine hundred and thirty-nine: *Provided*, That no such deduction shall be allowed which provides against a decline in inventory values below the inventory prices of goods on hand at the end of the fiscal period of the taxpayer ending in one thousand nine hundred and thirty-nine: *And provided further*, That any reduction in such reserve shall be added to the profits of the year of reduction for purposes of taxation under this Act. (S. 6 (1b), c. (97.3).)

.05 *Application.*—The provision allowing a deduction for reserve against future inventory losses is applicable only when the taxpayer is liable to the tax on his excess profits and not on his annual profits; see 16-100, CCH.

OUTDOOR ADVERTISING ASSOCIATION OF ARKANSAS,
Little Rock, Ark., August 8, 1941.

Mr. CHAIRMAN AND MEMBERS OF THE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

GENTLEMEN: My name is Willard D. Billingsley and this letter is being directed to you over my signature as assistant secretary of the organization set forth on this letterhead.

In the general tax bill, which recently passed the House, and which is now up before you gentlemen for consideration, you will find included in one of its sections an occupational tax on individuals, partnerships, or corporations "which are in the business of rendering an outdoor advertising service to others" and this communication has reference to that section of the proposed bill.

First, may I say that I know full well that additional taxes are necessary to meet the demands of the rather extensive defense program. Furthermore, I fully appreciate the problem with which you gentleman are faced and I know that the job is neither easy nor pleasant.

Please understand, further, that we of the outdoor advertising industry have no intention or desire to shirk our responsibilities. Myself and the others in this business are willing to pay our proportionate part of taxes, along with and on a par with other business, but do not feel that we should be singled out for this special tax, in addition to all others we are and will be required to pay.

A tax such as is proposed on our industry is not only confiscatory, because it would absorb the entire profits of the average outdoor advertising plant, but it is entirely unfair, inasmuch as no tax is proposed to be levied on any other national medium of advertising except radio.

I say that this tax would be confiscatory, because it would amount to from over 50 percent to more than 100 percent of the profits realized annually by the individuals, partnerships, and corporations engaged in the outdoor advertising business, after fair compensation for personal service is rendered.

A tax on any medium of advertising is an economic fallacy, in that it would add to the problems of marketing and distribution, thereby handicapping manufacturing, production, and sales service. We are not in the business of rendering or selling billboard space to others; our business is that of rendering advertising service.

Our billboards or advertising structures are the facilities through which we render that service and a tax on them would be similar to a tax on the tools of a workman or the services of a salesman.

The proposed levy, while it is ostensibly an occupational tax upon the business of "renting billboard space to others," is actually a tax upon outdoor advertising and while there is a provision in the measure for taxing the net time sales of radio stations on a graduated scale from 5 to 15 percent, there is no proposed tax on other major advertising media, such as newspapers, magazines, direct mail, window displays, and car cards. Furthermore, the proposed levy is not equitable because it discriminates between advertising and all other selling efforts.

Based on my knowledge of the physical facilities available in outdoor advertising and to qualify this statement, I will say that I have been engaged in this industry for more than a quarter of a century, the proposed tax will not produce the gross revenue anticipated according to the announcements in the public press. Furthermore, the administration and mechanics of applying the tax, determining the measurements of the structures, etc., would be more costly than the gross revenue produced by the tax.

Outdoor advertising (billboards) is an efficient and economical method for the dissemination to the public by Government and industry respecting subjects important to the welfare of the Nation and its citizens and certainly should not be handicapped by a tax not levied on other forms of such communication. In the present emergency, it would be detrimental to the success of the national-defense program and the maintenance of the national morale, if any of the fundamental means of disseminating information to the general public was to be crippled or made ineffective by the process of taxation, especially in view of the fact that it would not, in the final analysis, produce important revenue to the Government or serve any sound economic or sociological objective or purpose.

The record of service to the country by the organized outdoor advertising industry during the period of national emergency represented by the World War and its aftermath is one which should cause those elected representatives of the people responsible for the Nation's welfare to give serious thought to the future needs of the country, as well as the present, before lending their support to such un-American and unsound confiscatory and discriminatory proposals as contemplated in the measure which is the result of the deliberations of the House Ways and Means Committee.

Recent contributions in space, labor, and materials in the national interest, made by the men and women owning and operating outdoor advertising facilities in behalf of the United States Army and the United Service Organizations are evidence of the readiness and capacity of the organized outdoor advertising industry to serve the public interest.

In the World War of over 20 years ago, a similar tax on outdoor advertising, but expressly excluding newspaper advertising, was proposed and the Ways and Means Committee, realizing that it was unfair and patently discriminatory, after investigating the matter, deleted it. Moreover, the committee found that the possible returns would be so small in proportion to the levy contemplated and the disastrous effects upon business generally, especially the businesses served by outdoor advertising, would be so great that it would be uneconomical to impose any tax on outdoor advertising.

The same arguments as were proposed at that time are still cogent. Outdoor advertising is a national sales facility and offers the manufacturer and the merchant the lowest-cost advertising facility available to them for the movement of goods from the manufacturer through the retailer to the consumer. Certainly a trade facility of this nature should not be penalized by a special tax which is not applied to other national advertising media, such as the newspapers, etc., as we have previously stated.

A tax on any form of advertising is uneconomical, because it would serve to slow up business activity and therefore decrease the national income. Consequently, it is my contention that the proposed levy on outdoor advertising structures is absolutely unsound. As a matter of fact the levy, as proposed, loses sight of the fact that outdoor advertising is a national advertising medium. By its very terms, it proposes a tax on those concerns "who rent billboards to others" and makes it an occupational tax for such service. It, purposely or otherwise, disregards the fact that outdoor advertising is not a business of "renting space" but is a national and recognized trade facility which the leading manufacturers of this country use for the exploitation of their products because it is the most economical medium per thousand of circulation for that exploitation.

In closing, may I say that additional national income we must have and this means added taxation and if advertising must be taxed, the outdoor advertising industry will bear its proportionate part. But in taxing advertising, let's tax all advertising, that of the magazines, the newspapers, the radio, outdoor, car cards, direct mail, and keep all divisions of the advertising industry on a fair and equitable parity with the various competing media.

I sincerely trust that you gentlemen upon whose shoulders rests the responsibility of the future of our great American Nation and its people, will not permit the Federal tax bill, with its discriminatory sections relative to outdoor advertising, to go before the United States Senate without giving due consideration to the data which I have set forth above and either delete this section from the bill or amend it so as to place all advertising on a parity.

Yours truly truly,

W. D. BILLINGSLEY, *Assistant Secretary.*

THE HAYWARD-LARKIN CO.,
Spokane, Wash., August 13, 1941.

The Honorable WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate,
Washington, D. C.

DEAR MR. SENATOR: Your committee now has before it for consideration the 1941 revenue or tax bill. Included in this bill is an item proposing to tax billboards on an annual basis.

We employees of this company in Spokane wish to go on record as opposing this proposed tax. While we cannot appear at the public hearing, which we understand will take place in the next few days, we wish to point out the following reasons for opposing this tax:

(1) It is discriminatory in that only one other form of advertising is taxed, leaving such forms as newspapers, magazines, direct mail, etc., untaxed;

(2) It is confiscatory in that it attempts to tax a substantial portion, if not all, of the net income left to the billboard owner after he has paid for his costs of operation.

(3) A tax on advertising is unsound in that it interferes with the sale or distribution of goods, which interference can decrease other sources of revenue to the Federal Government.

(4) Billboards perform a valuable public service which cannot be kept up if exorbitant taxes are imposed on the industry.

(5) The net revenue to be derived from this source would be negligible and out of line with the hardships it would create on the thousands of operators and employees.

(6) It proposes to tax property instead of income, a new field for the Federal Government and one which sets a bad precedent.

As your time, no doubt, is very limited, we are not attempting to go into detail, as we feel confident that persons appearing at your hearing will stress the points we have mentioned above. We do, however, hope that you will give every consideration toward the elimination of this item from the bill, both because it is discriminatory and because it would prove a false source of revenue.

Very truly yours,

(Signed by 33) EMPLOYEES OF THE HAYWARD-LARKIN CO.

TANNERS' COUNCIL OF AMERICA,
New York, August 14, 1941.

CHAIRMAN, FINANCE COMMITTEE,
United States Senate, Washington, D. C.

DEAR SIR: We refer to section 2401, chapter 10, of H. R. 5417, relating to retailers' excise taxes on furs. If your committee votes to retain this tax on furs, we desire to express on behalf of tanners of shearlings (wooled sheepskins) our approval of the action of the House of Representatives in making this a retailers' excise tax rather than a manufacturers' excise tax.

We are informed that a certain section of the fur industry is endeavoring to have the tax imposed at the point of dressing and dyeing. This would be manifestly unfair in the case of dyed shearlings (wooled sheepskins) because of the question of tax on skins being dressed and dyed for Government uses and those going into slippers and as trimmings on coats.

The largest part of the industry's production of dyed and electrified shearlings is, at present, going to the Army and Navy for military use, principally for aviators' clothing. The balance of the production is going into trimmings for slippers, collars on leather, wool, and sheep-lined coats, and some for the manufacture of women's fur coats. If the tax on furs is allowed to stay as it is written in the House draft of the bill, namely, to be added by the retailer, only dyed shearlings that are sold as furs will be affected. This seems to be the intention of Congress, as the section is apparently designed to cover articles made of wooled sheepskin which have been processed and dyed to resemble fur (such as imitation beaver, imitation wombat, etc.), and articles of which sheepskin so dyed and processed is the component material of chief value. Under rulings of the Treasury Department in connection with the Revenue Act of 1932 certain articles made of shearlings but not commonly or commercially known as articles made of fur were held to be not taxable. This classification included articles made of the so-called "domestic type" wooled sheepskins (ordinarily used as a protection against cold rather than for decorative or style purposes) which had not been dyed and processed to resemble or imitate fur. Examples of such exempt articles are boys' and workmen's sheep-lined coats and shearling-lined slippers and gloves. The term "domestic type" as used by the Treasury Department included sheep and lamb skins of either domestic or foreign origin, such as sheep or lamb skins from merino or crossbred sheep or lambs.

To insure the imposition of a tax for fur purposes only and to prevent taxation of articles in which shearlings are used for other than fur purposes, we believe that the following wording, as it now appears in the House revenue bill, should be retained:

"The is hereby imposed upon the following articles sold at retail a tax equivalent to 10 per centum of the price for which so sold: Articles made of fur on hide or pelt, and articles of which such fur is the chief component material of chief value."

On behalf of tanners of shearlings.

Respectfully submitted.

MERRILL A. WATSON,
Executive Vice President.

OMAHA, NEBR., *August 6, 1941.*

Hon. BEN F. JENSEN,
House of Representatives, Washington, D. C.

DEAR BEN: In the Revenue Act of 1941, as I understand it now stands, there is included a 10-percent excise tax to be applied against all electrical appliances. This includes a number of appliances, particulary those for cooking and water heating, which are highy competitive with appliances using other means of heating, such as gas, bottled or liquid gas, kerosene, gasoline, etc.

I do not believe there is any objection to the excise tax itself, but it does seem rather unfair to impose it upon the electrical appliances and not upon the other types of heating, especially gas. If this law is enacted as drawn, it would impose a considerable hardship on the electrical-appliance dealers and would discriminate against the taxpayer who wants to select electrical cooking and water heating equipment.

Would it not be possible and practical to include in the tax other types of cooking and water heating? I believe that it would be fair and would also add a considerable source of revenue to the bill without working any injustice on anyone.

If there is anything that you can do to have this bill amended to include these other competitive sources of heat, I would consider it a personal favor. But the time this letter reaches you it may be too late to do anything on this matter in the House, but if you can conveniently, would you call it to the attention of our Senators from Iowa?

With best personal regards and best wishes for you in these trying hours, I am,

Sincerely yours,

W. C. RATHKE.

STATEMENT OF HERBERT C. RORER, OF PHILADELPHIA, PA., REPRESENTING THE AMERICAN PHARMACEUTICAL MANUFACTURERS' ASSOCIATION

Mr. Chairman and gentlemen of the Senate Committee on Finance, my name is Herbert C. Rorer; my address, Philadelphia; and I represent the American Pharmaceutical Manufacturers' Association. This association substantially and importantly represents manufacturing pharmacy in the United States.

I am instructed to place the association on record before your committee as strongly urging a differential in the tax on ethyl alcohol for nonbeverage use as compared with that for beverage use. The establishment of such a differential would be effective to correct an inequitable tax situation wherein pure alcohol for use in the production of essential medicines is taxed at the same rate as alcohol for beverage use, thus increasing the cost of such medicine and of medical care for the sick.

It is in the public interest to reduce the cost of such medical care, and we believe it has been reliably shown that the Government would not suffer loss of revenue from the establishment of this differential. Thus, we have a situation in which the public can benefit without loss of Government revenue in times when it is of such great importance.

The members of the American Pharmaceutical Manufacturers' Association appreciate the opportunity to place this testimony on record before your committee.

STATEMENT SUBMITTED BY THEODORE NETTER, OF PHILADELPHIA, PA.

TAX COLLECTED ON A NONEXISTENT COMMODITY

Hundreds of thousands of dollars in tax have been collected by the United States Government on whisky that did not exist when the collection was made.

Treasury Decision 4653—Schedule of allowances for loss by leakage and evaporation—copy of which is attached marked "Exhibit A," provides for loss of whisky and other distilled beverage spirits caused by evaporation and leakage, graduated over a period of time beginning with 2 and ending with 80 months. Frequently it is found in taxpaying distilled spirits, when removed from internal-revenue bonded warehouses, that the loss by evaporation is greater than the schedule of allowances. Therefore, the cost of the actual gallons received by the taxpayer is many times greatly increased over the amount it should normally be.

Whisky must be aged in wooden barrels to meet the requirements of the purchasing public. Evaporation is natural and needful. The best possible white-oak wood obtainable is used in the manufacture of whisky barrels. It is impossible to obtain oak wood that is uniform in texture. Therefore, the loss caused by evaporation from some barrels is greater than others. The result is a heavy burden upon the taxpayer.

Attached are two regage forms prepared by United States Government gagers, showing the original contents, the actual proof-gallon contents, at the time of the regage, the tax-gallon contents as compiled under Treasury Decision 4053, and the actual loss in each instance on tax alone to the taxpayer under the present tax rate is $3 per gallon.

It is your petitioner's belief that Congress does not wish to levy a tax on something that does not exist. Therefore, the Treasury decision referred to governing the loss allowed should be annulled in its entirety and the tax collected only on the actual number of gallons of distilled spirits received by the taxpayer.

EXHIBIT A.—*Copy of schedule of statutory allowances for loss by leakage and evaporation*

Maximum allowance casks of 40 wine-gallons capacity or more—proof gallons	Period of storage in warehouse		Maximum allowance casks of 40 wine-gallons capacity or more—proof gallons	Period of storage in warehouse	
	More than months	Not more than months		More than months	Not more than months
1.0		2	7.5	33	36
1.5	2	4	8.0	36	40
2.0	4	6	8.5	40	44
2.5	6	8	9.0	44	48
3.0	8	10	9.5	48	52
3.5	10	12	10.0	52	56
4.0	12	15	10.5	56	60
4.5	15	18	11.0	60	64
5.0	18	21	11.5	64	68
5.5	21	24	12.0	68	72
6.0	24	27	12.5	72	76
6.5	27	30	13.0	76	80
7.0	30	33			

EXHIBIT B.—*Storekeeper-gager's report of spirits gaged*

Return of each package gaged for tax payment from I. R. B. W. No. 11 of Foust Distilling Co., in the State of Pennsylvania, this 10th day of March 1941, produced at distillery No. 11, in the State of Pennsylvania, by Foust Distilling Co.

Serial numbers of packages	Kind of spirits	Net weight, pounds	Wine gallons	Proof	Proof gallons	Taxable gallons	Loss allowed	Kind and serial number of stamp	Number of months in warehouses
12727 to 12736, inclusive—10 packages.	Whisky	2,702	351.27	110 average.	387.39	405.4	105.0	TP 3133695 to 3133701, inclusive; TP 455070; 3133702 to 3133703, inclusive.	59 plus.

Original proof gallons, 510.86.
Date of original entry, Mar. 26, 1936.

(Signed) W. D. MYERS,
Storekeeper-gager.

MEMORANDUM

Number of gallons on which tax was paid	405.40
Actual number of gallons in packages as above	387.39
Number of galloons not received on which tax was paid	18.01
18.01×$3 tax equals	$54.
Allowance made by distiller (Foust Distilling Co.) to Theodore Netter, taxpayer, of above packages	No
Loss to Theodore Netter	54.

EXHIBIT C.—*Storekeeper-gager's report of spirits gaged*

Form 1620—Long.
Treasury Department.
Internal Revenue Service.

Return of each package gaged for taxpayment from I. R. B. W. No. 3, of the Bedford Distilling Co., in the State of Ohio, this 9th day of May 1941, produced at distillery No. 3, in the State of Ohio, by the Bedford Distilling Co.

Serial numbers of packages	Kind of spirits	Net weight, pounds	Wine gallons	Proof	Proof gallons	Taxable gallons	Loss allowed	Kind and serial number of stamp	Number of months in warehouses
24626 to 24650, inclusive—25 packages.	Whisky.	5.716	745.40	112 average.	834.96	925.80	275.0	TP 1247277 to 1247301, inclusive.	61 plus.

Original proof galleys, 1,201.74.
Date of original entry, Mar. 20, 1936.

(Signed) PAUL E. OBERSER,
Storekeeper-Gager.

MEMORANDUM

Number of gallons on which tax was paid	925.80	
Actual number of gallons in packages as above	834.96	
Number of gallons not received on which tax was paid	90.84	
90.84X$3 tax equals		$272.52
Allowance made by distiller (Bedford Distilling Co.) to Theodore Netter, taxpayer, of above packages		126.90
Loss to Theodore Netter		145.62

STATE OF ARKANSAS,
OFFICE OF LIEUTENANT GOVERNOR,
Little Rock, August 12, 1941.

CHAIRMAN AND MEMBERS, SENATE FINANCE COMMITTEE,
Washington, D. C.

GENTLEMEN: While I am writing you in protest of a proposed increase in the Federal gasoline tax, I wish to state that no Arkansan, whether he be an official or a private citizen, wishes to shirk his responsibility in the defense program. It has been suggested by various news commentators that an additional tax on gasoline might be levied to help the Government finance its present program, but I should like to ask the Senate Finance Committee to consider a few points:

As you know, Arkansas is largely an agricultural state, having only 9 cities of more than 10,000 population. The rate of growth during the past decade is the lowest in the history of the State. The present population represents a density of 37 inhabitants per square mile. Evidence as to the low-scale per capita income of our population and, in many instances, the dire need for the so-called necessities of life has been furnished various branches of the Federal Government. In this respect Arkansas varies from many States that are rich in revenue-producing industries.

We have recently succeeded in refunding our tremendous highway indebtedness of $136,000,000. With an irrevocable pledge to use $3,500,000 of our revenue for highway maintenance annually, we fear that an additional increase in tax on gasoline at this time would necessitate a decrease in the use of gasoline and seriously hazard our program.

At the time automobiles were introduced they were rightly considered a novelty. But the day has long passed when an automobile can be classed as a luxury. I cannot think of a single modern business in which the automobile and the use of gasoline is not indispensable to its continuance. For that reason, if for no other, it would seem that gasoline should be removed from any category which places it on the same basis with cosmetics, liquor, and commercial amusement.

Sincerely yours,

BOB BAILEY, *Lieutenant Governor.*

THE J. B. WILLIAMS CO.,
Glastonbury, Conn., August 12, 1941.

Hon. WALTER GEORGE,
Senate Finance Committee, the United States Senate,
Washington, D. C.

DEAR MR. GEORGE: This company wishes to go on record with the Senate Finance Committee as being opposed to the elimination of the average-earnings method as one of the methods for computing the excess-profits credit. While this company filed its 1940 excess-profits-tax return and expects to file its 1941 excess-profits-tax return on the basis of an excess-profits credit worked out by using invested capital, it feels, nevertheless, that in all fairness to industry the alternative average-earnings method should be continued as one of the methods for arriving at the credit.

The dollar sign is not the measure in all instances of what is excess profits and what is not excess profits. Furthermore elimination of the earnings method for the reasons advocated by the Treasury Department attacks the profits of corporations having small invested capital for reasons of revenue and profit control only rather than for the more fundamental reason of taxing profits due to the emergency.

Congress, in the Revenue Act of 1940, as amended, did a splendid job in recognizing the need for two methods, and it is earnestly hoped that Congress, in the Revenue Act of 1941, will continue to evince the same realism.

Another point we wish to urge upon you is that the 10-percent munitions-tax levy on the profits of companies using the invested-capital method, while equitable in principle, in our opinion, attacks the profits of companies not benefiting from defense business It is felt that if the 10-percent tax on the difference between the preemergency earnings and the excess-profits credit is to stand, then such percentage should be reduced by an amount representing the percentage of nondefense business billed out by the taxpayer to the total billings, as, for example, a company's billings is made up of 75 percent defense work and 25 percent nondefense work. The special munitions tax, then, of 10 percent would be reduced by 25 percent to 7½ percent.

Respectfully submitted.

THE J. B. WILLIAMS CO.,
C. S. CAMPBELL, *Vice President.*

DUNKIRK LAUNDRY CO., INC.,
Dunkirk, N. Y., August 5, 1941.

Hon. WALTER F. GEORGE,
Acting Chairman, United States Committee on Finance,
Senate Office Building, Washington, D. C.

MY DEAR MR. GEORGE: Considering the fact that the Honorable James M. Mead is not a member of the United States Senate Committee on Finance, I felt that I would not write any of the other members of the committee but would ask that you bring to the attention of the committee what comments I make relative to the proposed 10 percent tax on commercial washers used by the laundry industry.

First, I would like to state that neither I nor our company is interested in this proposed tax on commercial washers for the very good reason that we are not in the market and will not be in the market for a washer for a number of years because of the fact that our washroom equipment is now 95 percent modern monel equipment with a capacity at least 100 percent in excess of present requirements. For this reason the 10 percent proposed tax, if enacted, would have no effect on us, and I believe that if the proposed tax should be enacted it will be much less effective than might be thought by reason of the fact that our condition as respects washroom equipment is probably that of the majority of the operators of plants throughout the country.

I would only say on this subject that it seems to me that this proposed tax is highly discriminatory in that such commercial washers as might be purchased now or for several years in the future being subject to this tax would entail a hardship on the laundry industry, whereas our chief competitor being the housewife, the home washing machine is proposed to be exempt from such tax.

The laundry industry is distinctly a local service business; the investors in the equipment are largely local, and, as compared with other national businesses, we surely would come under the heading of small business. Small business, particularly where that business cannot modify its selling price, is already at a distinct disadvantage as compared to industries which can revamp their selling

prices depending on costs, a condition which does not exist in the laundry industry by reason of the fact that the chief competitor of every local laundry is the housewife herself and by no means is the competition between the several plants in a given community.

I think that those interested in the laundry business take a great deal of pride in the fact that we approve of the national-defense program, and we, of course, expect that program to be financed by taxes; we simply think that such financing should be general and include the home washer, if any washers are to be taxed, and not simply tax the commercial washer alone.

The commercial laundries of the United States serve millions of local customers every week; in addition, they provide employment, which, according to the last figure I have, is between 250,000 and 300,000 persons, the greater majority of which are women; it happens, of our employees, 66 percent are women.

My contention is further that the commercial laundry is one of the chief factors reducing home labor, and they accomplish this purpose more effectively than the home washer by reason of the fact that the commercial laundry is in position to relieve the homemaker of all of her laundry labor, whereas the home washer relieves her of only a portion. In fact, in our case that portion of our family sales which the homemaker could do with a home washer is but 30 percent of the total amount of family sales, and this means that the washer in the industrial laundry in our case is reducing the homemakers' labors two and one-third times as much as the home washer is reducing her burdens. If this same percentage holds true throughout the United States, then the industrial washer is two and one-third times as effective in its reduction of labor to the homemaker as is the home washer, and a tax on the industrial washer is to the disadvantage of 700 homemakers out of each 1,000.

The laundry industry is already burdened by its increased labor costs due to unemployment tax and old-age benefits which the industry is in harmony with and paying the bill for, though the housewife has not these similar costs and already has a distinct advantage over the commercial laundry by reason of these taxes on industry which the homemaker does not have at all.

We are hopeful that your committee will feel favorable toward an adverse report on this subject to the Senate.

Respectfully yours,

DUNKIRK LAUNDRY CO., INC.,
A. W. CUMMINGS, *President.*

SIMPLEX MANUFACTURING CO.,
New Orleans, La., August 1, 1941.

HON. ALLEN J. ELLENDER,
United States Senate, Washington, D. C.

DEAR SIR: We are a Louisiana firm, located in the city of New Orleans. We are engaged in the manufacture of a light-weight motorcycle, known as the Servi-Cycle, which is the only light-weight motorcycle manufactured in the United States. These machines are sold over the entire United States and are exported to several foreign countries.

Since the beginning of their manufacture in 1935 they have steadily gained in popularity and are being used extensively for messenger and delivery purposes. Our business is steadily growing and undoubtedly holds great possibilities of benefits, not only to ourselves but to the city of New Orleans and the State of Louisiana as a whole. We understand that there has been proposed a 7-percent excise tax on the manufacture and sale of automobiles. Motorcycles, either large or light weight, all fall under the same classification as automobiles for excise-tax purposes so this excise tax vitally concerns us.

We believe that motorcycles, especially lightweight machines, should be put into a separate classification by themselves and either bear no excise tax at all or a lighter burden than that imposed upon automobiles.

Lightweight motorcycles are largely used by messenger and delivery boys whose income ranges from $6 to $14 per week. Any added excise tax would be an additional burden upon these boys in the lower-income bracket. Their continued employment is based upon their ownership of a lightweight machine.

It is our understanding that this additional excise tax on automobiles is proposed to serve a double purpose. First, it will bring additional revenue to help pay the cost of the defense program; and, second, it should tend to decrease the sale of automobiles, thereby conserving vital metals and materials for defense purposes.

Our machine can be used in the place of trucks and automobiles in a great many instances, and takes the place of larger units in messenger service and many delivery services, and also provides a more economical mode of transportation.

The material required to produce one of these machines by actual weight is less than 5 percent of that used in the ordinary automobile. The rubber used thereon is less than 5 percent of that required for an automobile or truck, and less than one-sixth of the gasoline consumed by an automobile or truck is required for the operation of a Servi-Cycle or less than one-tenth of those required in automobile production. Therefore, the conservation of materials and man-hours of skilled labor vital to the defense program is readily seen when a Servi-Cycle replaces a heavier motorized unit.

There has been introduced into this country, in direct competition to us, a lightweight motorcycle imported from England which has an export price f. o. b. England, of approximately $80. The import duty imposed upon these machines is at the rate of 10 percent of the export price, which amounts to approximately $8. The excise tax on our machine at the seven-percent rate would amount to $9.02 on our lowest priced machine which would make the excise tax paid on a United States product higher than the import duty on an English product.

We do not believe that it is the purpose or intent of Congress to impose on a manufacturer located in the United States an excise tax higher than an import duty or an imported vehicle of the same class.

For the above reasons we feel that one of the following steps should be taken:

1. Classify a lightweight motorcycle as "motorcycle weighing less than 150 pounds," and let it bear no excise tax or a tax which is appropriate.

2. Make the separate classification and leave the rate of excise tax the same as it now is, that is 3½ percent.

3. Provide that imported machines also pay the excise tax in order that a United States manufacturer will not be forced to pay a greater amount of excise tax than their importers pay in duty.

We call your attention again to the fact that this is entirely a Louisiana industry. Ours is the only motorized vehicle manufactured in the South, and our industry bids fair to become a very prominent one in this field. We earnestly believe that we have by far the greatest opportunity for expansion of any industry in the United States today and, therefore, ask your aid in the revision of that part of the excise-tax measure which applies to lightweight motorcycles by one of the above means, our preference being in the order named.

We will appreciate your kind cooperation in this matter.

Very truly yours,

SIMPLEX MANUFACTURING CO.,
JERRY L. PRENTISS,
Purchasing Agent.

COLLETTE MANUFACTURING CO.,
Amsterdam, N. Y., August 5, 1941.

SENATE FINANCE COMMITTEE,
Washington, D. C.

HONORABLE SIRS: We desire to file the following brief of our grievance against that portion of the Revenue Act of 1941 as it applies to sporting goods.

From reading this portion of the act, we interpret your intention to permit tax-free children's toys, such as baseball bats under 26 inches in length, badminton rackets under 22 inches over all, pool tables under 45 inches in length, hockey sticks under 30 inches in length, and so forth. There is no question that your clear demarkation of these items was not to tax children's toys. How can you reconcile a bat under 26 inches in length as a toy and not a dime rocket ball that goes with this small bat.

Where is your demarkation of other toys, such as footballs and basketballs, that sell to children from 3 years to 12 years, made, not from leather, but imitation leather; the baseballs aforementioned, stuffed with cottonseeds, excelsior, or waste felt, and for the little shaver from 3 to 12 years old?

Why should the manufacturer of badminton sets, tennis rackets, golf bags, baseball bats, and golf clubs be shown partiality in the juvenile items he makes?

The football and baseball manufacturers make footballs from imitation leather for kiddies, which are sold for 25 cents to $1. He also makes leather footballs up to $15 each. The same applies to the baseball manufacturers. He makes

baseballs stuffed with excelsior, cottonseeds, or felt scrap which sell to the kiddies for from 10 to 50 cents. He also makes balls, with rubber or cork center wound with yarn, which sell up to $2.

Any layman reading this law as it now stands can see a clear discrimination between manufacturers of various sporting goods items.

Isn't it pretty small to tax the babies' toys and shut your eyes to such items as roulette wheels and other adult gambling devices sold in the toy departments of every big department store in the country?

If we need money for defense, go ahead and tax toys but why discriminate between us toy manufacturers?

We urge you to reconsider this portion of the act that there will be no discrimination between us manufacturers of toys.

Very truly yours,

COLLETTE MANUFACTURING CO.,
By A. F. HECK, *Sales Manager.*

	Cents
1 only No. 25 no-lace football, retail price	25
1 only No. 3W318 football, retail price	25
1 only No. 5W813 football, retail price	50
1 only No. 3W63 white football, retail price	39
1 only No. 10 baseball, retail price	10
1 only No. 75 baseball, retail price	10
1 only No. 31 baseball, retail price	25
1 only No. 57 baseball, retail price	25

(No charge.)

NOTE.—These balls are sold to children from 3 to 12 years of age.

Do you gentlemen actually intend to tax these kiddies' toys?

Samples of the above balls are being sent you under separate cover.

AMERICAN MERCHANT MARINE INSTITUTE, INC.,
New York, August 4, 1941.

Hon WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington, D. C.

Re: Federal gasoline tax.

MY DEAR SENATOR GEORGE: Section 554 (b) of the revenue bill of 1941 (H. R. 5417) as passed today by the House of Representatives would add a new section 3469 to the Internal Revenue Code providing in part as follows:

"(a) *Transportation.*—There shall be imposed upon the amount *paid within the United States*, on or after the effective date of part V of title V of the Revenue Act of 1941, for the transportation, on or after such effective date, of persons by rail, motor vehicle, water, or air, *within or without the United States*, a tax equal to 5 per centum of the amount so paid * * *."

If enacted, this section would require the payment of a 5 percent tax upon all steamship tickets sold in the United States for transportation from the United States to or from foreign countries. At the present time the only steamship passenger traffic of any consequence is to points in Central and South America. The establishment and maintenance of passenger services to countries in South and Central America has been a keystone of this country's foreign policy. The good-neighbor relations which the Government has sought to develop with other American countries depend to a large extent upon the promotion of passenger and tourist traffic. The deterrent effect of the proposed tax upon the building up of these relations will be exceedingly great. On the other hand, the revenue to be derived from such a tax would be quite small. It is accordingly urged that the application of the proposed tax be restricted to transportation within the United States. This purpose could be accomplished by striking out the words "or without" appearing in the phrase "within or without the United States" italics above.

In addition to urging the abandonment of this proposed tax for the reason stated, I desire to point out to you the difficulties of administration and the possibilities of unfair discrimination. The tax would be applicable only to amounts "paid within the United States." Prospective steamship passengers will attempt to avoid tax by purchasing their tickets at some steamship office outside of the United States where the tax is not and cannot be made applicable. It is submitted that is unfair to those persons purchasing steamship tickets in the United States and paying the tax thereon to permit other persons to avoid the

tax by transmitting funds to a point without the United States for the purchase there of identical tickets. Furthermore, steamship companies will be subjected to the annoyance and additional communication cost of having to make sales in foreign ports of steamship space to be used by persons residing in the United States.

In view of its detrimental effect upon inter-American relations, the petty annoyances in connection with its collection and the small amount of revenue to be derived therefrom, it is respectfully requested that your committee delete from the bill the tax upon steamship tickets for transportation in foreign commerce.

Respectfully yours,

JOHN J. BURNS, *General Counsel.*

AMERICAN MACHINE & FOUNDRY CO.,
Brooklyn, N. Y., August 7, 1941.

Senator WALTER GEORGE,
Senate Finance Committee, Washington, D. C.

DEAR SENATOR: This company wishes to go on record with the Senate Finance Committee as being opposed to the elimination of the average-earnings method as one of the methods for computing the excess-profits credit. While this company filed its 1940 excess-profits-tax return and expects to file its 1941 excess-profits-tax return on the basis of an excess-profits credit worked out by using invested capital, it feels, nevertheless, that in all fairness to industry the alternative average-earnings method should be continued as one of the methods for arriving at the credit.

The dollar sign is not the measure in all instances of what is excess profits and what is not excess profits. Furthermore, elimination of the earnings method for the reasons advocated by the Treasury Department attacks the profits of corporations having small invested capital for reasons of revenue and profit control only, rather than for the more fundamental reason of taxing profits due to the emergency.

Congress, in the Revenue Act of 1940 as amended, did a splendid job in recognizing the need for two methods and it is earnestly hoped that Congress, in the Revenue Act of 1941, will continue to evince the same realism.

Another point we wish to urge upon you is that the 10-percent munitions tax levy on the profits of companies using the invested capital method, while equitable in principle, in our opinion attacks the profits of companies not benefiting from defense business. It is felt that if the 10-percent tax on the difference between the pre-emergency earnings and the excess-profits credit is to stand, then such percentage should be reduced by an amount representing the percentage of non-defense business billed out by the taxpayer to the total billings, as for example, a company's billings is made up of 75 percent defense work and 25 percent non-defense work. The special munitions tax, then, of 10 percent, would be reduced by 25 to 7½ percent.

Respectfully submitted.

AMERICAN MACHINE & FOUNDRY CO.,
R. C. MORSE.

HARNISCHFEGER CORPORATION,
Milwaukee, Wis., August 14, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Referring to the proposed tax bill, which is under consideration at the present time, I wish to go on record with reference to existing policies of this country.

I am of the opinion that the first consideration should be to make a drastic cut in unnecessary expenses.

I also believe that the bill, which was ordered out by the House, does not have sufficient increase in the base of the present taxes. At the present time, I am informed that about 10 percent of the population must carry the tax load of the country and, in view of the enormous expenditures which are being incurred, this is certainly very inadequate.

I am also of the opinion that the only solution for securing a sufficient amount of revenue is to pass a Federal sales tax.

Very truly yours,

W. HARNISCHFEGER.

NEW JERSEY LEAGUE OF WOMEN SHOPPERS,
Newark, N. J., August 15, 1941.

Senator WALTER GEORGE,
United States Senate, Washington, D. C.

DEAR SIR: We should like to present our views with regard to the all-important tax measure now being discussed by the Senate Finance Committee.

First, we wish to state that such proposals as the reduction of income-tax exemptions to $750 for single persons and $1,500 for married couples will prove a dangerous and unnecessary burden on people whose living standards are already perilously low. Mr. Leon Henderson in recent testimony has said, that the wage earner's dollar has already dropped 6 percent since June 1939. That means that the $750 exemption for a single man will no longer buy $14.42 worth of food, clothing, and shelter weekly. Conservative figures show that the cost of food, which figures largely in the budget of low-income groups, has risen 13 percent. On the basis of such facts, it can objectively be considered dangerous to the health of the Nation to raise the needed revenue by lowering income-tax exemptions. A general sales tax on articles which are not clearly luxuries, it seems to us, falls also into the category of pernicious tax legislation.

We urge that needed revenue be raised from the following sources. Secretary Morgenthau, too, has testified that much more revenue could be secured from excess-profits taxes than is netted at present.

1. Corporation profits above 6 percent of invested capital should be considered excess profits, and should be taxed on a graduated scale. To tax profits may hurt some people, but not in an elementary way; to tax food is dangerous to the well-being of the vast majority of our people.

2. Undivided-profits taxes should be written to prevent corporations from increasing their large surpluses.

3. The proposed 6-percent surtax on corporate earnings above $25,000 should be put into force.

4. Income from all Government securities, issued in the past or present, State, municipal, and Federal, should be taxed.

5. Transfers of wealth by gift, inheritance, insurance should be covered by a single tax; transfers of any kind totaling more than $25,000 should be taxed.

6. Upper-bracket incomes should be taxed more sharply and loopholes closed.

7. Families should be required to file single joint returns where combined earnings are more than $4,000.

It has been demonstrated that the collection of taxes from low-income groups is very costly, often absorbing a considerable share of the revenues themselves. Our proposals will net more than sufficient returns to cover the needed revenue. We urge your careful study of these proposals and their incorporation in any tax legislation which is written.

Sincerely yours,

NEW JERSEY LEAGUE OF WOMEN SHOPPERS,
HANNAH SMITH, *President.*

STATEMENT OF JOHN L. CONNOLLY, SECRETARY AND GENERAL COUNSEL, MINNESOTA MINING & MANUFACTURING CO., ST. PAUL, MINN.

Mr. CONNOLLY. Mr. Chairman and members of the committee, my name is John L. Connolly; I am secretary and general counsel of the Minnesota Mining & Manufacturing Co., St. Paul, Minn., which is and has been for the past 30 years engaged exclusively in the manufacture of coated abrasives, which is sandpaper, scotch adhesive tape, rubber cement, roofing granules, and other related products.

DIFFICULTIES OF SITUATION REALIZED

The management of the Minnesota Mining & Manufacturing Co. realizes the tremendous task of this committee in raising $3,500,000,000 in revenue in the next fiscal year. It is in complete harmony with the defense program, and stands ready to do its part in financing this program.

The House has demonstrated that the $3,500,000,000 can be raised without disturbing the present methods of computing the credit for excess-profits taxes.

HEARINGS BY HOUSE AND SENATE COMMITTEES ON PRESENT METHODS OF COMPUTING CREDIT

The present two methods of computing excess-profits tax credits were embodied in the Second Revenue Act of 1940 after your committee and the House Ways and Means Committee had held hearings and given this matter a great deal of consideration.

The invested capital credit is inapplicable to our company for the reason that the company's average earnings for the base period are in excess of 10 percent of our invested capital for the same period.

TREASURY'S PROPOSAL

Under date of May 19, 1941, the Assistant Secretary of the Treasury, John L. Sullivan, appeared before the House Ways and Means Committee and proposed that the excess-profits tax law be amended so as to eliminate the credit based on average earnings and allow only a credit based on the percentage of the net income to invested capital for the base period, not to exceed 10 percent. As I read his testimony before your committee and that of Secretary Morgenthau, the Treasury Department still advocates this change.

EFFECT ON OUR COMPANY IF TREASURY'S PROPOSAL HAD BEEN IN EFFECT IN 1940

For the year 1940 our gross income before taxes was 25 percent greater than for the year 1939, but our net after taxes increased only 6 percent for the same period. For the year 1940 our income and excess-profits taxes were equal to 32 percent of our gross taxable income, and if the Treasury Department's proposal had been in effect for the year 1940, our taxes would have amounted to 56 percent of our gross taxable income (i. e., net income before Federal income taxes). If in effect in 1937, it would have taken 58 percent of our gross taxable income.

WE ARE A GROWTH COMPANY

While we do not presume to speak for any other company, we feel confident that throughout the Nation there are countless industries in the same situation in which we find ourselves with regard to the Treasury Department's proposal to eliminate the average earnings provision of the excess-profits tax and to base this tax solely on invested capital. One of the inequities of the existing law is the failure to allow an additional credit for growing companies using the average earnings credit. These businesses and industries, like our company, are sincerely and honestly and conscientiously trying to do their bit regardless of whether or not they benefit from the defense program either directly or indirectly. In our case, the invested capital of the company, as shown on our books, does not begin to tell the story of such investment.

REASONS WHY THE INVESTED CAPITAL METHOD IS INEQUITABLE TO OUR COMPANY

Our financial statement does not show as capital investment the millions of dollars we have invested in our business by employing a large staff of laboratory and research workers to develop new products. This phase of our investment is in men not in machinery and buildings and, we submit, is living proof that we recognize the human value in the conduct of business as well as property values. It is an investment of the highest type, which, as we have pointed out, does not appear on our financial statement and would not constitute invested capital within the meaning of the excess-profits-tax law, and could not be used as collateral on which to borrow money. It is an investment when extreme courage was required to invest and reinvest in the development of products which might or might not become useful or salable. Today we employ 139 chemists.

TABLE SHOWING GROWTH OF COMPANY SINCE 1935

I would like to call your attention to a table which appeared in our company's annual report to its stockholders for the year 1940, which is follows:

Year	Income before income and related taxes	Percent increase	Net worth	Number of employees
		Percent		
1935	$2,617,418.66		$6,925,272.33	1,287
1936	3,343,886.53	28	8,155,811.16	1,632
1937	4,444,878.57	33	9,482,958.89	1,724
1938	4,250,417.21	4	11,223,087.10	1,740
1939	5,454,074.25	28	13,281,037.35	2,163
1940	6,823,786.75	25	15,162,800.10	2,675

It will be noted this table shows that, with the exception of 1938, during which year business activities of the country as a whole were considerably below the business activity for the year 1937; our growth and increase in business was steady. I call your attention also to the table which shows the number of employees and the increase in the number of employees which has been steady throughout the period under consideration.

The Minnesota Mining & Manufacturing Co. has operated profitably for a number of years, and we feel that one of the principal reasons for its success has been the constant development of new products and the investment of capital in plant and equipment to produce and market such products. To illustrate, the company has developed a line of new products which are in constant use in many lines of business, and did not replace products already on the market. A great part of our profits result from the expansion in the use of these new products which have found ready acceptance in the homes and industry.

NORMAL INCOME TAXES SHOULD BE DEDUCTED BEFORE COMPUTING EXCESS PROFITS TAXES

The purpose of an excess-profits tax, as expressed by the President and the Congress, was to prevent unjust enrichment and the creation of new "war millionaires" as a result of the defense program. The present act, as passed by the House, results in taxing normal profits at excess-profits rates. If additional revenue, rather than the prevention of unjust enrichment from the defense program, is the objective, it should be sought through other available means.

AMORTIZATION OF WAR FACILITIES

Subsection (l) of section 124 of the Internal Revenue Code as interpreted, requires a taxpayer who is selling supply items to the Federal Government under contract, to obtain a certificate of nonreimbursement in addition to his certificate of necessity, before he is entitled to a deduction for amortization. This was not the intent of the Congress when this law was passed, and, if there is any doubt, it should be corrected in this act.

THE EXCESS PROFITS TAX SHOULD BE COMPUTED UPON A PERCENTAGE IN RELATION TO THE CREDIT AS WELL AS UPON DOLLAR AMOUNTS

This provision was adopted in 1940 by the Senate, but eliminated in conference with the House. The Senate provision contained in the Revenue Act of 1940 should be adopted.

REPEAL OF THE DECLARED EXCESS PROFITS TAX, IF NOT REPEALED AN ANNUAL DECLARATION OF CAPITAL STOCK VALUE

The declared-value capital-stock tax and its companion excess-profits tax should be eliminated, and if this is impossible, the act should be amended so as to permit an annual declaration of capital stock value. It is impossible to predict what the earnings of a corporation for a 3-year period will be, but if your guess is low, you are going to be subject to a penalty, and if your guess is high, you have paid your penalty in advance. This has been true in the past and it is much more so during the present emergency.

CONCLUSION

In conclusion permit me to make the following suggestions:

1. That the present two methods of computing excess-profits credits be retained.
2. That the normal income tax should be deducted in computing excess-profits net income.
3. That subsection (i) of section 124 of the Internal Revenue Code be repealed or clarified so that a taxpayer who has applied for and received a certificate of necessity will not be required to apply for nonreimbursement certificate for each supply contract he has with the Federal Government.
4. That the provision contained in the Revenue Act of 1940 as passed by the Senate, providing that the excess-profits rates be applied to a percentage of the excess-profits credit, or the dollar amounts.
5. The declared excess-profits tax and declared-value capital-stock tax be repealed, or, if not possible, amended so that the capital stock value may be declared annually.
6. That the present act be amended so as to permit the full 100 percent of the average earnings as a credit; that this credit be increased from year to year as is permitted to taxpayers using the invested-capital method.

COPPERWELD STEEL CO.,
Glassport, Pa.

This is a copy of a brief submitted to Assistant Secretary of the Treasury John L. Sullivan and to Mr. Colin F. Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation, on the proposition that the amortization provision (sec. 124 (Code), Revenue Act of 1940) should be amended to provide an effective date of January 1, 1940 (as originally recommended by the Senate committee) rather than the presently effective date of June 10, 1940.

We urge that this statement of our case and brief be incorporated in the record of the Senate Finance Committee hearings for consideration in the present bill and for relief in a highly equitable class of cases. Submitted by Maurice J. Mahoney, assistant treasurer and attorney for Copperweld Steel Co., Glassport, Pa.

STATEMENT OF CASE OF COPPERWELD STEEL CO. FOR AMORTIZATION ALLOWANCES ON DEFENSE FACILITIES BEGUN AND PARTIALLY COMPLETED PRIOR TO JUNE 10, 1940

The following factual summary might well be entitled "the Case History of a Company" that has been harshly penalized for being patriotic—or, in other words, penalized for doing those things which the President of the United States, the Congress, and all informed citizens recognized were vitally necessary for the Nation's defense. The Copperweld Steel Co. in the latter months of 1939 and the first 6 months of 1940 expended approximately $4,000,000 (raised from the sale of new securities) for new plant equipment for the manufacture of high-alloy steels. As soon as production could be attained, these steels were taken directly by the British Government, the United States Government, and domestic corporations manufacturing military aircraft, naval equipment and machine tools, and its output has continued to go approximately 100 percent to these customers.

The company, before putting itself in position to supply these vital requirements, did not await the guarantee of protective legislation for accelerated depreciation or amortization of new equipment for this special purpose, but relied upon the general sense of fair play of the Congress and the executive departments that, at the least, it would not be penalized for having put its affairs in order to supply this country's most vital defense requirements. The resulting penalization and discrimination arises from the fact that the excess-profits-tax laws for 1940 and the provisions allowing amortization for new plant equipment were not made coextensive; that an arbitrary date of June 10, 1940, has been selected as the time for the beginning of our national-defense effort and only those projects literally begun or acquired after that date shall have the benefit of the special amortization provisions as finally enacted by the Congress. Such a result, we submit, penalizes this and other companies similarly situated out of all proportion to the revenue received therefrom and places this class of taxpayers at a distinct financial and economic disadvantage with those companies which awaited a guarantee of protective legislative benefits before expending capital for national defense facilities. All the present applicant seeks is that it, too, may be placed in an equal position with respect to the year 1940 and subsequent years with those corporations which waited without regard to whether it was later than some of us thought.

The relief sought may be granted in either of two simple ways: (1) By legislation amending the amortization provisions to make January 1, 1940, the effective date rather than June 10, 1940, and so make both the accelerated depreciation and excess-profits-tax rates coextensive throughout the year 1940; or (2) by giving the Commissioner of Internal Revenue discretion, in that class of cases where a taxpayer can show that new plant equipment acquired after January 1, 1940, has been used 100 percent for national-defense purposes (or whatever percentage has been used therefor), to give such taxpayers, to the extent warranted, equal treatment with those whose plant equipment was begun or acquired after June 10, 1940.[1]

We emphasize that, in bringing our case to your attention, we are not asking for or thinking in terms of receiving any advantage over companies which did not prepare themselves as we did, but we are asking not to be penalized and discriminated against for having done so.

HISTORY OF STEEL DIVISION DEVELOPMENT

Copperweld Steel Co. was organized August 16, 1915, under the laws of the Commonwealth of Pennsylvania. Since that time it has been engaged principally in the manufacture of copperweld (copper-covered steel) wire, widely used for electrical transmission purposes, with its plant and principal offices at Glassport, Pa. For some time prior to the latter months of 1939, the company's management had under consideration the construction of a small electric-furnace alloy steel mill from which the company's own steel requirements would be supplied. The plan contemplated an expenditure of approximately $1,200,000 to build a mill with an annual ingot capacity of 50,000 tons.

As the weeks moved on it became increasingly apparent that the outbreak of a European war was not only a possibility but rapidly becoming a probability. Progressively this probability became an inevitability. The deluge broke in September 1939. The position of the United States then became clearer. We would have to launch upon a greatly increased armament program for our own defense and, in all probability, serve as a source of supplies for the Allied cause against the Axis Powers.

It was just as widely recognized and remarked upon at this time that the United States was woefully unprepared to adequately defend itself. Our policy became one of remaining uninvolved but supplying the Allies until such time as we could prepare to defend ourselves in any emergency. The Neutrality and Embargo Acts were repealed, British and French purchasing commissions arrived in this country to survey American industrial potentialities and to place orders for all types of war equipment, particularly those involving the use of high-quality alloy steels. And, finally, there was a known shortage of electric-furnace capacity for the manufacture of these steels in the United States.

During the fall of 1939, numerous conferences were had by and between the officers of the company, and the consensus was that there would be an unprecedented demand for the higher quality steels; that all indications pointed to our own Government embarking upon a mammoth defense program. It further was the opinion that prompt action would be necessary for otherwise it would be either impossible or improbable, or both, to obtain the facilities for a steel plant or the services of the experts who could build and operate it.

As indicative in a small way of the trend of thought at around this time the following is offered:

In its report dated August 30, 1939, the Tax Research Institute of America referred to "the recent appointment of the War Resources Board" and discusses the industrial mobilization plan.

In its issue of September 16, 1939, the same publication referred to the President's recent declaration of a limited emergency. In this same report reference is made to the accomplishment of certain national defense objectives. The following statement appears in this report:

"Bear in mind that in the declaration of a 'limited' emergency under the Executive power of the President, he exceeded existing appropriations of Congress by stepping up the size of the Army, Navy, and Marine Corps. It is probable, therefore, that when it becomes desirable to step up procurement of materials, supplies, and munitions for the increased military machine, this, too, will be accomplished under the Executive powers existing in a 'limited' emergency."

[1] Under either method it will probably be necessary to make some provision for extend- time to apply for necessity certificates.

The issue of October 14, 1939, predicts as a certainty the removal of the embargo on munitions and the imposition of a cash-and-carry provision on all goods to belligerents.

On September 8, 1939, the president of the company appeared before the board of directors at a special meeting called for the purpose and recommended that the steel plant be located at Warren, Ohio, instead of Glassport, Pa., notwithstanding the fact that there would have to be a dual management and additional overhead costs. This plan was approved and arrangements made for the purchase of the necessary land at Warren since the available sites at Glassport were too small for the then contemplated expansion.

Under date of September 28, 1939, notices were mailed calling a special meeting of shareholders for November 29, 1939. This meeting was for the purpose of voting upon an increase in the authorized indebtedness of the company from $500,000 to $3,000,000. At this time the planned ingot capacity of the plant had been increased from the original 50,000 tons to 100,000 tons and the planned cost of the facilities was $1,500,000. However, when the proxy statement for this meeting was mailed out, under date of October 31, 1939, the estimated cost had been increased to $1,800,000, which amount appeared in the proxy statement.

At this time it still was the intention to manufacture the company's own steel requirements. Thus, from July to October, inclusive, the contemplated plan was changed from a 50,000-ton mill, with estimated cost of $1,200,000 to a 100,000-ton mill, with estimated cost of $1,800,000. Changes in outlook came almost from day to day, particularly during September and October, with resulting modification of plans. In the following months, however, developments occurred even more rapidly.

Construction of the plant at Warren was begun about November 1, 1939, and proceeded throughout the severest winter experienced by that district in 80 years. As the international situation unfolded from day to day, plans for the steel mill were changed "on the spot." Thus, the company was moving with the times and without awaiting protective legislation as, according to reports appearing in the press, was done by many manufacturers.

In May 1940 the company's president appeared before the executive committee of the board of directors and advised the members that the plant as then contemplated would cost $3,100,000. In the course of his report to the committee, the following statement was made:

"Before any material steps had been taken along the lines indicated (construction of a plant with capacity of 50,000 tons) the European war broke, and with this situation our entire problem changed. In order to insure our own supply of steel, as well as to insure our remaining in business in the event of our entrance into the war, or the mobilization of the productive facilities of the United States for aid to the Allied cause, two things became necessary: First, that construction of the plant be started immediately, and, second, that its melting capacity be increased. In order to attain these objectives, particularly the first, it was necessary for us to adopt an unprecedented course; that is, to begin the construction of a complete steel mill before the plans therefor had been drawn."

Shortly thereafter a letter was addressed to the holder of the company's $2,000,000 mortgage which had been placed against the company's properties in December 1939 in order to raise part of the funds to be used in the construction of the steel plant. In this letter the following statement was made:

"You are advised that, due largely to the outbreak of the European war as well as the prospects for a greatly increased national-defense program, our company altered its original program with respect to the construction of our steel plant at Warren, Ohio. As a result of these changes, the finished plant will cost $3,100,000 instead of $1,800,000 as originally estimated."

Subsequently, this amount was further increased to $3,300,000. In a report prepared by independent engineering experts in connection with a registration statement filed with the Securities and Exchange Commission, after mentioning the original estimated cost of $1,800,000, the following statement appears:

"Subsequently international and domestic developments indicated a substantial increase in the immediate demand for electric-furnace alloy steels and a further study of the market for these steels revealed the desirability of undertaking the production of higher grades and somewhat different types of alloys from those originally contemplated."

And, further:

"Also subsequent to the formation of the original plans, the developments in this country and the war situation abroad emphasized the desirability of enter-

ing production as soon as possible. A special effort was made to accelerate the erection of buildings and equipment and to complete construction as rapidly as possible."

* * * * * * *

"In our opinion, the additional and improved facilities are essential for the operations now contemplated by the company and under the conditions that have developed there has been justification for the speed-up program. We believe that the charges to the plant in the several principal categories of cost such as engineering and supervision, buildings, and equipment have been reasonable. In our opinion, the plant as a whole has been constructed at a reasonable cost and at a favorable one on a comparative basis. This is explained in great part by the company's clever and successful adaptation of used material for a large portion of the building frames and equipment."

Other statements of interest appearing in the engineers' report follows:

"There is an insistent demand for alloy steels for many types of military supplies, including shells, automotive and aircraft parts, and general ordnance requirements. The company's production should be sustained at a very high level as long as the demand for these supplies continues."

* * * * * * *

"It is impossible to predict the character and amount of the business after the cessation of the demand imposed or incidentally occasioned by the war situation and the defense requirements of this country."

After operations were begun it was found that the British Government was unable to procure its urgent requirements for annealed, spherodized, heat-treated and turned steels, the shortage in facilities necessary for the production of these items being the bottleneck in this country's steel producing facilities. Because of this condition, the board authorized increases in capital expenditures to bring the total plant cost to approximately $4,000,000.

Still later the board was advised of the inability to properly take care of domestic requirements with the then existing melting capacity. In view of this fact, an additional $1,000,000 was authorized to be expended for melting equipment and related facilities including additional floor space. Thus the cost of the plant as now authorized is estimated at $5,000,000.

From the foregoing it will be apparent that the plan as originally contemplated in effect has been entirely abandoned. As the international and domestic war and defense requirements clarified our company kept pace, placing its facilities in readiness. What started out to be a mere adjunct to the then-existing plant has been constituted a separate and distinct division, larger in size and in probable future operations than the original plant at Glassport. The reasons which prompted the management to make its recommendation for the construction of the steel plant originally contemplated have disappeared entirely. Plans for diversification of the company's bimetallic products have been tabled, and the company is not manufacturing any substantial part of its own steel requirements and has no present intention of doing so until the emergency period has ended or unless present conditions change materially.

Furthermore, a plant of the size and cost of the one now operating and nearing completion cannot be operated as a mere adjunct to the company's copperweld operations. The company definitely is in the steel business as an independent operator in an independent operation, being one of the five largest producers of electric-furnace steels in the United States.

It is in this position because of foresight with respect to the position which the United States has assumed toward Great Britain and with respect to our own national-defense program. The management was willing to back its judgment by proceeding with the building program heretofore described, confident that the facilities would be required and confident of the company's ability to compete on even terms with others in the field. It failed, however, to take into consideration the possibility that Congress would enact legislation which actually would result in penalizing the aggressive companies and favoring the timid-money ones.

Added emphasis to our unsatisfactory position under the law comes about as follows:

In computing the excess-profits-tax exemption under the average-earnings method, the base figure may be increased by new capital added to the business. New capital, however, is limited to capital raised after January 1, 1940. Hence, none of the capital raised in 1939 and used in the construction of our steel plant is eligible even though this capital was entirely non-income-producing during 1939 and during most of 1940. The effect of this new capital will be reflected when and

if we change to the invested-capital method of computing the excess-profits-tax exemption, which may be in 1941, but the net benefit will be negligable inasmuch as, in so changing methods, we will lose the benefit accruing from the relatively high earnings which we enjoyed during the base period years, i. e., 1936 to 1939, inclusive.

In other words, we are injured in one way or the other. During the base-period years, we established an earning power averaging perhaps 17½ or 18 percent on investment, an achievement attained not by inflation of our selling prices but by highly favorable purchases of many of our fixed assets and conservative policies of the management in matters affecting finances and accounting. This is an excellent record, but if we use the average-earnings method of computing the excess-profits-tax exemption, we lose the right to receive free from excess-profits tax any return on our capital raised in 1939—a total of 4½ million dollars, divided between 2½ million stock and 2 million in bonds. Hence, the effective rate to which we are entitled, taking our present capital into consideration, is very little higher than the 8 percent which the law allows under the invested-capital method.

Thus, while nominally offering alternative methods of computing this exemption, presumably to give at least some relief to businesses situated as ours, the alternatives are practically nonoperative so far as we are concerned. If we elect the one method, we lose the benefit of our 1939 capital additions; if we use the other, we lose the benefit of our favorable earning record. These two items being substantially offsetting, the net benefit is practically nil.

The effect of this is that in computing the exemption for excess-profits-tax purposes we receive only a relatively small amount by virtue of our Warren plant. Glassport business alone, despite the fact that its earning power was established without dependence on any war or defense program, will bring us close to the maximum brackets of tax rates, so that Warren income will be superimposed on the Glassport income and, hence, substantially, will all be taxable at top bracket tax rates. Had the steel division been organized as a separate corporation, the Glassport exemption would not have been greatly reduced, whereas Warren would be entitled to an exemption of four or five hundred thousand dollars, a condition which, alone, would result in a substantial savings in tax.

Unless some relief measure is available, this company will be forced to compete at an unfair disadvantage with companies which either through lack of foresight or sheer unwillingness to make any expenditures until protective legislation was enacted have been the major cause of retardment of the defense program.

If this company is denied the right to amortize at least the major part of the cost of its steel plant, it is respectfully submitted that a grave injustice will be suffered, an injustice so serious that it may jeopardize the continuation of the operations presently carried on and the larger ones which will follow upon the completion of the latest program of expansion, as well as the entire future of the business.

OUTPUT OF NEW STEEL PLANT

The new steel plant went into commercial production on October 1, 1940, manufacturing aircraft quality steels, S. A. E. alloy steels, oxidation-resistant steels, stainless steels, and other alloy steels. From the beginning it has operated on a three-shift, 24-hour day, at 100-percent capacity. Its entire output has been taken on orders direct from the British Government, direct from the United States Government, and by domestic manufacturers who have used these steels practically 100 percent in filling orders for the defense program. These steels have been turned directly into aircraft parts for the United States Army and Navy, aircraft engines, rifle barrels, boiler tubes for battleships and destroyers, munitions, armor-piercing shells, armor plate, many kinds of ordnance equipment, foreign Diesel engines, and machine tools.

Shipments for these accounts were in excess of $3,500,000 through December 31, 1940; for the first 3 months of 1941, $3,265,277; total shipments for the 6 months ending March 31, 1941, aggregate more than $6,765,000.

It will thus be seen that this company was among the first to alleviate the bottleneck in the production of high-alloy steels and has been a real factor in supplying the very essentials so vital for this Nation's defense. Nevertheless, for putting itself into position to do just this, without awaiting a guarantee of protective legislation, the company has been definitely and substantially penalized by the date set in the Second Revenue Act of 1940 as the beginning of this country's defense effort—June 10, 1940.

SUMMARY

Briefly, the entire history may be summarized by the simple statement (which we believe you will find entirely confirmed in the material set forth in the attached paper) that we expanded and diversified our plant from the one originally planned because we anticipated as long ago as September 1939 the exact conditions which now exist. Having so anticipated, the company backed the judgment of its management by authorizing the greatly increased expenditures which were necessary in order for our business to be placed in order and ready to take its place in the field.

All this was done without awaiting any protective legislation because we were confident of the need for the facilities and that if and when an excess-profits-tax law would be enacted Congress would protect the investment of private capital by the inclusion of equitable amortization provisions. This came to pass, but we are one of the unfortunate companies who were left out. The inequity of this is emphasized because we were doing exactly what the administration desired; i. e., speeding up the construction of the defense industries.

In bringing our case to your attention we are not asking for or thinking in terms of receiving any advantage over companies which did not anticipate requirements as we did, but we are asking not to be penalized for having so done.

Even more serious than the competitive disadvantage, which might be dismissed as a relative matter no better or worse than other inequities which necessarily are inherent in any tax legislation, is the absolute disadvantage which is not based on competitive position and which is so serious that it constitutes a very real threat to our ability to survive.

From conditions at present being encountered it may be stated definitely that failure to obtain substantial relief through amortization of facilities constructed prior to June 10, 1940, not only will jeopardize the future of our business but also will jeopardize our ability to continue operations at the level necessary to meet the great demand which has been placed upon us and for the fulfillment of which our plant already is equipped. And this is to say nothing of the larger operation which is scheduled for 1941 and 1942.

Being an entirely new development, the steel division required (and still requires) not only large amounts for capital construction but also for the building up and carrying of very large inventories. In financing this development the cash resources of the business have been drained to the limit. In addition, we already have sold (in 1939) senior securities aggregating $4,500,000 ($2,500,000 in preferred stock and $2,000,000 in first-mortgage bonds) and are borrowing $1,000,000 from banks in order to supply part of the funds required in the steel-division construction and operation. All of this is in addition to 75,000 shares of common stock which were sold in July 1940 for $1,350,000.

The mortgage above referred to is against our Glassport plant as well as the steel plant, which was hardly started when the loan was negotiated. Thus, in order to raise funds necessary for the steel development, we have mortgaged the future of our original business which was firmly established and virtually depression-proof.

Obviously, either the sale of additional securities or the continuation and increase of bank loans will be made much more difficult, if not impossible, if we do not have the protection which is granted by the amortization provisions of the law. If, because of the competitive disadvantage which we must suffer with respect to our steel operation, together with the hazards necessarily attendant upon an expansion in the field of war and defense industry, our future financing must be based entirely on the prospective earnings and assets of our Copperweld division, I can say definitely that we already are considerably overextended and that our position is not a desirable one from the viewpoint of investors or bankers. This is precisely the unfortunate position in which we now find ourselves.

It is impossible to see how provision for the repayment of our existing and possible additional loans can be made and the very large working-capital requirements of the steel division supplied if we have to pay out in taxes the tremendous amounts which will be due if we are not allowed amortization. The ill effect of all of these conditions will be greatly increased, of course, under the proposed higher rates which now are almost certain to be adopted for 1941 and subsequent years and if the amortization period is shortened, as it may be under the provisions of the present act.

RELIEF SOUGHT

This applicant is not asking the benefit of the amortization provision for the amounts originally contemplated to be spent—some $1,200,000—but it definitely believes that the remainder of the expenditures made prior to June 10, 1940, entered into for the foregoing reasons should be treated no differently than the expenditures by those companies who began construction after June 10, 1940. We are asking therefore that the amortization date be set at January 1, 1940, to be effective coextensively with the other revenue provisions for the year 1940.

Respectfully submitted.

COPPERWELD STEEL CO.,
T. G. COUNCILOR,
Assistant to the President.
MAURICE J. MAHONEY,
Assistant Comptroller.

JOHN W. CAFFEY,
Greensboro, N. C., August 21, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR GEORGE: As director of the North Carolina Association for Wine Control and as representative for the producers and growers of grape and fruit products in the Southern States (Virginia, North and South Carolina, Georgia, Florida, and Alabama), I am in constant contact with the conditions relating to the wine industry in this area. You, too, of course, know that Georgia, North Carolina, and Virginia have considerable grape and fruit production. Our soils are particularly adaptable to this phase of agricultural development. I, therefore, feel that the farmers who are interesting themselves thusly ought to be encouraged and this can only be done by holding the wine tax on a reasonable level.

Although the House proposal contained in the 1941 revenue bill provides for a 33⅓ percent increase in wine taxes, I am advised that the wine industry generally is willing to accept this increase, which is corresponding with that provided for on liquor. If there should be a decrease in the liquor rate, of course, we feel that wine should likewise be benefited, and most certainly we feel that no further increase at this time could be made without seriously impairing the normal agricultural expansion in grape and fruit production in the Southern States.

Accordingly, I hope that you will recognize these potentialities, and especially in view of the fact that the industry will not impose upon the committee by requesting a formal hearing.

With high esteem, I have the honor to be,
Sincerely yours,

JOHN W. CAFFEY.

AERONAUTICAL CHAMBER OF COMMERCE OF AMERICA, INC.,
Washington, D. C., August 22, 1941.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: On behalf of its members, including practically all manufacturers of airplanes, airplane engines, and accessories for airplanes in the United States, the Aeronautical Chamber of Commerce of America, Inc., bespeaks consideration by the Senate Finance Committee of the following suggestions in regard to the pending legislation amending the Internal Revenue Code.

CAPITAL STOCK TAX

Under the code every third year, 1938, 1941, 1944, etc., are declaration years for capital-stock tax. Such declarations, with specified adjustments, hold for the 3 years for the purpose of computation of the capital-stock tax and the declared-value excess-profits tax. The Revenue Act of 1939 gave permission for an upward adustment of the declared value at June 1930, and June 30, 1940.

At the present time, due to a blanket extension of time, the corporations are giving consideration to the value to be declared this year. Under the existing law they must do this without knowing whether they will again have the

privilege of increasing such declaration in 1942 and 1943. The result is that they must try to anticipate their earnings for 1941, 1942, and 1943 in the hope that they may make a declaration now that will save them from excessive declared-value excess-profits tax for those years.

Never was there a time when prognostication of earnings was more difficult. Legal restriction of profits, wages increases, price control, and perhaps even inflation are among the clouds on the horizon which make such prediction more uncertain than ever before.

We recommend that this uncertainty be relieved by having the code amended so that upward declarations for 1942 and 1943 will be permitted and that this be made definite before the extended time for filing capital-stock-tax returns has elapsed (September 29, 1941). For the benefit of those who file their returns prior to the enactment of such legislation we recommend a period of 30 days in which to amend.

AMORTIZATION DATE

Under existing law and regulations the cost of emergency facilities, the construction, reconstruction, erection, or installation of which was completed after June 10, 1940, or which were acquired after that date, may be amortized over a period of 5 years.

This provision of the law merely gives recognition to the fact that corporations engaged in furnishing defense products should be permitted to recover out of earnings free of tax the cost of the extra facilities during the period when such products are being produced. Otherwise after the end of the emergency they would still have a large undepreciated balance in their plant account representing property that is not in use or that is economically unable to earn the depreciation. It does not and cannot produce remuneration for such facilities beyond their cost.

The propriety of the amortization principle having been recognized by law it should be made to apply to all facilities acquired, constructed, etc., for the purpose of enabling the contractor to fulfill the greatly increased demand on his capacity caused by the defense program. The President declared a limited emergency on September 8, 1939, and any plant facilities contracted for after that date for the purpose of enabling contractors to meet the needs of the British Government and its allies and of our own defense program should be included in the amortization privilege. This date was used in the draft of the provision but it was changed by the House of Representatives to July 10 (the date the President announced that efforts would be made to allow amortization). The Senate changed the date to January 1, 1940, but the date was compromised to June 10, 1940, in conference.

The effect of using this later date is to reward those contractors who waited for some assurance of amortization while penalizing those who went ahead at once in preparation for the big job ahead.

We therefore recommend that the date be eliminated entirly, relying upon the required certificate of necessity, or that it be made September 8, 1939, instead of June 10, 1940, and that a reasonable time be allowed for application for certificates of necessity in those cases which would be opened up by this change.

CERTIFICATES OF NONREIMBURSEMENT

The situation in regard to certificates of nonreimbursement was very ably presented in a joint letter from the Secretaries of War and Navy to the Speaker of the House under date of July 30, 1941. The amendments suggested in the form of a proposed joint resolution would go a long way toward correcting what now gives promise of becoming a hopeless tangle. Many companies have several hundred, and some perhaps thousands, of contracts which would require clearance, and progress so far indicates little hope that the situation will be under control by the time the bulk of the 1940 income-tax returns will be filed.

It has been suggested that the certificates of nonreimbursement be eliminated and we are in accord with this view. Under existing law and regulations (aside from amortization), the cost of plant, other than land, is recoverable out of gross earnings over the life of the property in determining net income subject to taxation. In normal times this takes the form of straight depreciation. When the life of the property is shortened by longer hours or extra shifts, the rate of depreciation is accelerated. Whether by straight depreciation or accelerated depreciation no certificate of necessity, no certificate of nonreimbursement, and no certificate of Government protection is necessary. Amortization is merely another form of depreciation applied over a shortened period estimated to repre-

sent the term of the defense effort. In no case is the result of this provision a duplication of the return of the cost of the facility. It is simply a permission to charge off the cost during the income-earning period instead of deferring part of the write-off to a later time when there may be no income to charge it against. Regulation, audit, and examination by the Revenue Bureau are sufficient safeguards against double deductions. The certificate of necessity is sufficient requirement for eligibility. Certificates of nonreimbursement should be eliminated.

NEW CORPORATIONS

Under the excess-profits-tax provisions of the laws, corporations which were in existence through the base period 1937 to 1939 have a choice of two methods of computing their excess-profits credit. Corporations formed near the end of the base period have no net earnings basis and are limited to the invested capital basis. Our experience indicates that the net-earnings basis is of material benefit to the older corporations while the struggling new companies are denied this benefit.

It is realized that the adjustment of this inequity is an extremely difficult problem and we know that your committee has given it consideration. Suggestions have been made for (*a*) an extension of the base period to years after 1939 until 3 years' earnings are available; (*b*) for a constructive earnings credit of 10 percent of sales; and perhaps several others.

We do not presume to say what is the best solution but do feel that these new corporations need the encouragement that would flow from some assistance along this line.

We know that these recommendations have been presented by others and have probably been discussed in your hearings. We ask that this letter be placed in the record and be considered in your deliberations on the new revenue bill.

Respectfully yours,

AERONAUTICAL CHAMBER OF COMMERCE OF AMERICA, INC.
JOHN H. JOUETT, *President.*

(Whereupon, at 3:30 p. m., a recess was taken until 10 a. m., Saturday, August 23, 1941.)

REVENUE ACT OF 1941

AUGUST 23, 1941

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

The committee met at 10 a. m., pursuant to adjournment, in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Senator, are you ready to go?

Senator HAYDEN. Yes.

STATEMENT OF HON. CARL HAYDEN, UNITED STATES SENATOR FROM THE STATE OF ARIZONA

Senator HAYDEN. Mr. Chairman, like all other Senators, I have received many communications relative to the revenue bill. A considerable number of them apparently are based upon the idea that nobody wants to pay any more taxes than he is now paying, but there are some special matters which I should like to bring to the attention of the committee.

I am attaching hereto and ask that it be printed in the record of the hearings a statement prepared by Congressman Jack Nichols, of Oklahoma, outlining the effect upon the aviation industry of any increase in the Federal gasoline tax.

Congressman Nichols has been called out of the city, and he therefore asked me to present his views to the committee. I am sure the committee will be interested in observing that in two-thirds of the States either no gasoline tax is collected on aviation fuel or the tax, when collected, is refunded. Since the proceeds of gasoline taxes are used primarily for the construction of highways, it would seem perfectly logical that the proceeds of a tax on aviation gasoline, if collected, should be used to assist in the construction of commercial airports.

He points out that in a great majority of States there is no tax on aviation gasoline, because the theory of the tax is that it is applied to roads; that the present payment of the gasoline tax by the commercial air lines, amounts to more than $1,000,000 a year, that the increase would tax them about $750,000 a year more, and that the effect would be a tax of about 1½ cents per mile flown on the air lines. Congressman Nichols also states that private flyers last year paid about $350,000 in gasoline tax, and that this would make their gasoline tax amount to more than a half million dollars.

I ask that Mr. Nichols' statement be included in the record.
The Chairman. We will be pleased to have it included.
(The statement referred to is as follows:)

STATEMENT OF HON. JACK NICHOLS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Aviation and the gasoline tax.—Despite a 27-percent increase in traffic, the commercial air lines suffered a deficit of more than $2,000,000 for the first quarter of 1941, according to Brooks Earnings Indicator, Inc., which analyzed the revenue statements of 15 major air-line companies. The loss was attributed to a rise in operating expenses, together with an increase in scheduled flights. Now it is proposed to increase further the Federal tax on gasoline, which would raise the operating costs of aircraft still higher and thereby plunge the commercial air lines into greater financial difficulties.

During 1940 the scheduled air carriers consumed 74,535,000 gallons of gasoline and 1,288,000 gallons of lubricating oil, according to the reports of the Civil Aeronautics Administration. All of this gasoline and lubricating oil was subject to the Federal levies and the cost of both items was increased by the amount of the tax. For the first half of the year, the air lines were paying operating taxes on gasoline and lubricating oil to the Federal Government at the rate of about $800,000 annually. With the enactment of the Revenue Act of 1940, which raised the levy on gasoline from 1 cent to 1½ cents a gallon and that on lubricating oil from 4 cents to 4½ cents a gallon, the air lines were forced to pay an additional $376,000 annually. As a result, they now are paying Federal taxes on these two operating items at the rate of $1,176,000 each year.

If the proposed increase from 1½ cents to 2½ cents a gallon is enacted, the scheduled air carriers will have to pay another $745,000 annually. On the basis of the 1940 consumption, this would bring their Federal payments on gasoline and lubricating oil up to $1,921,000. Actually, the tax burden upon commercial air lines would run well over $2,000,000 per year because of the increase in scheduled flights during the current year.

It has been estimated that the average commercial airship consumes approximately 90 gallons of gasoline per hour and travels about 155 miles in that period. The mileage rate, therefore, is about 1.7 miles to the gallon. At the present time, the Federal Government is collecting a tax on gasoline at the rate of 1½ cents per gallon so that the tax rate now being imposed on air operation is close to a cent a mile.

If the Federal tax on gasoline is increased to 2½ cents per gallon, it will correspond to a mileage tax on air transportation of 1½ cents per mile.

Even at the present rates, air travel is paying much higher mileage taxes than any other medium of transportation.

The tremendous efforts of the Civil Aeronautics Administration in its civilian pilot-training program has brought about an expansion of private flying which even in an accelerating field such as aviation is nothing short of remarkable. Two years ago there were about 25,000 civilian pilots in the United States. Today there are more than 100,000. The importance of the civilian-pilot-training program in the defense effort and the urgent need for trained pilots not only for the military and naval air forces but also for ferrying airships, testing planes, and other defense activities was acknowledged by Congress only a few months ago in its appropriation of $25,000,000 for civilian pilot training.

In order for this program to be effective, those pilots who have completed the training courses together with the flying students in the 900 training centers throughout he country must fly a prescribed number of hours to retain or to obtain their licenses. An indication of the effect which this program has had upon private flying operations may be obtained from the mileage reports of the Civil Aeronautics Administration. Last year private operators flew a total of 264,000,000 miles as compared with 178,000,000 miles during 1939, an increase of almost 50 percent.

During the present year, it reasonably may be expected that private flying operations will increase by a corresponding percentage, provided of course that no deterrents are raised, such as increased costs of operation, which would tend to discourage private airplane usage.

Last year, private flyers used 22,400,000 gallons of gasoline and 660,000 gallons of lubricating oil. At the present rates of Federal taxation on these two operating commodities, they now are paying $366,000 annually into the Federal

Treasury. This figure is low, really, for it does not take into account the increase in private flying operations during the current year; more than likely, their tax payments will run over a half million dollars.

If the Federal gasoline tax is raised, the tax burden upon private pilots will be increased by approximately $250,000 per year. In view of the expensive program which the Federal Government already has undertaken to train civilian pilots and to encourage private flying, it hardly seems wise or consistent to exact such a penalty upon their operations. For certainly an increased tax upon plane operation will tend to discourage flying. Not only would an increase in the gasoline tax be contrary to the established intentions of Congress to develop an adequate reservoir of pilots for national defense, but it also would render useless some of the training that already has been given for this purpose by making it more difficult for civilian pilots to obtain their necessary hours in the air.

The present Federal tax of 1½ cents a gallon on aviation fuel is equivalent to a sales tax of 10 percent. When viewed in the light of the resistance which generally is expressed toward a 2 or 3 percent sales tax on other necessary commodities, this levy is outrageous. Yet it is proposed to increase the tax on this necessity to 2½ cents per gallon, which would correspond to a sales tax of approximately 17 percent.

Every State in the Union, and the District of Columbia as well, is now collecting a tax on motor fuel at rates ranging from 2 cents to 7 cents per gallon. Recognizing, however, that the aircraft operator does not derive any special benefits from such taxes as does the highway user in the way of improved roads, some two-thirds of the States either refund the tax on gasoline which is used in aircraft or exempt aviation fuel entirely. Of the 18 States that levy a tax upon gasoline used in aviation, 8 have tax rates which are lower than those on motor fuel.

This is tangible recognition of the impropriety of levying a tax upon gasoline used in the propulsion of aircraft.

The gasoline tax was originated as a highway use tax to pay for the improvement and repair of roads, and, with some minor exceptions, it always has been used for that purpose in the States. Since the need for highway improvements is the only justification for levying a tax on gasoline, it should be reserved for the States and devoted to that purpose. Furthermore, the air carriers should not be made subject to it inasmuch as they do not reap any of the benefits that result from highway improvements.

If, in the development of aviation, it had turned out coal or wood was a more efficient fuel than gasoline to propel airplanes, there would have been no necessity for any distinction in aviation usage and no need for the exemption and refund provisions in the States' gasoline tax laws. Nor would the Federal Government now be levying a tax of almost 1 cent per mile on plane operation, because Congress has never placed any such levies on coal, wood, or any other fuel used in transportation.

It seems most unfair, therefore, that the scheduled air carriers should be forced to pay, as they now are paying, $1,176,000 per year and threatened with another $745,000 tax charge in the current proposal to increase the gasoline levy, simply because the fuel which they use is a petroleum liquid similar to that used in highway transportation.

TAX ON BOTTLED SOFT DRINKS

Senator HAYDEN. The next matter I want to bring to your attention is that of the one-sixth of a cent per bottle tax on soft drinks. We have a peculiar situation in Arizona, because of the large grapefruit crop, for which there has not been an adequate market. In the past few years between 4,500 and 5,000 tons, or between 40 and 50 percent of the tree crop, has been handled each year by the Desert Citrus Products Association of Arizona, which uses the grapefruit surplus to make a soft drink. The association claims their profits have been very, very small, and that this tax would seriously affect them.

I have also received a number of general protests against the one-sixth cent bottle tax on soft drinks made to retail at not more than 10 cents. From the statements which have been made to me, it would appear that bottling companies will find it difficult, if not impossible, to pass this tax on to the consumer, and that many of the smaller companies will be forced to go out of business, if one-sixth of a cent per bottle is added to the cost of their product.

I attach hereto and ask that they be made a part of the record informative statements submitted to me by individuals who are in a position to know the actual effect of this tax proposal.

Senate LA FOLLETTE. Is the grapefruit drink carbonated?

Senator HAYDEN. Yes; it is a carbonated drink.

The CHAIRMAN. That is a tax on carbonic acid gas, and the carbonated water. This drink that you are referring to, that is not a still drink, that is a live drink?

Senator HAYDEN. Yes; to make it palatable the grapefruit juice is mixed with carbonated water. That is the way they dispose of the grapefruit surplus.

(The letters referred to are as follows:)

DESERT CITRUS PRODUCTS ASSOCIATION,
Tempe, Ariz., May 28, 1941.

Hon. CARL HAYDEN,
United States Senator, Washington, D. C.

DEAR SIR: As we understand it there will come before the House of Representatives and the Senate, in connection with the new tax structure, a bill providing for, according to the information we have, a 1-cent tax on so-called soft beverages.

Our association is owned by approximately 600 grapefruit growers in the State of Arizona and our function is to process and sell such surplus tonnage of grapefruit as our members are unable to sell through fresh-fruit sales channels. I might add that due to general economic conditions that have prevailed for some years past that our association has been called upon to handle between 40 and 50 percent of the tree crop of our members.

In connection with our efforts we have helped to develop the introduction of grapefruit carbonated beverages which you can realibze is an independent outlet for the fruit used and can hardly be considered as offering any competition to the sale of fresh grapefruit. Such being the case, this from the growers' point of view, is highly desirable business.

The surplus of grapefruit in our State has been so large that additional help has been asked for and received through the Federal Surplus Commodities Corporation, and I know we have had your support in this regard, but I must mention it to bring out the point that in order to move the growers' total crop all possible outlets must be utilized.

It is our opinion that the soft beverage industry expects, and is willing to be taxed, but as to the amount of the tax the industry is unanimous in their thoughts that 1 cent per bottle will very likely fail to produce as much revenue as some lesser tax that could be absorbed by all interested handlers, thereby keeping the price to the consumer at its present general level of 5 cents.

We have been in close contact with the manufacturer that we are selling grapefruit juice that finds its way into the beverage industry, and we have been told that there is a strong likelihood that if the 1-cent tax is assessed, the volume of grapefruit juice we can expect to sell to them in the future will be very greatly reduced, and we can quite clearly agree on that point.

This matter concerns our growers in a rather vital manner, because the volume of grapefruit that we are selling through these channels has now reached the point of from 3,500 to 5,000 tons per year. I can safely state that if this above tonnage, or any considerable portion of it, would have to be diverted to either the fresh fruit sales channels or our canned juice outlets that additional burdens would be put on us that could only result in increased difficulty in handling the growers' crops.

We respectfully submit all the above to you for your careful consideration. Kindly understand that we, your fellow citizens of the State of Arizona, expect

and will gladly bear our share of all taxes that it is found necessary to levy in the defense of our country, but we do feel that careful consideration of this beverage tax will probably reveal that the Treasury will be benefited to the same extent by some lesser tax that would not disturb the volume of consumption.

Respectfully yours,

DESERT CITRUS PRODUCTS ASSOCIATION,
E. J. KITTERMAN, *Manager.*

HOUSE OF REPRESENTATIVES, STATE OF ARIZONA,
Phoenix, Ariz., May 31, 1941.

HON. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR: The excise tax proposal submitted by the Assistant Secretary of the Treasury calls for the imposition of 1 cent per bottle on soft drinks.

Please let me call your attention to a few facts of which I would appreciate your consideration.

The bottled soft drink industry recognizes its patriotic duty of participating in the national revenue-raising problems, and submits that it is ready and willing to bear its share of such burden, distributed equitably, and in recognition of the vital and equal interest of all industries and all consumers in the preservation of the American way of life.

Soft drinks are recognized as wholesome foods, consumed largely by young people and wage earners of low income. As the proposed tax is many times the margin of earnings of both the bottler and the retailer, the sales tax would have to be passed on to the consumer by an increase in the retail price. Experience has proven that, when in competition with other 5-cent items, an added cent or two to a bottle of soft drinks will greatly curtail the sales, thus reducing the volume produced and all activities connected with the industry, which is primarily a local business, employing local labor, paying local taxes, and otherwise participating in the general economic life of the community.

It is my opinion that with other nickel items available (as the case would be with only a 5-percent tax added to them), soft drinks at a higher retail price would suffer 40-percent loss in volume. This would close 35 percent of the bottling plants in the Nation, throw out of employment 60 percent of the workers, stop the sale of thousands of trucks, millions of gallons of gasoline, and basic ingredients normally used in the production of this valuable food product.

Candy bars, ice-cream cones, and soda fountains are the greatest competitors to the bottled soft drink; they can regulate the size of their package to meet the 5-percent increase in cost and still sell for 5 cents while the bottlers have millions of dollars invested in bottles which cannot be replaced with smaller ones to meet the added taxes. The bottler must absorb the entire tax and try to pass it on with an increase in the sale price, taking the bottled beverage out of the 5-cent class. The upheaval to the industry would be disastrous, not only to the bottlers but to the allied industries.

Many bottlers, including myself, have built their businesses upon confidence of protection, not destruction, from the United States Government. We have invested our life earnings in the business; if it is to be wiped out with this tax there is no alternative but the relief rolls.

Previous special levies on soft drinks have been characterized by the Secretary of the Treasury as "difficult to administer and widely evaded," justifying their repeal as "relatively unproductive and unnecessarily vexatious."

Thanking you in advance for anything you can do to equalize this excise tax bill before final passage, and with best wishes for your personal success,

Yours very truly,

W. W. MITCHELL.

CRYSTAL ICE & FUEL CO.,
Prescott, Ariz., August 11, 1941.

Hon. CARL HAYDEN,
United States Senator from Arizona,
Senate Office Building, Washington, D. C.

DEAR SENATOR HAYDEN: As one of the large number of soda-water bottlers doing a relatively small business, I wish to urge that you protest vigorously the special tax of one-sixth cent per bottle now before the Senate.

It is impossible to pass this tax on the consumer. One-sixth cent per bottle is 4 cents per case of 24 bottles and is by far the major part of our net profit. If we have to pay this, it is doubtful that we can continue in the bottling business.

A tax of this amount would not leave sufficient gross profit to take care of bottle replacement to say nothing of equipment. We already have had substantial raises in material costs on top of several special levies.

Soda water is classed as a food product. This, therefore, seems discriminatory as I understand no other food product is incorporated in the bill.

Please do your utmost to help us. We definitely want to pay our part of any defense program but feel that the one-sixth-cent-per-bottle tax would be an unequal burden on us.

Sincerely,

KENYON TRENGOVE, *Manager.*

TAX ON AUTOMOBILES AND TRUCKS

Senator HAYDEN. Another complaint comes from the Mexican border. The automobile dealers there think their business will be utterly ruined unless the excise tax on automobiles manufactured for export equals the excise tax on cars made to sell in the United States.

Section 544 of the revenue bill increases the rates of taxes on automobile and truck bodies. The automobile dealer of Arizona does not protest against increased taxes on automobiles and parts, because he fully realizes that that industry must, along with all others, bear the burden of higher taxes in the emergency. Dealers have, however, presented to me a serious problem which results from increasing the excise taxes upon automobiles manufactured for sale in this country, without at the same time making a proportionate increase in the excise taxes on automobiles manufactured for export.

A substantial part of the retail business of automobile sales along the Mexican border comes from sales to individuals living in the northern part of the Republic of Mexico. If the taxes on cars manufactured for domestic sale make the domestic price materially higher than the price for the same automobile sold at retail by the Mexican distributor, Arizona automobile dealers face a serious curtailment in volume of their business.

The situation is particularly well illustrated in the two cities of Nogales, Ariz., and Nogales, Sonora. The population of Nogales, Sonora, is 3½ to 4 times as large as the population of Nogales, Ariz., but the business houses on the American side of the line furnish staple goods of all sorts to the residents of both cities, and American business firms have, through the years, beeen expanded to cater to a volume of trade 3½ to 4 times as large as the normal volume of trade that would be expected in a city of the size of Nogales, Ariz.

It is obvious that, unless the tax rate upon automobiles manufactured for domestic sale is equalized with the rate upon automobiles manufactured for export, American automobile firms in Nogales and other similar points along the Mexican border will be seriously and adversely affected. I am attaching hereto and ask that they be printed in the record certain letters I have received outlining this situation. I am sure the committee will give very sympathetic attention to these facts.

The CHAIRMAN. Yes, sir; that may be done.

(The letters referred to are as follows:)

AUTOMOBILE DEALERS ASSOCIATION,
Phoenix, Ariz., May 22, 1941.

Hon. CARL HAYDEN,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR CARL: The officers and directors of this association wish to call to your attention the very serious situation in which all automobile dealers on the Mexican border will be placed if there is any increase in the existing excise tax on automobiles and parts without a similar tax being levied on the same merchandise exported to Mexico or without some provision whereby any excise tax collected on automobiles or parts shall be refunded when and if such merchandise is exported.

Inasmuch as the existing excise tax and any increases that may be made in same are, or should be, primarily to provide revenue for defense, it would seem fair and logical to impose an equal tax on all merchandise of the same character that is exported. If this is not done, residents of foreign countries are being accorded the privilege of reduced prices which, in the final analysis, are made possible only by sacrifices of the American people.

At present, we are reliably informed, a very substantial percent of the business of automobile dealers in Nogales and Douglas consists of sales to residents of Mexico, amounting in some instances to more than 40 or even 50 percent of total volume. If any increase is made in the existing excise tax imposed upon the manufacture of automobiles for sale or use in the United States without a similar levy being imposed on the same class of merchandise for export, it will be virtually impossible for dealers located on the Mexican border to continue in business. We hope you will give this situation your earnest consideration.

It is our observation that all the automobile dealers as well as all the other citizens of Arizona are willing and anxious to pay their share of the defense program, but are vigorously opposed to grossly discriminatory and unfair taxes which will restrict and impede essential highway transportation at the very time when it is most vital to the welfare of the Nation.

Sincerely yours,

ARIZONA AUTOMOBILE DEALERS ASSOCIATION,
HENRI BEHOTEGUY, *Manager.*

[Telegram]

NOGALES, ARIZ., *June 5, 1941.*

United States Senator CARL HAYDEN,
Washington, D. C.:

May we urgently request that you personally do everything possible to impose the new excise defense tax on automobiles built for export as well as domestic use; unless this applies to Mexican export business all border dealers will be penalized to a point where they will be unable to continue operations and, therefore, create an unemployment problem which, in Nogales alone would mean at least 200 people. Kindly keep us posted through the Arizona Dealers Association of Phoenix as to any developments concerning this matter and please be advised that we are vitally interested and concerned regarding the ultimate outcome of this matter.

Very truly yours,

BUCKHORN AUTO SALES. J. F. JOHNSON.
JOHN ELIAS MOTORS. JOHN ELIAS.
BOICE MOTOR CO., J. H. BARBEE.
SANTA CRUZ COUNTY CHAMBER OF COMMERCE, DON SMITH, *Secretary.*
JACKSON MOTOR CO., J. A. JACKSON.
SAXON MOTOR CO., A. E. SAXON.
CHESHIRE MOTOR CO., ROY V. CHESHIRE.

CHARLES G. BOICE,
Nogales, Ariz., July 31, 1941.

Hon. Senator CARL HAYDEN,
Washington, D. C.

DEAR MR. HAYDEN: We have been informed by the Arizona Automobile Dealers Association that the new excise tax is soon to be placed before the Finance Committee for debate.

Since we are located along the Mexican border, you can readily see how we will be affected should this tax not apply for export business. As you already know, all cars built for export carry a 10-percent export discount, which alone puts us to an extreme disadvantage. Should the Mexican dealers get exemption on the new excise tax it would be impossible for us to do business competitively, as they would have an additional 7-percent advantage.

Our export business in the last 12 months runs a little over $60,000, and if we are deprived of this volume due to the present tax question, it will be impossible for us to continue operating in this district. Every car dealer along the Mexican border is confronted with the same problem and we are all vitally interested in the ultimate outcome.

We know you will represent us to the very best of your ability, and feel sure that by properly explaining the border situation, that we will receive the necessary protection from the standpoint of an American merchant doing business in the good old United States of America.

Yours very truly,

CHAS. G. BOICE,
J. H. BARBEE, *Manager.*

CHESHIRE MOTOR CO.,
Nogales, Ariz., August 1, 1941.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

MY DEAR SENATOR: Due to the writer's absence from the city, I was unable to get the information to you about our sales south of the border that Mr. Henri Behoteguy, of the Arizona Automobile Association, requested that I send you.

I have gone back over our records for the calendar years of 1937, 1938, 1939, and 1940, and find that we delivered in old Mexico from Nogales, Ariz., 184 new cars and trucks during those 4 calendar years. The total volume for our establishment was $185,000.

We, of course, feel that this business would be lost to us if the excise tax is not included on cars manufactured and shipped to Mexico.

Trusting that this is the information you desire and assuring you of our deep appreciation for what you are attempting to do for car dealers along the border, and with sincere personal regards, we are,

Yours very truly,

CHESHIRE MOTOR CO.,
C. C. CHESHIRE, *President.*

Senator BROWN. Does not the Mexican Government collect a tax?

Senator HAYDEN. Yes. That is paid anyhow. Mexico has a regular import duty which a man buying the automobile in the United States must pay if he takes it into Mexico, but if our domestic excise tax is higher than the export excise tax plus the Mexican tariff rate, the Mexican living along the border will simply not buy his car in the United States.

TAX ON TOILET PREPARATIONS

Another item that I want to bring to your attention is that section 553 of the revenue bill, as passed by the House of Representatives, imposes a 10 percent tax on the retail sales of toilet preparations and requires that beauty parlors and barber shops shall make monthly returns of toilet preparations used in the treatment of patrons and consider the total quantity used during any such month as though it had been sold at retail. It would appear to me that this latter provision

would be difficult, if not impossible, to administer and I believe that the attached protest of Miss Marjory Ricks, of the Tucson Hair Dressers Association, Local 106 of the National Hair Dressers Association, is entirely justified.

I am sure the committee will be glad to give sympathetic consideration to the statement of Miss Ricks.

(The telegram referred to is as follows:)

TUCSON, ARIZ., *August 10, 1941.*

Senator HAYDEN,
United States Senate,
Washington, D. C.:

Calling your attention to House bill 5417. The adoption of section 2404 (b) would inflict a serious hardship on our industry since the use of cosmetic items is merely an incident to our work, revenue being derived almost entirely from the services rendered. A 10-percent tax on the retail price of goods consumed, therefore, would be entirely disproportionate. We wish to call your attention to a previous bill passed in 1929, still in effect, taxing the manufacturer 10 percent.

TUCSON HAIR DRESSERS ASSOCIATION,
LOCAL 106 OF NATIONAL HAIR DRESSERS.

Senator HAYDEN. Paragraph (b) of this section, to which attention is drawn in the telegram as being wholly unworkable, provides:

(b) *Beauty parlors, and so forth.*—For the purposes of subsection (a), if any person operating a barber shop, beauty parlor, or similar establishment, uses any article described in subsection (a) in the treatment of any customer or patron, the total amount so used during any month shall be considered as sold at retail by such person during such month, and the fair retail price of such amount, as determined by the Commissioner, shall be considered to be the price at which so sold.

There is now a 10-percent tax on the preparation itself when manufactured, and you could, without difficulty, add a 10-percent tax on the retail sale of the preparation if sold by the bottle, but how can you enforce a provision requiring the barber or the lady who keeps the beauty parlor to look at the bottle at the end of the month and to tell the revenue agent how much was used during the month and how much tax should be paid? I think you ought to turn this matter over to the experts and see if you are not causing some confusion.

Senator TAFT. If the barber charged 35 cents for the haircut and 10 cents for putting something on, that is 10 cents, no matter how much the bottle cost.

Senator HAYDEN. It says, "The total amount so used during the month." If a barber uses some of Ed Pinaud's hair tonic on my hair—you notice my absence of hair—and I happen to be the only customer upon whose hair that product is used during the month, the barber must calculate the exact amount I used. Maybe he can allow a little for evaporation in the bottle; I don't know.

Senator BROWN. I am afraid he would consume the whole bottle.

TAX ON OUTDOOR ADVERTISING

Senator HAYDEN. With reference to section 557 of the proposed Revenue Act of 1941, I am in receipt of various protests against the imposition of tax upon outdoor advertising, and I am attaching hereto for the information and attention of the committee certain telegrams from organizations in Phoenix, Ariz., which I ask be incorporated into the record. I am sure the Senate Committee on Finance has no desire

to discriminate against any legitimate industry, and I therefore direct your particular attention to the telegrams I attach hereto.

(The telegrams referred to are as follows:)

PHOENIX, ARIZ., *August 5, 1941.*

Senator CARL HAYDEN,
Care United States Senate, Washington, D. C.:

The House general tax bill includes special tax on outdoor advertising signs which is an unfair attack on our livelihood and would no doubt curtail work for us. We will appreciate your influence toward eliminating this special tax from the bill before final passage.

SIGN & PICTORIAL PAINTERS LOCAL UNION,
F. L. JAMES, *President.*

PHOENIX, ARIZ., *August 5, 1941.*

Senator CARL HAYDEN,
Care United States Senate, Washington, D. C.:

The House general tax bill now before the Senate proposes a special tax on outdoor signs which we feel will place a serious curtailment on outdoor advertising causing serious reduction in labor. It seems unfair to single out one advertising medium for special tax and we earnestly solicit your support to eliminate this unjust tax from the general tax bill.

LOCAL 120, INTERNATIONAL BILL POSTERS AND BILLERS,
T. J. MERRIGAN,

PHOENIX, ARIZ., *August 6, 1941.*

Senator CARL HAYDEN,
Care United States Senate, Washington, D. C.:

Special tax on billboards in general tax bill will curtail labor in that industry and we will appreciate sincerely your efforts to remove this unfair tax from the bill.

A. E. WILLIAMS,
President, Phoenix Building Trades Council,
M. C. LEDBETTER.
President, Central Labor Council,
O. H. JOHNSON,
Editor and Business Manager, Phoenix Labor Press,
JACK PRICE,
Secretary-Treasurer, District Council of Carpenters,
HERBERT R. JOHNSON,
Business Agent, Painters and Decorators Local 86,
JOHN C. PHILLIPS,
Business Agent, Roofers Local Union 135.

PHOENIX, ARIZ., *August 5, 1941.*

Senator CARL HAYDEN,
Care United States Senate, Washington, D. C.:

We are definitely behind our national-defense program and appreciate that the cost must be met by taxation, yet we feel that the proposed billboard tax as now set up by the House Ways and Means Committee in the general tax bill is unfair to our industry and is further unfair in that it proposes to tax only one or two advertising media instead of including all advertising media. Our national association advise they feel the ultimate revenue to be derived from this tax would not be over $2,000,000 instead of the $7,000,000 originally estimated, and the cost of collection, field checking, and so forth, would consume the major portion of the gross income. We also feel that outdoor advertising as a recognized national sales facility should not be penalized by a special tax over and above the regular income-tax corporation taxes, etc., which we will be called upon to pay. If this confiscatory and discriminatory proposal is enacted into law, it will not only affect the owners and operators of outdoor advertising plants but

through curtailment will materially reduce property owners' income for sign rental and will also seriously handicap highly skilled labor, which makes it very doubtful that this proposed special tax will be of any assistance whatever to our national program. Kind regards.

OUTDOOR ADVERTISING ASSOCIATION OF ARIZONA,
AL N. ZELLMER, *Secretary.*

TAX ON JEWELRY

Senator HAYDEN. Section 553 of the Revenue Act of 1941, as passed by the House of Representatives, imposes a tax of 10 percent of the retail sales' price of jewelry, including clocks, watches, flatware, and hollowware, made of gold or silver, or plated.

The jewelers of Arizona do not ask that this tax be eliminated, because they realize that all persons and all industries must bear an increased burden of taxation, but the attached telegrams, which I ask be made a part of the record, point out that jewelry already bears a 2-percent tax in the State of Arizona, and urge that a Federal rate of 5 percent be adopted.

Inasmuch as a 5-percent rate was imposed by the Federal Government during the World War, it would appear that this protest is justified and reasonable, and I shall appreciate your giving it your very careful consideration.

(The telegrams referred to are as follows:)

PHOENIX, ARIZ., *August 12, 1941.*

Senator CARL HAYDEN,
Senate Office Building, Washington, D. C.:

Could you use influence to modify proposed jewelry tax? Ten percent exorbitant; already have 2-percent State sales tax. Many jewelry commodities are essential, therefore why discriminate against jewelry industry? Five-percent tax appears ample and fair. Thank you for your attention.

FUNK JEWELRY CO.

BISBEE, ARIZ., *August 11, 1941.*

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.:

We are opposed to a 10-percent tax on jewelry if jewelry is to be taxed. We recommend a levy on 5 percent or less; 10 is too much and will hurt our business. Will appreciate your effort in behalf of a levy of 5 or less.

L. L. GILMAN JEWELRY.

BISBEE, ARIZ., *August 11, 1941.*

United States Senator CARL HAYDEN,
Washington, D. C.:

If it is decided to retain a tax on jewelry sales, we are earnestly soliciting your support in securing a rate not to exceed 5 percent. We feel that 10 percent would greatly reduce sales and injure our business. Anything you can do will be greatly appreciated.

L. R. BREHM.

PHOENIX, ARIZ., *August 12, 1941.*

Senator CARL HAYDEN,
Senate Office Building, Washington, D. C.:

Appreciate your influence to modify proposed jewelry tax. Heavy 10 percent bad for us because already have 2 percent State sales tax; 80 percent our business watches, clocks, definite necessities. Diamonds practical necessity in marriages; silverware necessity, so why penalize jewelry stores and let dime

stores sell inferior substitutes? Fountain pens and many other items just as much necessity as many clothes and household items. Prohibitive tax will cause evasions; income taxes will reduce purchases of our best customers if our business suffers because double taxing then possible tax revenue falls; higher priced clothing, electrical products, furniture can be classified as luxuries, so why single out jewelry? We think general sales tax on all business is fair, otherwise certainly jewelry tax should not be more than 5 percent to avoid wrecking a business that is vital in national welfare. Can you help bring about this fair arrangement?

FRANK SEIGLEY.

TAX ON RADIO BROADCASTING

Senator HAYDEN. The committee has, I know, heard considerable testimony respecting the proposed tax on net time sales of radio broadcasting stations and networks as contained in section 601 of the Revenue Act.

As expressed in the attached telegram from the Gila Broadcasting Co., of Safford, Ariz., this tax would appear to be discriminatory, since it is not applied equally to other advertising media. I hope the committee will give very careful attention to the statement of the Gila Broadcasting Co., which I ask to be made a part of the record.

(The telegram referred to is as follows:)

SAFFORD, ARIZ., *July 27, 1941.*

Hon. CARL HAYDEN,
United States Senator from Arizona,
Washington, D. C.:

With other members of the National Association of Broadcasters this company feels that the defense-tax bill in its present form taxing radio and billboard and excluding other advertising media is discriminatory. While taxable amount of net sales in bill excludes this company we feel that singling out radio and billboard advertising for defense tax is wrong in principle and solicit your valuable aid in formulating tax bill placing burden equally on all forms of advertising. With sincere regards.

GILA BROADCASTING CO.,
L. F. LONG, *President.*

TAX ON REFRIGERATORS

Senator HAYDEN. Section 546 of the revenue bill, as passed by the House of Representatives, amends section 3405 of the Internal Revenue Code, to increase to 10 percent the tax now imposed upon the manufacture of household type mechanical refrigerators and makes a new tax applicable to commercial types of refrigerators, including ice-cream cabinets, food and beverage display cases, water coolers, and milk-cooler cabinets.

I attach a letter from Mr. F. E. Samuels, of Phoenix, Ariz., protesting against this tax imposition, and I hope that the committee will give most careful consideration to his statements.

(The letter referred to is as follows:)

FRANK SAMUELS DISTRIBUTING CO.,
Phoenix, Ariz., August 8, 1941.

Hon. CARL HAYDEN,
United States Senate, Washington, D. C.

DEAR SENATOR: My attention has just been called to the proposal for instituting a 10-percent excise tax on commercial refrigerators, refrigeration, milk coolers, etc., and I wish to add my protest to the including of such items in the new tax bill which is pending in Congress.

I am sure you will agree with me that refrigerators and refrigeration are not luxuries in the State of Arizona but are absolute necessities in the handling of perishable foods. I am sure it would work a hardship on a great many of your constituents should these items be included on the tax bill, and I think this item is worthy of your very careful consideration, and I hope you will materially assist in the rejection of this unjust tax, which action will certainly be appreciated by everyone handling perishable foods.

With kindest regards, I am,

Yours very truly,

F. E. SAMUELS.

Senator HAYDEN. There may be another item I shall want to bring to the attention of the committee on Monday that relates to copper. I hope by that time the Treasury will have completed its study of the proposal.

That is all I care to say this morning, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Mr. Shipley.

(No response.)

The CHAIRMAN. Mr. Bean.

STATEMENT OF D. D. BEAN, D. D. BEAN & SONS CO., EAST JAFFREY, N. H.

The CHAIRMAN. Mr. Bean, will you give your name and for whom you appear?

Mr. BEAN. My name is D. D. Bean. I represent our own company, the D. D. Bean & Sons Co.

The CHAIRMAN. You are down on the match tax?

Mr. BEAN. I am down on the match tax.

The CHAIRMAN. We have not had anyone on that yet.

Mr. BEAN. I understood that there was someone down here.

The CHAIRMAN. I do not recall. There might have been something said about matches.

Mr. BEAN. You are not going to have a tremendous one this time, but I am sure I am here because I feel it is mighty important to our little company.

The CHAIRMAN. The Retail Association witness made some mention of matches.

Mr. BEAN. Mr. Chairman, may I thank you for this opportunity to appear before you for the purpose of submitting this information which, I trust, outlines the very unhappy situation in which book-match manufacturers find themselves as a result of the proposed legislation levying a tax of $1 per case, which is 33 percent of the manufacturers' price.

As an individual book-match manufacturer, I believe, of course, that the subject under discussion vitally affects my own business. In submitting this information to you, I am speaking for the independent book-match manufacturers as a whole, as well as for my own company. Although we have no organization to convey this information to you as a group, I have been urged by the other independent manufacturers, to a man, to make this appeal to you.

It is with this thought in mind that I have been prompted to come down here today from New Hampshire, and at the risk of telling you

things about the match business which are already familiar to you, nevertheless, in the telling they will perhaps become clearer, and at any rate will be in the record and the burden and the responsibility of carrying them in my own mind will be relieved.

I want to tell you at the outset that I am in sympathy with your tremendous problem in seeking ways and means to raise revenue, and I know that our industry is willing to bear its part of the burden. I know, on the other hand, that it is not the intention of this committee to place a burden on the book-match manufacturers which threaten the very survival of this particular industry.

Let us differentiate right at the start between book matches and wooden stick matches. We are dealing on the one hand, in the case of wooden matches, with a product that is sold to the consumer, just as a pound of butter is sold; as contrasted with book matches which are given away gratis to the purchaser of tobacco products in the same way that straws are given at soda fountains.

Senator TAFT. That is a little hard on manufacturers of stick matches, if their competitors should be giving matches away free of charge.

Mr. BEAN. They started it. There is a fair comparison. In other words, they give you a straw with a glass of soda, and they give you a light with the cigar that they dispense.

Our company and the independent book-match manufacturers for whom I speak make only book matches.

That is the point I wish to bring out to you.

Senator TAFT. What do you mean by "independent"? Whom do you refer to as not independent?

Mr. BEAN. I do not like to get into that matter, but we refer to the "independent" as those outside the one great concern that practically makes all the matches in this country. That is common knowledge, I think.

Senator TAFT. What is the relative production?

Mr. BEAN. Why, of the book match, the independents probably make 25 and possibly 30 percent of book matches, and they do not make wood matches. The so-called trades, the Diamond, or whatever name you may call, make 75 percent of the book matches and probably 95 percent or more of the wood matches. To my knowledge, they make practically all the wood matches.

The CHAIRMAN. Well, there were a lot of these matches imported. On all the fancy stem wooden matches the tax has been 5½ cents per thousand. There is no change in that.

Mr. BEAN. In the fancy match?

The CHAIRMAN. Yes.

Mr. BEAN. Well, the fancy match, I really am not taking that under consideration at all.

The CHAIRMAN. You are not concerned with that?

Mr. BEAN. No; we are not concerned with that.

The CHAIRMAN. There is a new tax imposed of 2 cents per thousand on the wooden stem and the paper matches.

Mr. BEAN. That is right. That is where I propose to show you these inequities are.

The CHAIRMAN. You are talking about the paper match?

Mr. BEAN. I am talking about the paper match wholly. I think you will find that we are not asking for anything that is not obviously misintended to be in this law.

These matches are purchased from us by wholesalers throughout the country who, in turn, distribute them to the various retail outlets wherever tobacco products are sold.

That is our book match.

Now, there is a common expression among people engaged in the match business that book matches—I am referring wholly now to book matches—are handled like sugar, that is, due to their being a common every-day necessity of literally millions of people, the quantity is large and the manufacturer and wholesaler work on a very narrow margin.

For instance, a very large investment in specialized machinery is required to go into the match business—machinery which makes possible the purchase of all materials in their unprocessed form to be worked through the factory to the finished product with which you are familiar. There is no such thing, for example, as buying in semifinished form any part of the match.

It must be developed from the crudest raw materials right in your own factory, thus eliminating all in-between costs. And, gentlemen, I think you will agree with us when we say we are proud of the fact that we sell a case of 2,500 book matches—a total of 50,000 individual lights—all manufactured, sold, and delivered from Boston to San Francisco for $3. In other words, a little better than 8 books or over 160 matches are delivered in the wholesaler's place of business at a cost of 1 penny. We believe it is obvious on the face of it that the manufacturer cannot in any way assume any part of this tax.

We then pass the tax along to the wholesaler, who, in turn, passes it along to the retailer, and here we are faced with our problem, which has its seat in the very nature of the book-match business as differentiated from the wooden match.

As contrasted with a tax of approximately 25 percent on the wooden match, which is sold to the public at a fair margin of profits at present, the retailer is asked to pay a tax of 33 percent for an article which he has to give away. He is naturally going to be left torn between two evils. He must on the one hand give up his practice of giving out gratis matches and thereby antagonize his cigarette and tobacco customers, or he must suffer this loss himself.

Then I think right there you will find those people that are handling this at the tobacco end cannot afford to take this loss.

Leaving out this proposed tax for the moment, mounting materials and labor costs are already increasing the price of book matches to the retailer to a point which has become very burdensome; I might say to a point which has already brought the retailer face to face with a very serious problem—and an increase of 33 percent over his present rising costs is obviously prohibitive.

I spoke of a threat to the very survival of the book-match business. I meant just this. Isn't it fair to assume that book matches are going to have to be sold—and under a great handicap, because here is a product which a whole generation of the public has become accustomed to receiving free. Again, isn't it fair to assume that the sales of wooden matches, none of which are manufactured by the

independent book-match manufacturers, will increase to the detriment of book matches. Furthermore, wooden matches are handled by an entirely different type of retailer than is the case with book matches. The largest distributors of wooden matches are the chain groceries which, as their records indicate, earn substantial profits. They, inasmuch as wooden matches are sold, not given away, could if they wished to do so, either absorb the tax or pass it on in whole or in part to the consumer.

I therefore maintain that the one or two companies which are equipped to manufacture both wooden matches and book matches will be materially benefited by this disproportionate tax and that this tax which fails to differentiate between book matches and wooden matches will work to the detriment of the independent book-match manufacturers and the general public. This is a condition which we feel confident you gentlemen do not want to encourage.

On the basis of the amount of the tax itself, which would amount to 33 percent of the wholesale price, it is percentagewise one of the highest, if not the highest tax which has been proposed. By way of comparison, the proposed tax on such nonessential luxuries as jewelry and furs is only 10 percent. And, in spite of this high percentage, it can only yield a gross of approximately 2½ million dollars at the present rate of book-match manufacture, which as we have pointed out above, is certain to decline.

To conclude, I respectfully submit that the tax fails to differentiate between book matches and wooden matches. Therefore, I earnestly petition your committee to give further consideration to this inequity in the proposed legislation.

The CHAIRMAN. Thank you, sir.

Senator TAFT. What does the retailer pay today for book matches; the retail tobacco dealer?

Mr. BEAN. He pays about $3.

Senator TAFT. $3 for how much?

Mr. BEAN. For 2,500 books. That is about 50,000 matches.

Senator TAFT. $3 for 2,500 books?

Mr. BEAN. Yes; a book like this [indicating].

Senator TAFT. How much will the tax add to his cost?

Mr. BEAN. $1.

Senator TAFT. He has to pay $4 for 2,500 books of matches?

Mr. BEAN. He has to pay $4 for 2,500 books of matches if he pays this tax; yes, sir.

The CHAIRMAN. Very well, we thank you, Mr. Bean.

Mr. William Shipley? Has he come into the room?

(No response.)

The CHAIRMAN. Mr. Calamia.

STATEMENT OF ERIC CALAMIA, NEW YORK, N. Y., PRESIDENT, RETAIL TOBACCO DEALERS OF AMERICA

Mr. CALAMIA. Mr. Chairman and gentlemen, my name is Eric Calamia. I am president of the Retail Tobacco Dealers of America.

The Retail Tobacco Dealers of America is a national association representing thousands of small, independent retail tobacconists in many parts of the country. I myself am a retail tobaconnist, and have been for a great many years.

I asked permission to appear before this committee so that I might point out for your attention a peculiar circumstance as regards the distribution of book matches.

The practice on the part of retail tobacco dealers of supplying gratis matches with practically every purchase of tobacco in any of its forms has been in vogue for so many, many years that today we feel it has become a universal custom in all parts of this country. It is a form of service that the consumer has learned not only to look for and expect but today takes for granted.

Senator CONNALLY. Do you handle chewing tobacco as well as smoking tobacco?

Mr. CALAMIA. That is on a declining scale, sir.

Senator CONNALLY. You handle it?

Mr. CALAMIA. Yes.

Senator CONNALLY. And snuff?

Mr. CALAMIA. And snuff. Those may be exceptions.

There is a wrong impression on the part of many that the retail dealer is supplied with these matches without cost, possibly because they invariably carry advertising matter of some sort on their covers. However, this is a wrong impression. The retail dealer is compelled to purchase his matches, and usually does so from the same wholesaler of tobacco products that supplies him with his other tobacco requirements.

The cost today of a case of book matches is $3 to $3.25.

The CHAIRMAN. What do you call a case?

Mr. CALAMIA. A case of 2,500 books of matches.

Under this proposed tax that case, costing $3 to $3.25, would be liable to a tax of $1 a case. This the retail dealer definitely feels is a disproportionate tax, particularly in view of the fact that the matches are not sold, that he gives them away, that he has no opportunity to pass a part or the entire tax on to the consumer, but must absorb it in its entirety himself.

He feels that under this proposed tax what is supposed to be a tax on matches in reality becomes a tax upon the retail dealer.

Gentlemen, you have probably heard this from many sources, but we feel that tobacco is indeed a very competitive item, that the opportunity even under a large volume of business of earning a sufficient return to pay normal overhead is indeed difficult.

What has been my experience, after 35 years in the retail-tobacco business, I know is equally true of thousands and thousands of small tobacco dealers through all parts of the country. It is hard to tell you exactly what the normal requirements of any one retailer would be, but a very fair and conservative average would be that his consumption is from 2 to 4 cases of matches a month.

Under this proposed tax of $1 a case, that would be subjecting the retail dealer to an additional tax of from $24 to $48 a year.

Senator CONNALLY. Do you have the individual books of matches advertising your company or your store? Do you do that?

Mr. CALAMIA. The average retail dealer has a match that carries an advertisement of some nationally known product.

Senator CONNALLY. I know, but don't you have your name on there, or the tobacco merchant's name on there?

Mr. CALAMIA. The larger hotels do; the large chain stores do.

Senator CONNALLY. I am talking about you.

Mr. CALAMIA. No, sir. We buy from the distributor any match he might have. Today it might carry a gum advertisement, tomorrow it might be a razor blade. We have no control over that.

Senator CONNALLY. Does not the advertising pay part of the cost of manufacturing?

Mr. CALAMIA. If we consider those that have our own name on them we would have to change the price from $3 to $8.

Senator CONNALLY. That is not answering my question. The fact that it has advertising on it reduces the price of the match, does it not?

Mr. CALAMIA. It reduces it from $8 to $3. I am talking about the type of match that is available to the retail dealers, the book matches.

Senator TAFT. That is, if you buy a case of matches, with a gum advertisement on it, you still pay $3?

Mr. CALAMIA. That is right. If you have your own name on it, then, instead of costing $3, it costs considerably more and you cannot buy one case at a time. I am talking about the cheapest rate that the little independent dealer would have to resort to.

Senator TAFT. If you have an ad on it—does that reduce the price below $3?

Mr. CALAMIA. No; $3 is the cheapest form of book matches, $3 and $3.25. It has recently gone up to $3.25.

The CHAIRMAN. What is the price of the wooden-stem match, do you know?

Mr. CALAMIA. It would be about 75 cents a gross.

The CHAIRMAN. A gross?

Mr. CALAMIA. Yes, sir—no; it is not packed in gross any more. It is a dozen packages with 10 boxes in a package, or 120 boxes. Formerly they were packed a dozen boxes in a container.

Senator TAFT. 75 cents for what?

Mr. CALAMIA. 75 cents per dozen packages of 10 boxes to a package.

Senator TAFT. 120 boxes?

Mr. CALAMIA. That is right.

The CHAIRMAN. Are those the ordinary penny box matches?

Mr. CALAMIA. That is right, sir, the safety match.

The CHAIRMAN. All right.

Mr. CALAMIA. Gentlemen, I want you to know that my retail tobacco dealers would not want me to appear here if they thought this matter was trivial, particularly in view of the problem they realize you are faced with, and the purpose for which this money is being raised, but they do not believe it is petty or trivial to them; it is a very serious item. They wanted me to call to your attention particularly the fact that they cannot pass this proposed tax on; that 30 to 33⅓ percent, in their opinion, was a very high and disproportionate tax and that it is impossible for them, as small merchants, to pass this on in any fair and reasonable manner.

I would like permission to leave this brief, with some of these facts, for the record.

The CHAIRMAN. Yes, sir; you may give them to the clerk.

(The brief submitted is as follows:)

BRIEF PRESENTED BY ERIC CALAMIA, PRESIDENT OF RETAIL TOBACCO DEALERS OF AMERICA, INC.

Mr. CHAIRMAN AND GENTLEMEN: I am president of Retail Tobacco Dealers of America, Inc., the tobacco retailers' National Association, representing thousands of independent retailers throughout the country. I, myself am an independent retailer of tobacco products.

I would like to call to your attention the serious hardship which the 2-cent per thousand tax on paper book matches proposed in the Revenue Act of 1941 would impose upon the retail tobacco dealer. The custom for many years has been for all retailers in our trade to provide matches gratis to consumers of tobacco products. As the average tobacco retailer uses from two to four cases of book matches a month, the proposed tax of 2 cents per thousand or $1 per case would be a direct levy on the individual storekeeper of from $24 to $48 a year.

Many people fail to realize that the retail dealer has to pay for these matches even though they carry advertisements on their covers. Since 95 percent of the book matches are given away, it is obvious that the retailer is saddled with any increase in the cost of matches and it becomes an added item to his overhead and cost of doing business. The returns to the average independent retail tobacconist are hardly sufficient now for him to eke out a living wage. The increase of $1 per case, which would be a 33⅓ percent increase on the present cost of matches, is a tax of immense proportions to him.

What I know from my own personal experience, after 35 years in the retail-tobacco business, is true of the thousands and thousands of other tobacco retailers throughout the country.

I hope that this committee will come to realize that the proposed tax on book matches would single out the small independent retailer for a disproportionate burden for he would have to absorb the tax himself as he has no way of passing it on. Because of this unusual condition I trust that you will determine to eliminate this tax on paper book matches from the Revenue Act of 1941.

RETAIL TOBACCO DEALERS OF AMERICA, INC.,
ERIC CALAMIA, *President.*

Dated: Washington, D. C., August 22, 1941.

The CHAIRMAN. Mr. Stokely.

STATEMENT OF W. B. STOKELY, JR., STOKELY BROS. & CO., INDIANAPOLIS, IND.

The CHAIRMAN. Mr. Stokely, will you give your name and for whom you are appearing?

Mr. STOKELY. My name is W. B. Stokely, Jr., Indianapolis, Ind. I am appearing for Stokely Bros. & Co., manufacturers of canned foods, and the National Canners Association. The National Canners Association is an association of about 3,000 canning plants, all over the United States.

I am appearing here with regard to the excess-profits tax. I am not appearing in the guise of a tax expert. I am appearing simply as a businessman who has a great problem, and this problem is general to our industry.

The problem is this: The canning industry is one where we have wide swings of price levels up and down and consequent wide swings in profits. We might have a big year one year and a terrific loss the next year.

This industry is closely related to agriculture. Most canneries grew out of farming arrangements. Either a farmer went into the canning business, or a group of farmers got together and organized

a cannery. These canneries are general all over the United States, and, in general, they are located in small towns and small communities, and they furnish a source of employment to farmers.

They not only furnish income to the farmers, from the standpoint of taking his crop, but the crop matures at a time when the farmer, in his ordinary activities, is not so busy on the farm, and as a consequence, the farmer and his family come in and work at the cannery. We give preference to farmers in that employment.

It acts as a nice supplement to his income.

Our problem is this: the base period that has been selected, that is, 1936 to 1939, inclusive, was a period of depression for this industry. There was a very severe depression, as far as the canning industry is concerned, in all those years, except one. 1936 was normal, but 1937 was a depression year, and 1938 was very much worse, and 1939 presented a slight recovery, but was still very bad.

This condition was so general to the industry that very few members of the industry can use the average earnings method, and most of them, including ourselves, built up debt positions in those years that are a burden to us now, to the extent that unless we can retain a part of the earnings which are coming to us now to pay out those debts, I do not know how we are going to finance ourselves through this next slump period which always comes in this industry.

All the recorded history of this industry shows that every so often you get 2 or 3 bad years. It so happens that this particular base period on the average represented the 4 worst years—and this is the average of the 4 years because there is 1 good year in the 4—the 4 worst years that the industry has ever had, and that is true generally.

We are then forced to the invested-capital method of considering this situation, and canners are notoriously undercapitalized. In other words, being right next to the farmer, they have gone into business there and they are able to borrow money from the can company and from the local bank, and the farmer gives them credit on his crops until such time as the canner has disposed of his pack.

So if everything works all right, the canner can make a nice return on his capital but, if the breaks go in the other direction, two things can happen that hurt him. If there is a large crop, it hurts him because a surplus is built up and this surplus goes on the market at a sacrifice price.

Senator CONNALLY. How long can you keep the canned goods before they finally deteriorate?

Mr. STOKELY. Most products you can keep fairly indefinitely, if you are financially strong enough to do it.

Senator CONNALLY. I am not talking about financing. How long will a can of tomato juice stay good?

Mr. STOKELY. Well, it will not spoil in 3 years, we will say. However, it deteriorates slightly in quality.

Senator CONNALLY. When you have a big surplus of those products, do not you buy them, can them, and keep them over for the next year?

Mr. STOKELY. We buy them and can them, but we cannot keep them over.

For instance, I will give you an illustration. Our company does $22,000,000 of business. We have an invested capital of approximately $6,000,000 and that includes the amount that we have invested in our plants, which runs around $3,500,000.

So, we have $2,500,000 to finance a $22,000,000 business.

Senator CONNALLY. I contribute to the prosperity of your company. I drank a can of tomato juice last night.

Mr. STOKELY. Thank you, Senator. That is a very great help.

Senator CONNALLY. It was your make, Stokely Bros.

Mr. STOKELY. I appreciate that.

Senator CONNALLY. It tasted pretty prosperous to me.

Mr. STOKELY. Well, we try to put something in the can that the public will like.

I want to say, for that reason, our swings up and down, as severe as they are, they are not as severe with us as they are with the smaller canner.

Senator CONNALLY. You are making money now, are you not?

Mr. STOKELY. Yes, today; but in 1938 we lost money, we lost $700,000 odd.

Senator CONNALLY. This bill is not on former years, it is on this year.

Mr. STOKELY. Yes. That is what is bothering me, because we have built up an indebtedness currently at our low point. We owe the banks, currently, or did at the lowest point of the year $1,250,000, and in addition to that, we owed them $3,000,000 payable over a period of 5 years at the rate of $600,000 a year.

Now the indebtedness goes from this low point, and we will borrow at our peak around $8,000,000.

Senator CONNALLY. If you choose the invested-capital theory—that is what you would have to do?

Mr. STOKELY. Yes.

Senator CONNALLY. It does not make any difference whether you owe any money or not. You pay on the invested capital.

Mr. STOKELY. It makes this difference. That, in some way we have to convince the banks that sometime we are going to pay them back. We cannot just go along on the theory that we are going to owe them indefinitely. So much matures every year.

In addition to that, the banks realize the nature of this industry; that it goes up and down in profits. I think this is a very important point as connected with the excess-profits tax:

When we make those larger profits for certain years they are supposed to offset the loss years to give us a fair average; if profits are chopped off to the extent this bill chops them off, then when the loss years come along and we already have a burden of debt, then we get into such a position that we cannot hope to survive.

Senator CONNALLY. You can defer your dividends for a while.

Mr. STOKELY. I am glad you brought that up, Senator. We have not paid any dividends on our common stock in the last 4 years; and we have not paid any dividends on our preferred stock in the last 3 years.

We are not asking for this relief on the basis of paying dividends. We are asking for relief on the basis of getting our company in a sound position to weather the next period of declining inventory prices, which is sure to come.

It always has come and it always will. At this time, we are being asked by the Department of Agriculture to increase our production to the limit, to increase tomatoes, increase peas, increase corn and other items. Food is an important element in these times and I agree with

them 100 percent, but we have to go out and contract with the farmer for these products. We contract in the spring and we take the crop which he delivers to us in the summer and fall at a specified, fixed price.

Senator CONNALLY. You fix it, though, do you not?

Mr. STOKELY. We fix it by contract with the farmer.

Senator CONALLY. You say you have a fixed price.

Mr. STOKELY. Yes.

Senator CONNALLY. You do the fixing.

Mr. STOKELY. If he does not like it, he does not sign the contract.

Senator CONNALLY. And he loses the tomatoes that he has planted.

Mr. STOKELY. We fix it before he plants the tomatoes. The contract is made in advance of his planting. We furnish the seed and fertilizer, and so forth.

Senator CONNALLY. That is right.

Mr. STOKELY. It so happens on a year like this, it was fixed a little lower than we realized in this respect. Next year it will be higher.

Senator CONNALLY. That is why you are making more money this year than last year?

Mr. STOKELY. That is one reason; yes, sir.

Going back to the request of the Department of Agriculture, we are cooperating with those requests 100 percent, and I think most canners are, but we are getting on very dangerous ground, considering the capitalization of the industry, as if we make good profits this year and they are mostly taken in the form of taxes. Next year, or the year following, or some year in the future, we will have commitments out for $15,000,000 or $20,000,000 or five or six times our working capital, in goods that are coming in to be canned and on which we do not know what loss we may have to take.

The CHAIRMAN. Mr. Stokely, what is your suggestion? We tried to help you.

Mr. STOKELY. Yes; I appreciate that. I would like to pass these around, if I may. This shows a chart of canned vegetable prices over a period of time.

I am attaching a copy of this to a statement that I am filing.

My suggestion is that, in this particular type of industry, we be given some additional relief on borrowed capital.

The CHAIRMAN. Are you on the invested-capital base?

Mr. STOKELY. We have to be.

The CHAIRMAN. You had loss years in the whole base period?

Mr. STOKELY. Yes. They were bad.

The CHAIRMAN. Pretty nearly all of them were loss years?

Mr. STOKELY. Three out of the four were very bad.

The CHAIRMAN. It is really the canners that led you to give this committee the carry-over of the unused credit.

Mr. STOKELY. We appreciate that carry-over very much.

The CHAIRMAN. Everybody has got it now, but it was originally inserted to take care of your situation.

Mr. STOKELY. I appreciate that, and it is very fine, except for this situation, that it does not reach back into those loss years. It takes our fairly good years, unless during the current period we should have some loss years.

The CHAIRMAN. Yes.

Mr. STOKELY. I further understand that this House bill has been modified to such an extent that it complicates the carry-over to where we do not really understand it, as to whether we have any carry-over or not under the proposed way of figuring this credit.

The CHAIRMAN. You still have the carry-over.

Mr. STOKELY. It does not reach back to that 1937-38-39 loss period.

The CHAIRMAN. I know. You have just got the present situation. Your suggestion is that we give you a more liberal allowance on borrowed capital?

Mr. STOKELY. Yes; and I have a proposed amendment, which I will not try to go into because I am not any tax man, but it has been drafted by the National Canners Association.

I would like to file it.

Senator BROWN. You get 50 percent on the borrowed money.

Mr. STOKELY. Yes.

Senator BROWN. What do you want to do?

Mr. STOKELY. I am suggesting under certain circumstances that companies which qualify under the circumstances that we are outlining here would be allowed 100 percent on their borrowed capital, instead of 50 percent.

The CHAIRMAN. You would have to have a lot more qualify than canners.

Mr. STOKELY. I think we tie it down here to where it will not apply to anybody except where it would be equitable for it to apply.

I would rather not go into the technical side of it.

The CHAIRMAN. You need not. We just want to get what you are suggesting.

Now, have you another suggestion?

Mr. STOKELY. Yes, sir. I have filed two more suggestions. One suggestion is: Inasmuch as the canning industry is a cyclical industry, if we are going to have an average-earnings basis, then we should not take the bottom of a depression for this particular industry for the proper time for testing the earnings that we should take as normal.

Insead of this particular 4 years, we should take any 4 consecutive years, say, out of the past 7 or 8.

I have only one further suggestion. The third suggestion is that, in line with the testimony of Mr. Miller here, that the Internal Revenue Bureau be given some broad discretionary powers to take care of obvious inequities.

The CHAIRMAN. That is the only thing that will help you to take care of the obvious inequities?

Mr. STOKELY. I am afraid it is.

Thank you very much, gentlemen. I would like to file a statement and I would like to file one for the National Canners Association, also.

The CHAIRMAN. You may do so.

(The statements filed by Mr. Stokely are as follows:)

STATEMENT OF W. B. STOKELY, JR., PRESIDENT OF STOKELY BROS. & CO., INC.

When I had the privilege of appearing before this committee in September of last year, I outlined somewhat the effect of the excess-profits-tax bill then being considered on our company and the canning industry generally. I pointed out at that time that the canning industry, as a whole, is an industry which is undercapitalized and an industry in which the fluctuations between profits and

losses from year to year are very great, due largely to conditions which are not within the control of the individual canner, and due to a large extent to the close relationship of this industry to agriculture, and the influence on operating profits caused by either short crops causing excessive costs of operation, or large crops causing overproduction and consequent declining prices resulting in low profits or operating losses.

The average-earnings basis for determining excess-profits tax is not open to the average canner or to our company, because in the years selected for the base period conditions were such that in 3 out of 4 of those years we suffered drastic reductions in income due to the fact that abnormally large crops in 1937, 1938, and 1939 produced a tremendous surplus which hung over the market and depressed prices to the lowest level in the recorded statistics of the industry going back to 1890. This is visualized by the two charts prepared by the Giannini foundation of the University of California, which I am filing for the record and attaching to this statement as exhibits A and B. These charts extend about halfway through 1939 and are the latest available.

I call attention to the fact that on canned vegetables, which represent the major end of our business, the prices in 1938 reached the low point of 60 percent of the average of the prices of 1924–29, inclusive, whereas these prices at the lowest point in the low depression year of 1932 went down to only 72 percent of this average. As an illustration of the severity in this drop in prices I would like to file and attach to this statement as exhibit C a copy of a plan which I submitted to the Government at that time as a measure of relief for the industry and which plan has been substantially adopted recently as a defense measure.

It will be seen, therefore, that we are forced to adopt the invested-capital method, rather than the average earnings method. The excess-profits credit under the invested-capital method as proposed in the House bill and as now determined under the Internal Revenue Code is inequitable to our industry and to our company, as we are in the type of industry where large profits on invested capital in favorable years must be made in order to wipe out the deficits of the bad years and give us a fair return upon our capital over a period of years.

Debts incurred in 1938 and 1939 are still overhanging our company, and unless we are allowed to retain sufficient of our present earnings to put our company in sound position during the present period, the next slump in prices of canned foods, whether caused by excessive crops or general business conditions, will certainly prove disastrous for our company and for the industry.

In this connection the question naturally arises what solution can be suggested that is fair and equitable, and at the same time will not defeat the general purposes of the bill. We believe that one relief which could and should be granted corporations in this industry which are dependent upon large sums of temporary borrowed capital is to permit them to include 100 percent of their borrowed capital in the determination of invested capital and the resulting excess-profits-tax credit. This would give our industry some measure of relief and allow us to cooperate more fully with the expressed desire of the Secretary of Agriculture in expanding our production to make available larger quantities of foodstuffs. We would not otherwise dare to expand our production because we would have to consider the probability of an eventual drastic shrinkage in inventory values which might involve us in bankruptcy.

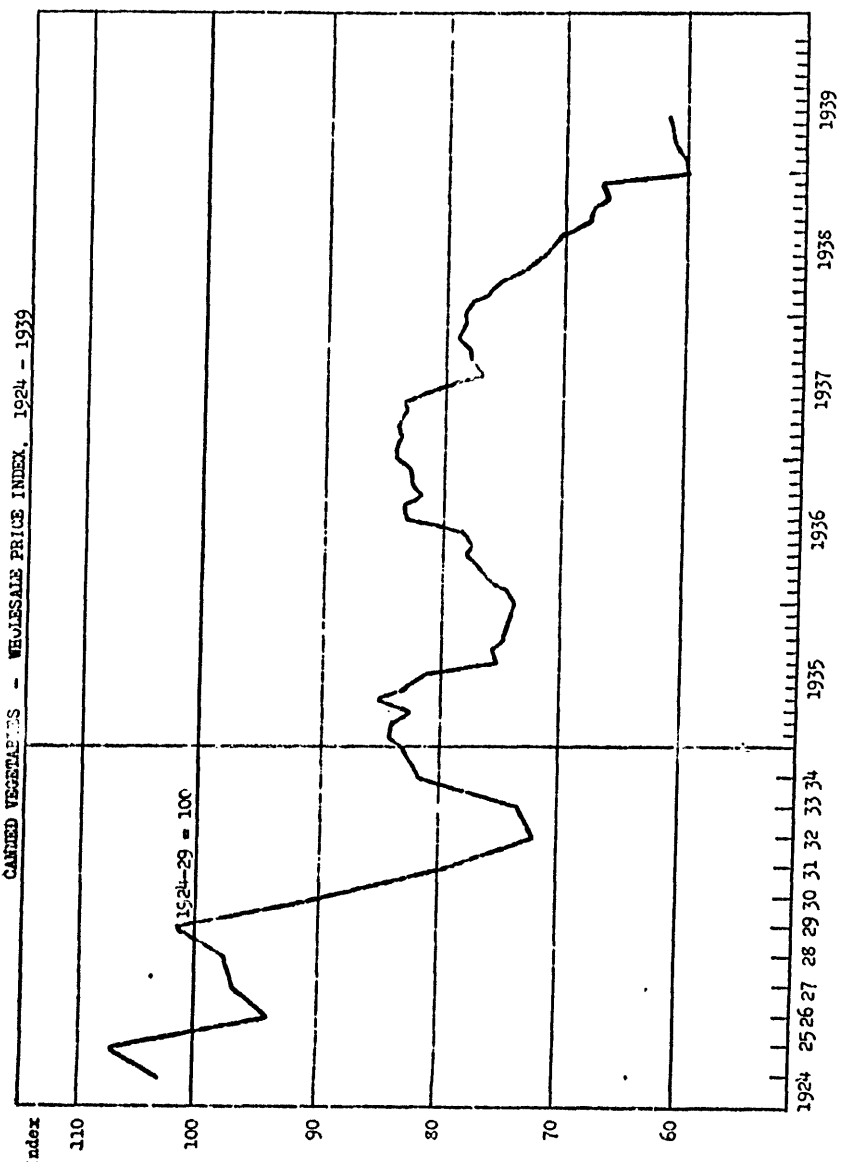
I file herewith and attach to this statement as exhibit D a proposed amendment to section 719 of the Internal Revenue Code, which in some measure affords relief to our industry. You will note that the amendment will only permit the inclusion of 100 percent of borrowed capital in cases of taxpayers in this particular industry and then only subject to the further qualification that their average short-term borrowed capital exceeds 50 percent of their average equity invested capital for the taxable year, and that their short-term borrowed capital fluctuates to the extent that the highest amount in the taxable year exceeds by a least 100 percent the lowest amount of such short-term borrowed capital during the same taxable year. With these safeguards the amendment will constitute no serious drain on the revenues to be produced by the bill. On the other hand, it will afford some measure of relief to this generally undercapitalized and debt-ridden industry and avoid the inequitable result under the present revenue act and the amendments proposed by the House bill.

The bill, as passed in the House, also carries a provision which is doubly burdensome to our industry, in that it is proposed that we be taxed an additional 10 percent on the difference between our average earnings during the base period, which as far as the canning industry is concerned represents an extreme depression period, and the amount which would be required to be

paid on the invested-capital basis. This subject has been covered by others who appeared before you, and we merely mention it for the purpose of adding our voice in all earnestness to the plea that this extra tax not be laid on companies which are already faced with an inequitable tax burden in this bill as passed by the House.

We believe that if an average earnings base period is to be used by this industry, it should not be determined on an average of 4 specific years which embrace 3 of the worst years in the industry's history. Our industry could be given some further measure of relief by giving the taxpayer the option to select any 4 consecutive years out of the last 7 as a base period for average earnings, in lieu of the 4 years provided by the bill.

EXHIBIT A



We desire to record also our full agreement with those who have appeared before you in support of a provision giving to the Commissioner of Internal Revenue broad discretion in adjusting excessive hardships in either income or invested capital. We particularly approve the draft of the proposed new section submitted by Mr. Robert N. Miller at the conclusion of his testimony on August 14, at page 489 of the record.

EXHIBIT B

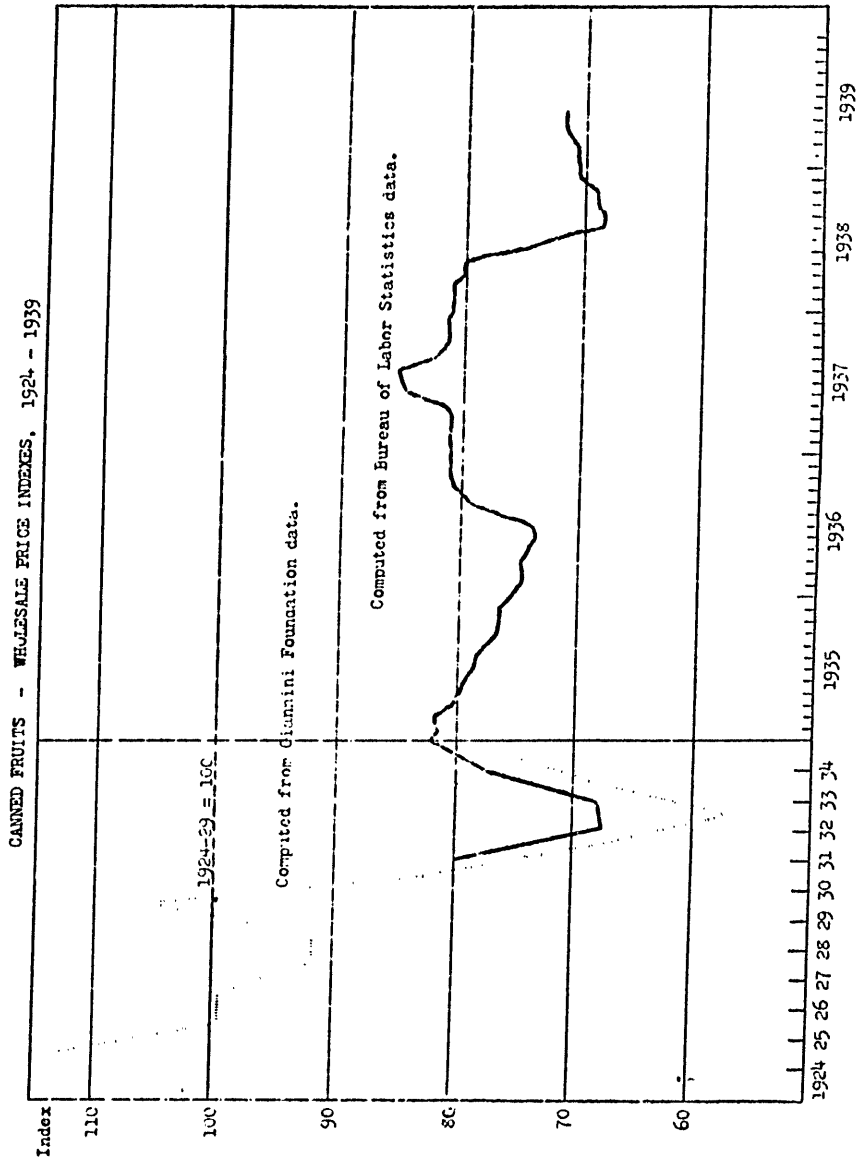


EXHIBIT C

INDIANAPOLIS, IND., *August 20, 1939.*

Mr. LAUCHLIN CURRIE,
Administrative Assistant to the President,
Washington, D. C.

DEAR MR. CURRIE: In compliance with out conversation, I have conferred with the directors and various committee members of the Four Way Plan.

I might say in this connection that these men are all actively engaged in business, occupying positions of high responsibility, and have given a great deal of time and study to this plan. They have been actuated by a combination of two major motives:

1. Many of them had personal experience during the World War and recall the conditions of confusion, lost motion, and extremely high prices, which occurred at that time.

2. For the general good of the industry with which they are connected.

They feel that the best interests of both the country at large and their own industry will be served by a plan such as is set forth in the attached pages. They feel that the setting up of the proposed reserve will bridge over a time in case of any emergency, so that the entire food situation, and we all realize how important food is, can and will be handled in an orderly manner, without dislocation of domestic food conditions; with a minimum of confusion and time, in the feeding of men in public service, and likewise at a great deal less cost per unit of food to the United States Government than if such a reserve were not in existence.

These and other reasons could be dwelt on in great length and detail, but I feel that all those interested realize the facts. Also, if any questions occur to you, my associates and I are available and anxious to answer them.

The basic thought in preparing the attached recommendation is to have available whenever needed for governmental uses a supply of foods in durable and quickly transportable shape at the minimum of expense to the United States Government.

Speaking strictly from a commercial, or even a mercenary standpoint, the intelligent and thinking canners of the United States, which we feel constitute the very great majority of them, believe it is much better for the industry that a cooperative move of this kind be made. Sales by canners under this plan would, without doubt, be made at much lower prices than those which would accompany a sudden emergency demand. However, as an offsetting advantage to the canners, the reserve plan would prevent interruption and dislocation of their services to their regular customers.

Thanking you for the opportunity to make this attached set of recommendations, and with every hope that they will be favorably received, I am

Very truly yours,

THE FOUR WAY PLAN, INC.,
By PAUL MORTON.

RECOMMENDATIONS FOR ESTABLISHING A NATIONAL CANNED-FOOD RESERVE IN ACCORDANCE WITH THE FOUR-WAY PLAN

The development into definite form of the ideas embodied in the four-way plan was a gradual process.

It was the outcome of discussions among a group of men, some of them connected with the canned-foods industry and some with other industries. At the outset these discussions were of a general nature, dealing with world conditions, with the relation of the United States to other countries in the present unsettled state of affairs, and finally with the possibility of cooperative action that would in advance, at a minimum of expense, accomplish those things which otherwise would be done under stress in time of emergency.

The later thinking of the group was influenced by somewhat similar activities in the locating and establishing of reserves in other items, such as metals, rubber, etc.

Copy of the four-way plan together with certain statistics is attached hereto.

This plan has been submitted confidentially and without publicity to interested parties in seven major divisions of the Government, namely, State, Treasury, War, Navy, Agriculture, Commerce, and Labor, and practically without exception it was felt that the ideas contained in the plan had such merit that further careful investigation of the proper method of putting it into effect should be made.

After careful study and much conscientious discussion of all angles, the following recommendations are respectfully offered as to the practical and economical operation of same:

That a reserve of 10,000,000 cases, made up of the three major canned vegetables, namely, corn, peas, and tomatoes, be accumulated as the major basis of the total canned foods reserve.

The reason for making the suggestion in this way is that records are available showing that in 1918 a total of more than this amount of the three abovementioned canned vegetables was requisitioned by the United States Food Administration. In other words, the general idea of this reserve, and of suggesting these figures, is to approximate, insofar as is possible at this time, what the first draft on canned food supplies might be.

In addition to the above 10,000,000 cases, a reserve be accumulated of proportionate quantities of the other canned vegetables, which are not normally used in such quantities as the three major items, such as green beans, lima beans, beets, etc.

Further components of the total reserve would include tomato products, such at catsup, juice, chili sauce, soup, etc., also canned fruit, and fruit juice.

These recommendations do not set specific figures as to number of cases of the items other than the three major canned vegetables, having in mind that the Governmental records of comparative usage, together with the experience of the departments making a study of nutrition, would permit these figures to be arrived at, using a base of 10,000,000 cases on the three major items, more accurately than could be done by others.

The above items are those which are of a seasonal nature, and are only produced through a short period during each year. It is felt, therefore, that a reserve on these items is of great importance. An immediate need of the great number of foods covered by the above list following after a short crop year, might constitute a considerable food crisis. In addition to the above, in order to make a properly rounded and balanced reserve, it is suggested that canned fish be included since this is also, to a great extent, a strictly seasonal production.

Likewise, a fully balanced reserve should include canned milk, canned meat products, and quite likely a certain amount of nonseasonal products, particularly pork and beans. While this latter item can be packed the year round so long as dry beans are available, it is thought advisable that enough for a start or backlog, in case of emergency, might well be included in this reserve set-up.

The packing of seasonal foods is in progress at present, and will be pretty much completed—other than citrus products—by the end of October. Suggestion is made that immediately after the completion of the seasonal packs the largest selection of goods is available from which to purchase. Also, it happens that acreage on canning crops has been materially reduced on practically all items this season. Yields are not large, and it is very probable that as low prices on most canned foods as will be seen for considerable time to come now exist.

It is assumed that the accumulation of these reserves would be made in the usual manner of issuing specifications for the goods together with terms of sale and purchase, and public bids received on same.

Due to the special nature of this reserve, it is suggested that certain features be included in the call for bids, most important perhaps, being the matter of storage. As one of the cooperative activities of any canner selling goods to be included in this reserve, it is contemplated that said canner furnish storage for the goods sold at his plant, or at any other point approved by purchaser, thus relieving the Government of the storage problem, which, again, in case of emergency, might be acute.

It is suggested that specifications call for 90 days' free storage by seller, after which storage would be provided by seller at the rate of one-half cent per commercial case per month or part thereof. If insurance is carried, cost of same to be borne by buyer.

It is suggested that bids be taken on foods in standard commercial corrugated or fiber cases, with separate additional costs quoted by seller if special boxes, for export or otherwise, are called for.

It is further suggested that all Government agencies draw their current canned-food requirements from this reserve and that replacement purchases to bring the reserve back to its original total amount be made at the end of each quarter of the calendar year.

Goods in storage in packers' warehouses to be put under Government seal.

There are numerous details which we have not attempted to cover here, as we believe they will present no practical difficulties, if the basic thoughts embodied in the reserve plan are approved by the Government. As stated in letter of transmittal to Mr. Currie, the originators of the plan and various other canners are available to provide all information possible. The plan has not been circulated through the entire industry. If that had been done the press would doubtless have featured it, and likely without full knowledge of facts. Summing up, the proposed national canned food reserve would accomplish various purposes, namely:

1. Provide food at prices approximately half what they were under stress purchasing which occurred in 1917–18.
2. Assure a supply well balanced as to nutrition.
3. Assure needed "seasonal pack" foods, which under this reserve plan would be ready at a moment's notice.
4. Provide foods of practically unlimited keeping qualities.
5. Provide food that can be transported anywhere with a minimum of transportation space.
6. Provide storage without taking space in Government warehouses which might be badly needed for other supplies.
7. The cans, being tin plated, would conserve a large amount of that highly important metal.
8. Avoid upsetting of movement of canned foods for domestic consumption during time of emergency, thus contributing, during such period, to the mental stability of the civil population. This is considered highly important. Shortage of food is a matter over which people in general easily get excited and even panicky.
9. Clear the way, if needed, so that canning plants could turn quickly to production of special emergency rations.
10. Prevent skyrocketing of food prices both for governmental and private use.

Those recommendations are submitted as a result of a most sincere desire to promote cooperation of Government and industry, in the belief that real cooperation is, in the long run, mutually beneficial to all concerned.

It is hoped that the fundamental thoughts we have attempted to present herewith will be approved by those to whom they are hereby submitted.

Respectfully,

THE FOUR WAY PLAN, INC.,
By W. A. MISKIMEN, *Secretary.*

CANNED FOODS VITAL STATISTICS

A $1,000,000,000 BUSINESS USING 1,003,000 EMPLOYEES

A. Agriculture:
1. Location: 45 States and Alaska, Hawaii, and Puerto Rico.
2. Acreage: 3,500,000.
3. Employees: 500,000 (fruits and vegetables only).
4. People affected: 2,250,000.
5. Farmers' income 1937: $125,000,000.
6. Seed: $7,000,000.
7. Taxes paid on land: $1,500,000.

B. Industry:
1. Companies: 3,047.
2. Plants: 3,400.
3. Capital: $500,000,000.
4. Employees at peak: 455,000.
5. Pay roll: $164,800,000.
6. Taxes: $25,000,000.
7. Production:

Year	Cases, not including meat	Value, not including meat	Value, with meat
1933	190,489,232	$465,979,190	Not available
1935	268,913,069	660,859,897	$700,373,500
1937	327,784,351	861,485,782	915,383,326

8. Surplus: (Over amount that would guarantee fair return to canner.) Carried 1937 to 1938, 40,000,000 cases. Value: $70,000,000.

9. Allied industries: (Figures used are for canned foods only.)

(*a*) Can manufacture:
Cans used: 11,205,000,000.
Value: $220,100,000.
Employees: 20,000.

(*b*) Label manufacture:
Canned food: 350,000,000 cases.
Value: $17,500,000.
Employees: 2,000.

(*c*) Materials—fuel, electric energy, and contract work: $320,000,000.

(*d*) Sugar, 1935: 585,000,000 pounds.
Value: $29,000,000.
Employees: 2,000.

(*e*) Machinery:
Value: $11,839,735.
Employees: 3,000.

(*f*) Shipping boxes:
Value: $24,500,000.
Employees: 4,000.

(*g*) Tin plate:
1,600,000 tons.
Value: $150,000,000.
Employees: 20,000.

C. Production:

	Cases	Value
1933		
Fruits	33,561,996	$84,997,839
Vegetables and soups	103,137,518	190,262,387
Sea foods	13,086,718	59,632,664
Milk products	40,703,000	131,086,300
Total	190,489,232	465,979,190
Meat and meat products	(1)	(1)
1935		
Fruits	43,597,567	112,986,899
Vegetables and soups	164,390,781	301,389,938
Sea foods	17,433,721	74,993,719
Milk products	43,491,000	171,489,341
Total	268,913,069	660,859,897
	Pounds	
Meat and meat products	201,777,716	39,513,603
Grand total		700,373,500
1937		
Fruits	63,764,485	166,465,930
Vegetables and soups	199,731,817	379,364,640
Sea foods	19,468,049	104,937,631
Milk products	44,820,000	210,717,581
Total	327,784,351	861,485,782
	Pounds	
Meat and meat products	267,371,350	53,897,544
Grand total		915,383,326

[1] No figures available.

NOTE.—Figures have been compiled from statistical reports where accurate data are available; otherwise they are estimates based on the best information obtainable.

"THE FOUR-WAY PLAN," A CONTRIBUTION DESIGNED TO ASSIST IN PREPAREDNESS FOR NATIONAL DEFENSE AND TO IMPROVE NATIONAL ECONOMIC CONDITIONS

The plan devised, known as "the four-way plan," is so-called because it is designed to achieve four highly desirable ends through one simple and economical move on the part of the Federal Government. The aims are as follows:

1. To round out the program of preparedness for national defense.
2. To improve and protect agricultural income.
3. To stabilize and increase employment.
4. To save and stabilize a basic industry.

Defense.—At the moment, we are living in a world littered with civil wars, power-mad dictators, armament races, and a grave question as to the ultimate safety of any self-respecting country, even our own, from the lawless aggression of military nations dominated by military fanatics. All of these add up to the distasteful but vitally necessary task of ample preparations for defense and for possible aid to other nations who by force of circumstances may soon, in defense of themselves, constitute the first line of defense for this country and democracy.

The situation in the canning industry at the moment has an immediate relevancy to these world conditions.

Canned foods occupy a very important position in any plan for national defense. As Napoleon said, "An Army marches on its stomach." All the battleships and fine weapons of defense that we might provide could not defend us against attack for 1 week if the men who operate them are not provided with food. It has been well demonstrated in previous wars that canned foods in large quantities are an essential part of the necessary provisioning for the Army and Navy, providing the men with a well-diversified diet in a form which can be easily transported and is not perishable.

The specific suggestion is that the various agencies of the Federal Government, Army, Navy, Marine Corps, veterans hospitals, C. C. C. camps, etc. purchase and use a sufficient portion of the present canned food surplus as a source of—

1. Current supply for said units.
2. Permanent reserve for immediate use in times of need.

As these goods are currently consumed it is suggested that replacements be made, thus the entire supply would be held intact when required for emergencies, but at the same time would be completely renewed periodically.

This reserve of foods would be immediately available:

1. In case of any expansion of the Army and Navy whether in actual war or as a preparedness measure.
2. As a quick food supply for other nations.

The time element is recognized as a most important factor in possible, apparently probable, war developments. It seems the opinion of many informed persons that the best chance for gain or victory by dictator nations in case of war would be the success of rapid crushing strokes at the very outset. If the democracies can withstand that period, their chances of final victory are vastly improved. Food—more particularly ready to use, transportable food—is a serious problem for European armies. Canned foods in variety and volume have never been developed over there as they have in the United States. Therefore, such a supply ready for immediate movement to the points of need could well be of tremendous importance in the world picture.

These suggestions apply, of course, to such canned foods as can be carried in proper storage for long periods without any deterioration whatever. Fully 98 percent of the canned goods available are of that character.

In addition to the potential value of such a supply for reasons above noted, this would be an economical time for the Government to set up such a supply as it is assumed the foods would be purchased on public bids and present prices are, as stated, very low, often less than cost.

Tin as an important metal was mentioned by Assistant Secretary of War Johnson in his broadcast address on April 5. Establishing a reserve supply of canned foods from present surplus would likewise conserve a very considerable supply of tin.

This reserve supply of canned food is highly important from the standpoint of national defense. It is believed operation of the plan constitutes a real service to the country, not only as a defense measure, but for other reasons covered in the following paragraphs.

Agriculture.—Canned foods are of basic importance to agriculture, utilizing the produce from several million acres, and providing a very important element in agricultural income in every State in the Union but three. In addition to the income actually derived from the canning crops, agricultural income is also affected in other ways. For instance, if the canning factories, 3,400 in all, are unable to take their usual amount of produce, a considerable proportion of it will undoubtedly be thrown on the already overstocked fresh market, thereby further demoralizing same, not only for these particular farmers, but all other farmers growing fresh produce.

There exists a trying, even hazardous condition in the canned foods business today. The preserving of perishable and seasonal food crops from farm and orchards in air-tight containers for use throughout the year is naturally an activity closely connected with agriculture. A large proportion of the factories today are in relatively small towns and in villages. They are an integral part of their respective communities, in fact, the canning factory is the major cash distributing agency for many towns and their adjacent areas. The degree of their prosperity or adversity very directly affects the income of the surrounding agricultural sections and of local business in the towns where located.

Employment.—The canning factories are also a very large factor in the labor market of the country. Hundreds of thousands of farmers and their employees are engaged in growing and delivering their crops to the factories. Additional hundreds of thousands are engaged in the factories themselves in preparing and canning the various products. There are also a great many thousands of additional employees in the affiliated industries, such as machinery manufacturers, box makers, label makers, can makers, and employees in the steel mills who make the tin plate that goes into the tin cans.

Industry.—Most canning plants, by the very nature of their origin and background, are better versed in preserving farm produce than they are in merchandising the finished goods. On the other hand, distributors of canned foods to whom the factories go to sell their finished goods have buyers whose sole job is to buy commodities at the lowest possible figure, having at hand market information from the entire United States on each item, and constantly insisting to would-be sellers that said sellers' prices are too high.

Again, due to the short season of packing time—often only a few weeks during harvest season for the perishable crops—most factories operate mainly on borrowed money, using their finished goods for collateral as fast as packed. The canning activity as a whole is very much underfinanced. As a result, finished goods very often cannot be carried and merchandised on a year round basis, and when, due to large crop yield or any slowing down of general business conditions, a surplus develops, "distress lots" of canned foods are plentiful, forcing the prices below cost. These stress conditions are very much in evidence at present.

Yields on produce and fruit were high in 1937 and 1938. Inventories of canned foods carried from 1937 to 1938 were heavy. The combination has kept the price of many canned foods below cost for nearly a year and a half. The small working capital per package of food preserved has been further depleted. Buyers naturally have used this condition to buy at lowest possible prices, and almost on a day-to-day basis.

Summary.—The situation, therefore, is as follows:

On the one hand we find a large surplus of canned foods of undoubtedly the best quality ever produced. This oversupply is a handicap to agriculture, labor, and industry alike. It forces discouraged canners to reduce operations drastically. Should a sudden, unforseen demand be made on the industry, under these conditions, a decided shortage would most certainly develop. This shortage could, and might, occur at a time when it would constitute a national calamity. Another major point is that this surplus of excellent canned foods is priced exceedingly low. The many items of canned foods included in this surplus supply make possible a wide and balanced diet. These goods keep perfectly over long periods, and are in compact form suitable for rapid, economical transportation and storage.

The suggestion is, therefore, repeated: That a government reserve supply of these canned foods be now established in the sincere belief that such reserve will be of material benefit in achieving the four following aims:

1. To round out the program of preparedness for national defense.
2. To improve and protect agricultural income.
3. To stabilize and increase employment.
4. To save and stabilize a basic industry.

NOTE.—Attached hereto is a brief compilation of some of the statistical facts regarding canned foods which may serve to emphasize their value and their importance as affecting agriculture and other related fields of activity.

EXHIBIT D

Amendment to Section 719 of the Internal Revenue Code

In lieu of subsection (b) of section 719 insert the following subsections:

"(b) *Borrowed invested capital.*—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall

be (except as provided in subsection (c)) an amount equal to 50 per centum of the borrowed capital for such day.

"(c) *Borrowed invested capital of corporations engaged in processing certain commodities.*—In the case of a taxpayer 65 per centum or more of the gross income of which for the taxable year is derived from processing, canning, or otherwise preparing for market any fruit or vegetable, or any fish or other marine life, the borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 100 per centum of the borrowed capital for such day provided—

"(1) Such taxpayer's average short-term borrowed capital for the taxable year exceeds 50 per centum of its average equity invested capital for such taxable year; and

"(2) Such taxpayer's short-term borrowed capital fluctuates during the taxable year to the extent that the highest amount exceeds by at least 100 per centum the lowest amount of its short-term borrowed capital during the taxable year.

"(d) *Short-term borrowed capital.*—The term "short-term borrowed capital" as used in subsection (c) means that portion of the borrowed capital referred to in subsection (a) which by the terms of the instrument evidencing the indebtedness matures in less than one year from the day for which the determination is made.

"(e) *Average equity invested capital and short-term borrowed capital.*—The average equity invested capital for any taxable year shall be the aggregate of the daily equity invested capital for each day of such taxable year divided by the number of days in such taxable year. The average short-term borrowed capital for any taxable year shall be the aggregate of the short-term borrowed capital for each day of such taxable year divided by the number of days in such taxable year."

AUGUST 25, 1941.

STATEMENT ON BEHALF OF NATIONAL CANNERS ASSOCIATION

RE COMPUTATION OF BORROWED INVESTED CAPITAL UNDER EXCESS-PROFITS-TAX LAW

The National Canners Association, a trade association whose members produce approximately 70 percent of the total annual pack of canned fruits, vegetables, and seafood, respectfully suggests that section 719 of the Internal Revenue Code should be amended to permit such canners of fruits, vegetables, and seafood, under certain restricted circumstances, to include 100 percent rather than 50 percent of their borrowed capital in computing invested capital for purposes of excess-profits taxation.

Such an amendment is essential in order to permit these canners in years of good earnings to pay off debts incurred in prior loss years and to build up a reserve for the loss years which, because of the nature of the industry, are inevitable.

As has already been demonstrated to the committee,[1] the canning industry, perhaps more than any other industry, is subject to extreme fluctuations in earnings from year to year. Profits and losses on the seasonal operations are determined entirely by natural factors—weather, crop condition, insect infestations, runs of fish, etc.—over which the canner can exercise absolutely no control. These natural factors may result in a serious underproduction or a tremendous overproduction, either of which is equally bad and may cause large losses for the year's operations. It is only when all natural factors combine to bring about a production nicely balanced with demand that the canner has a year of good earnings, and this may happen only once in 3 or 4 years. If the canner is to stay in business he must, during this single year of good earnings, make up the impairments which his capital has suffered during the bad years.

Under the terms of the present excess-profits-tax law, it is difficult if not impossible for a canner to thus make up his losses of earlier years. The annual fluctuations in earnings which have caused this difficulty make it impossible for him, in most instances, to compute his excess-profits credit under the income-credit method. Three of the years in the base period—1937, 1938, and 1939—were for most of the industry loss years, and most canners must, therefore, utilize the invested-capital method of computing their excess-profits credit.

Because of another peculiarity of the canning industry, however, the method of computing invested capital under the present law is extremely inequitable for

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[1] See the statement on behalf of the National Canners Association filed with the committee by Paul E. Shorb on September 5, 1940, in connection with the hearings on the Second Revenue Act of 1940 (pp. 340–347 of hearings on H. R. 10413, September 3–5, 1940).

most canners. Most canning enterprises are greatly undercapitalized and operate to a very large degree on borrowed capital. Yet the present law permits such canners to consider only 50 percent of their borrowed capital in computing invested capital. Because of their undercapitalization, and this limitation on the amount of borrowed capital which may be considered, the excess-profits credit of these canners is thus limited and they are denied the opportunity in a year of good earnings to make up their losses of earlier years.

The excess-profits credit carry-over authorized by section 710 (b) (3) of the Internal Revenue Code, is, of course, extremely helpful, but it is not sufficient. For it is limited to taxable years beginning after December 31, 1939, and thus does not permit canners to make up losses for the 3 extremely bad years 1937, 1938, and 1939. Moreover, as we have seen, the excess-profits credit, which may be carried over under section 710, is in itself restricted by the undercapitalization of canners and the limitation upon borrowed capital which may be considered in computing invested capital.

Accordingly, it is suggested that section 710 of the Internal Revenue Code should be amended in the fashion suggested at the end of this statement. It will be observed that this amendment permitting 100 percent of borrowed capital to be included in computing invested capital is subject to three limitations. First, it is limited to these processing industries, where its need is greatest. Second, it is limited to companies whose short-term invested capital exceeds 50 percent of its average equity invested capital. Finally, the amendment is applicable only when the company's short-term borrowed capital fluctuates during the taxable year to a specified degree. With these safeguards the amendment will constitute no serious drain on the revenues to be produced by the bill.

AMENDMENT TO SECTION 710 OF THE INTERNAL REVENUE CODE

In lieu of subsection (b) of section 710 insert the following subsections:

"(b) *Borrowed invested capital.*—The borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be (except as provided in subsection (c)) an amount equal to 50 per centum of the borrowed capital for such day.

"(c) *Borrowed invested capital of corporations engaged in processing certain commodities.*—In the case of a taxpayer 65 per centum or more of the gross income of which for the taxable year is derived from processing, canning, or otherwise preparing for market any fruit or vegetable, or any fish or other marine life, the borrowed invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be an amount equal to 100 per centum of the borrowed capital for such day provided—

"(1) Such taxpayer's average short-term borrowed capital for the taxable year exceeds 50 percentum of its average equity invested capital for such taxable year; and

"(2) Such taxpayer's short-term borrowed capital fluctuates during the taxable year to the extent that the highest amount exceeds by at least 100 per centum the lowest amount of its short-term borrowed capital during the taxable year.

"(d) *Short-term borrowed capital.*—The term 'short-term borrowed capital' as used in subsection (c) means that portion of the borrowed capital referred to in subsection (a) which by the terms of the instrument evidencing the indebtedness matures in less than 1 year from the day for which the determination is made.

"(e) *Average equity invested capital and short-term borrowed capital.*—The average equity invested capital for any taxable year shall be the aggregate of the daily equity invested capital for each day of such taxable year divided by the number of days in such taxable year. The average short-term borrowed capital for any taxable year shall be the aggregate of the short-term borrowed capital for each day of such taxable year divided by the number of days in such taxable year."

The CHAIRMAN. Mr. Parker.

STATEMENT OF LOVELL H. PARKER, TAX ASSOCIATE, WASHINGTON, D. C.

Mr. PARKER. Mr. Chairman and gentlemen of the committee, I am listed to appear today as a "tax associate." I have prepared a rather lengthy, though condensed, memorandum covering certain

phases of the bill in general. That memorandum is too long to discuss, and with your permission, I will file it for the record.

That is the first memorandum you have before you. I think you may find some figures of value in it, especially those in connection with the surtax rates, which is a subject which has not been completely developed, I think, before the committee.

Since I asked for time, one of our clients, the Republic Steel Corporation, has asked me to present briefly two points in their behalf concerned with the excess-profits tax, and with your permission, I will read a statement thereon. I think it will take perhaps only 8 or 9 minutes. The two points which will be discussed are, first, the special 10-percent tax imposed under certain conditions upon companies making use of the invested-capital method, and, second, the reversal of the method of credits which results in the excess-profits tax being computed without prior deduction of the normal tax. I now read from the memorandum presented in behalf of Republic Steel Corporation:

Under date of September 5, 1940, in connection with hearings on the Second Revenue Act of 1940, Republic Steel Corporation, the third largest steel company in the world, filed a memorandum with this committee advocating a minimum credit allowance of 6 percent on invested capital before the imposition of an excess-profits tax. (See hearings, p. 255.)

Copy of this memorandum is attached hereto for consideration by the committee in connection with the memorandum which I am now reading. For present purposes I desire, however, to quote the conclusion of the memorandum of September 5, 1940, as follows:

> We submit that if Republic Steel Corporation is not permitted to earn at least 6 percent of its invested capital before the imposition of any excess-profits tax the expansion of its business will be retarded, the number and welfare of its 50,000 employees adversely affected, and, in the long run, the amount of taxes paid the Government diminished rather than increased.
>
> The same considerations are present in the case of most of the other units in the steel industry as has been shown by industry figures heretofore appearing in this memorandum. Undoubtedly they also obtain in other important industries.

I pause at this point to say that at the conclusion of this memorandum I shall read to the committee a letter from the treasurer of one of the largest companies in an entirely disrelated industry which will bear out what has just been stated about industries other than the steel industry. Resuming our quotation from the original memorandum:

> Therefore, we respectfully urge that the Congress of the United States make appropriate provision in the proposed tax bill for the allowance of a credit of 6 percent at least upon invested capital before the imposition of an excess profits tax.

In enacting the Second Revenue Act of 1940, Congress saw fit to permit an 8-percent credit, which provision this company regarded as not only fair but wise from the Government's own standpoint.

The memorandum, above mentioned, sought only to show that in its own case, and in the case of many corporations with similar histories, 6 percent was the very minimum which should be allowed if the absolute necessities of successful operation over a period of years were regarded. Republic Steel Corporation has no desire to make exorbitant profits out of the national-defense program. It has no desire—

even if it were able—to build up unnecessary surpluses, pay unreasonable dividends, or to create any millionaires. It does desire to maintain its credit, to pay its debts, to promote the welfare of its employees, to maintain its plants, and to pay some dividends at least to its stockholders who have invested their money in its business. It feels that the best interests of the country as well as its own will be served by such a program.

Earnings history of last decade.—For the 11-year period 1930 to 1940, inclusive, the total net income of Republic Steel Corporation after deducting deficits has amounted to approximately $15,500,000.

The year of highest earnings was 1940, when earnings amounted to approximately $21,100,000. The year of greatest loss was 1932, when the company showed a red figure of approximately $11,260,000. If the earnings for 1940 were eliminated, there would have been a deficit of over $5,000,000 as a result of operations for the 10 preceding years. In fact, Republic Steel Corporation was unable to pay any dividends on its common stock from 1931 to December 1940. The total average annual return on its invested capital of approximately $300,000,000 in the 11 years in question, has been about 1.8 percent.

Senator CONNALLY. That includes 1940, does it?

Mr. PARKER. That includes 1940; yes, sir.

Even in the banner year, 1940, its earnings were less than 8 percent on its invested capital.

A corporation cannot continue to exist over an indefinite period on such a small margin of profit. Where its history shows that a procession of peaks and valleys is inherent in its business life, it must be permitted a reasonable profit, before excess-profits taxes are applied, in the good years in order to recoup the losses of the deficit years. This is especially true in the case of the steel industry whose history shows great fluctuations in earnings.

Objections to proposals in pending revenue bill.—The pending revenue bill (H. R. 5417), as passed by the House of Representatives, makes substantial changes in the excess-profits tax as it now exists. We shall not protest against the proposal to reduce the rate of credit from 8 to 7 percent on invested capital in excess of $5,000,000, although we think that a continuation of the present 8-percent allowance would be better for the Government itself in the long run if large future revenues are to be obtained from corporation income taxes. However, we do wish to register a strong protest, first, against the special 10-percent tax proposed, and, second, against computing the excess-profits tax before deducting the normal tax—that is, against reversing the credit allowed by existing law.

Senator BROWN. Tell me, as a tax expert, does the 10-percent reduce the credit below the 4.9, or is 4.9 the minimum?

Mr. PARKER. The 10 percent would reduce it below that. Just the reversal of the credit would result in the 4.9 percent.

Senator BROWN. Is that so?

Mr. PARKER. Yes, Senator. It is almost impossible to say what the 10 percent would do. It would depend on the earnings during the base period. It might not apply at all.

Senator BROWN. I get it. In some instances it could reduce it to a point below 4.9?

Mr. PARKER. That would be the effect; yes, sir.

Senator BROWN. So instead of 8 as we originally had it, we reduce it to a point, in some instances below 4.9?

Mr. PARKER. That would be the result; yes, sir.

Senator BROWN. I see.

Mr. PARKER. These two subjects will now be briefly discussed.

Special 10-percent tax: The pending revenue bill proposes a special 10-percent tax on corporations using the invested capital method. We believe and will attempt to show that this represents an unfair and unwise discrimination against companies which are, of necessity, forced to use the invested capital method.

First, we should like to point out that the Treasury Department itself has consistently advocated the sole use of the invested capital method. Without taking sides in such a controversial issue, we feel that the bill should at least insure that those companies whose earnings history compels them to use the invested capital method will not be penalized in so doing, as against companies which are able to make use of the average earnings base. Yet this is exactly what happens under the provisions of the House bill.

Congress has recognized the necessity of the two separate methods. It has said in effect that corporations shall at least be entitled to some fair and reasonable earning on invested capital before the imposition of an excess-profits tax.

It has further said that in the case of corporations which are fortunate enough to have a history of stable earnings, their average earnings over a period shall constitute the criterion, even though the credit so established may represent many times the rate of return on invested capital allowed to companies using the invested capital method.

We submit that the two methods are designed to take care of two entirely different situations and therefore are in no way related. And yet, in the House bill, for reasons which certainly have no support in logic or fairness, the two methods are commingled in the case of companies compelled to use the invested-capital method—but not in the case of those using the average-earnings method. After providing for crediting a reasonable return on invested capital, 8 and 7 percent, the House bill then says in effect: "But we will also relate your credit to your earnings history and, if you have had only a small percentage of earning or none at all during the base period, then we will tax you 10 percent on the difference between those earnings and current earnings."

In other words, it penalizes such companies for lacking the very characteristic, that is, stable earnings, which, if possessed, would have enabled them to make use of the average-earnings method in the first instance and thus possibly receive a credit much greater than would be permitted under the invested-capital method.

Equality of treatment in this situation, if the House proposal is to be accepted, would require that corporations which use the average-earnings method be limited to a definite percentage return on their invested capital no matter what their average earnings may have been. The two principles are exactly the same. Of course, we do not advocate this because two wrongs do not make a right.

This special 10-percent tax may apply, in fact, to corporations having earnings of less than 1 percent on their invested capital, where such corporations had no base period earnings.

We think we have said enough to demonstrate not only that the proposal is unfair and discriminatory, but that it will make irrepara-

ble inroads on the income of companies which must be permitted to retain a substantial proportion of their earnings in good years if they are to survive the inevitable bad years.

Reversal of credits.—Equally as unfair as the provision just discussed, but at least not discriminatory since it applies to all corporations alike, is the proposed reversal of credits, whereunder excess-profits taxes are assessed against income prior to deduction of the normal tax. It should be noted, however, that the House bill benefits corporations using the average earnings method with respect to the method provided under existing law by providing that the earnings of base period years be computed without deduction of income taxes.

In effect, this reversal of credits amounts to the imposition of an excess-profits tax not on real earnings but on money already absolutely earmarked to pay the normal tax, which is universally recognized in accounting practice as a regular fixed business expense, to be deducted before real net earnings are arrived at. It is no different in substance than if an excess-profits tax were levied on money about to be used to meet an interest payment, a real-estate tax, a pay roll, or any other fixed business expense.

It is impossible to say by what process of reasoning a tax on such a fund can be called or considered a tax on excess profits. It is not a tax on profits at all, much less on excess profits. It is, in practical effect, a tax on a liability.

The House report on the bill (H. R. 5417), in fact, admits that this reversal of the credits is equivalent to a reduction in the rate to be allowed on invested capital before the imposition of the excess-profits tax. The report states as follows:

> The effect of the reversal of the deduction is that the 8-percent credit on invested capital provided in the bill is equivalent to a credit on invested capital of 5.6 percent after deduction of the normal tax and surtax, and the 7-percent credit on invested capital is equivalent to a credit on invested capital of 4.9 percent after deduction of the normal tax and surtax.

When the rate on invested capital allowed to the larger companies is practically only 4.9 percent, such rate is far too low to permit of successful operation in the future years, as was pointed out in our original memorandum filed with the Committee on Finance on September 5, 1940.

Conclusion.—We respectfully urge, therefore, that the special 10-percent tax be abandoned and that the credit of normal tax against net income before computing the excess-profits tax be allowed as in existing law.

Such action we believe to be for the good of the Government as well as the taxpayer, because by removing inequities and penalties, it will encourage reasonable expansion and cooperation in the defense program, and will tend to keep our national income on the upgrade, thus increasing the revenue yield, since there will be more income to tax. More important than the revenue for the one fiscal year, 1942, is the sustained revenue yield for subsequent fiscal years.

Submitted in behalf of Republic Steel Corporation by Lovell H. Parker, tax associate, Guy & Brookes, Washington, D. C.

Now, I would like to submit this letter by Mr. Weaver.

The CHAIRMAN. Mr. Parker, before you leave the Republic Steel Corporation case, if the special 10 percent were eliminated you would have a credit of approximately 5 percent against your excess profits?

Mr. PARKER. You mean because, on the first $5,000,000 you would get a certain amount of credit at 5.6 percent?

The CHAIRMAN. I mean the elimination of the 10-percent special tax would have that effect in your case, which would be higher than any earnings of this particular company during the 11-year period, or during any fixed period as shown by your table, except in 1923 and 1929. In both those years it did make somewhat above it, and also in 1926.

Mr. PARKER. Of course, in 1940, as we pointed out, nearly 8 percent.

The CHAIRMAN. Yes; that is true.

Mr. PARKER. And still when you consider the amount that must be used in a corporation for expansion and other purposes, and the number of stockholders involved—because, after all, these corporations are more or less cooperative enterprises, and there are a lot of small stockholders whose income depends on these corporate earnings and if the stockholders get income, then they pay taxes—I do not think, considering the last 10 years, when you have average earnings of only 1.8 percent, that is sufficient, it having already been pointed out that when this emergency period is over an economic disturbance will arise which will require some backlog in the treasury of a company.

Senator LA FOLLETTE. How does the first quarter of 1941 compare with the first quarter of 1940?

Mr. PARKER. 1941?

Senator LA FOLLETTE. Yes.

Mr. PARKER. It is above it, Senator.

Senator LA FOLLETTE. Do you know how much?

Mr. PARKER. No; I do not, Senator. I can find that out and supply it for the record, if you desire. I haven't the 1941 figures here.

The CHAIRMAN. With the elimination of the 10-percent tax, that special 10-percent tax, as I have stated here several times in the hearing, in view of the graduated tax you have got a flat deduction in your case of approximately 5 percent, and then with the graduated rates, you have net earnings, from your showing, of approximately 7 percent, after the payment of all taxes, normal and excess.

Mr. PARKER. The graduated rate would be of substantial benefit, Senator, if it were based on percentage brackets instead of on dollar brackets, but when you get a large company, your relief from that graduation becomes insignificant.

The CHAIRMAN. That is true and it reflects directly back on the stockholder, of course.

Mr. PARKER. And, therefore, the company. The big companies making big earnings, regardless of the fact that they may have 600,000 stockholders, will practically pay 60 percent on nearly their entire income.

The CHAIRMAN. That is true. I think even under the graduated rate and with the elimination of the 10 percent, it should be up considerably.

Mr. PARKER. This letter, which I had started to present, reads as follows:

INTERNATIONAL PAPER CO.,
New York, N. Y., August 20, 1941.

Mr. LOVELL H. PARKER,
GUY & BROOKES, *Washington, D. C.*

DEAR MR. PARKER: I have read with great interest the memorandum of the Republic Steel Corporation with respect to proposed changes in invested-capital

method of computing excess-profits tax and am in complete agreement with the reasoning behind this memorandum.

While you deal only with the steel industry, many other industries, including our own, are similarly affected. For the 10 years ending December 31, 1940, International Paper & Power Co. was able to pay only $0,731,000 in dividends on approximately $93,000,000 of preferred stock outstanding during this period, an average of only slightly more than 1 percent per annum. Of this amount $5,787,000 was paid in 1940. During the same period, the common stock received no dividends at all.

I feel that the reduction in the invested-capital credit from 8 to 7 percent on amounts over $5,000,000, the special 10 percent tax proposed, and the elimination of the normal income tax as a credit against excess-profits tax income, discriminate against the very class of corporation which it should be in the interest of the Government to build up. This discrimination consists of (1) a reduction in the invested-capital credit plus the imposition of the 10-percent tax proposed whereas the base-period-earnings exemption is increased by eliminating the deduction of income taxes in the base period, and (2) an additional penalty by the elimination of the normal income tax credit against excess-profits-tax income whereas this is minimized to the corporation using the average-earnings-base credit by adding back normal income taxes in determining the average-earnings-base credit. While it is true that this latter provision applies to all corporations generally, the fact is that the "average earnings" corporations have a material amount to add back while the "invested capital" corporations add back nothing or an insignificant amount and it only helps them in reducing the additional 10-percent tax proposed.

Why should any investor invest his money in an industry which is subject inherently to heavy losses in some periods and large profits in others if the large profits when earned are appropriated by the Government in the form of discriminatory excess-profits taxes?

I am not arguing against excess-profits taxes as such but merely for reasonable credits before computation, taking into consideration companies inherently having widely fluctuating earnings and low earnings in the base period. To my mind the credits provided in the 1940 act are reasonable and should not be changed.

Undoubtedly the changes in these credits made by the House bill will produce more needed taxes. My thought is that this needed sum should be raised in some manner that will affect all corporations alike (unless it can be raised through broadening the personal income tax base, a wage tax, or a sales tax) and not by a method that discriminates against the very class of corporations which should be helped, if private investment for profit is to be preserved.

Yours very truly,

H. R. WEAVER,
Vice President and Treasurer.

Now just briefly recapitulating what we have said, in the case of the Republic Steel Corporation, one of the largest steel companies and fairly typical of the steel industry in this country, it appears that over an 11-year period total earnings on its average invested capital during that period were only at the average annual rate of 1.8 percent.

Furthermore, but for the large earnings in 1940, it would actually have earned $5,000,000 less than nothing on its invested capital over a period of 10 consecutive years.

Finally, for the 10 years preceding December 1940, the corporation was unable to pay a single dollar as dividends to its common stockholders.

Now, in the case of the International Paper Co., the biggest company of its kind in the world and therefore typical of the paper industry over the entire decade from 1930 to 1940, it was able to pay only a total of approximately 10 percent to its preferred stockholders on the money invested by them in the company, that is, an average of only 1 percent per year. Of this amount over 50 percent was paid in 1940, the only really good year of operations during the period.

During the same decade, the company was unable to pay a dollar to its common stockholders.

In other words, here are two large industries, one admittedly having to do with the national-defense program, and one having no direct connection with the defense program, both of which——

Senator CONNALLY (interposing). Let me ask you, this company that paid 10 percent on preferred stock, what relationship did that bear?

Mr. PARKER. That was 10 percent in 10 years, or 1 percent in 1 year.

Senator CONNALLY. Ten percent in 10 years?

Mr. PARKER. That is right. We think therefore, that these two cases show the necessity for permitting companies so situated to earn a fair return upon their invested capital during years of active business if they are eventually to survive the years of deficits from operations which must inevitably follow if history repeats itself.

That is all, thank you.

Senator VANDENBERG. Mr. Parker, I would like to ask you one general question. If there is anybody in the country who knows the problem with which we are confronted from this side of the table, you do, because of your long experience with it. I have run through superficially your general brief, in addition to the particular subject which you have been discussing and, in every instance, you seem to be suggesting the elimination of tax revenue from this bill. Would you care to offer any suggestion to us as to where we might make up the amount that we would lose if we follow your suggestion with respect to deductions?

Senator CONNALLY. May I suggest that Mr. Parker has quit the prosecution and gone over to the defense?

Mr. PARKER. Yes; I do not mind answering that question, Senator.

Of course, in the first place, under a revision of surtax schedules, I did not mean to reduce the total revenue, I meant ironing out the surtax schedules so as to make them more consistent.

If you lower the base, you will get just as much from the income tax on individuals as before, I believe.

Now, as to corporations, I would make the base fair, even if you had to increase the normal corporate rate. Going further than that, of course you face a real problem, and I know that some Members of Congress have publicly stated, even those who have objected in the past to any form of sales tax, that we might have to come to such a tax. What form that should be is hard to say.

I studied those taxes for years. For instance, the gross income tax is the most productive. It permits of pyramiding and is unsatisfactory at too high a rate.

Then there is the manufacturers' sales tax, the retail sales tax, and the purchase tax, which is now used in England.

The only thought I had was if you have got to have such a tax, why wait? If it is admitted that you have got to have one anyway.

Senator VANDENBERG. If you had to choose between the various general tax principles that you have related, which one would you choose?

Mr. PARKER. I believe in going rather slowly in trying out new taxes. I think we should try out the purchase tax first which, while

a good deal like the sales tax, eliminates the tax on the necessities of life, and is more flexible than the ordinary sales tax, because the items are specified which are to be exempted or taxed.

Senator VANDENBERG. Thank you.

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

Mr. PARKER. Thank you, Mr. Chairman and Senators of the committee.

(The matter submitted by Mr. Parker is as follows:)

[Open letter to the Senate Committee on Finance from Lovell H. Parker, Tax Consultant, Washington, D. C.]

To the Committee on Finance,
United States Senate,
Washington, D. C.

MY DEAR CHAIRMAN AND MEMBERS OF THE COMMITTEE: While it will undoubtedly be impractical on account of the time element to attempt a complete revision of our internal revenue laws in connection with the bill now pending before your committee, I do believe that, in view of the very high rates which are proposed, the income tax base should be made as equitable as possible at this time to prevent grave injustices. In other words, the income tax base is just as important, or more so, than the rates of tax.

I am taking the liberty of drawing to your attention certain matters which I consider worthy of consideration in connection with this bill, whether they are general or special in character.

1. *How much additional revenue?*—When discussions with respect to the revenue bill of 1941 began before the House Ways and Means Committee, on April 24, 1941, the Secretary of the Treasury asked for $3,500,000,000 of additional revenue, which he admitted would be "an increase without precedent." At that time it was estimated that about two-thirds of the cash expenditures necessary to run the Government during the fiscal year 1942 would come from taxes (existing and proposed) and that one-third would be provided for by borrowing. There was no magic to that formula nor is there now.

On May 22, 1941, I made a statement before the Ways and Means Committee (see p. 1405, vol. 2, of House Hearings on Revenue Revision of 1941), from which I quote:

"However my theme is to suggest to the committee that it should so design this tax bill as to raise 2½ billion dollars in the first year instead of 3½, and if you do you will probably get 3½ billion dollars in the second year; whereas if you put a 3½ billion-dollar tax on the country in the first year you will probably only get 2½ billion dollars in the second year; that is, under the impact of the tax program as proposed by the Treasury Department, the burden will be so great as to decrease the national income and to decrease the tax revenue."

It is true that since the above statements were made the appropriations have been increased several billions of dollars, and I realize that your committee will, in all probability, try to reach a goal of 3½ billion dollars. I still feel, however, that more important than immediate revenue is continuous revenue for future years. If, therefore, your committee can design a bill which will provide for 3½ billion dollars of additional revenue in the first year, that is much to be desired, provided that it does not in subsequent years depress our national income and our tax revenue because of the effect of the new tax system on our economy. It seems necessary, if we are to place our principal hope for revenue on income taxes, that we have a large volume of income to tax and that, therefore, the tax bill must be designed to give reasonable incentive to our citizens to work, invest and produce income which can be taxed.

To answer the question of how much additional revenue should be raised, I would reply that the limit and the methods should be so fixed as not to prove a deterrent to the maintenance of our national income over the years immediately ahead.

2. *Surtax schedule.*—It is remarkable how little testimony has been given to the committee on the subject of surtax rates. Yet this schedule, under the new proposal of starting surtaxes on the first dollar of taxable income, vitally affects millions of our citizens.

Of course, the schedule is supposed to be based on the principle of ability to pay. This phrase "ability to pay," however, has been wrongly used. It has

served as an excuse for all kinds of punitive taxes and all kinds of tax reduction schemes. That is, one school of thought would take away in taxes 100 percent of a man's earnings over the national income average of about $1,400 per capita; the other school would either abandon the income tax or levy on income the same tax percentage, regardless of the amount of the income.

Fortunately, up to this time, the Congress has adopted neither of these extreme courses, but has attempted to adopt a schedule which, while at times steeply graduated, has, with possibly some exceptions, left the taxpayer a reasonable sum after the payment of his income tax as a reward for his labor, knowledge, and ability. Thus his efforts and his incentive to employ his talents usefully have been fostered. In my opinion, the surtax schedule proposed in the pending bill in many instances passes the danger point and will not leave the taxpayer sufficient reward to give him the proper incentive.

The Revenue Act of 1918, enacted in a similar period, imposed unprecedently high income taxes and yet this proposed revenue bill of 1941 far exceeds the rates of tax imposed by the 1918 Act. In fact, every person with a net income of over $2,300 pays more tax under this bill, and many as much as 80 percent more. The total income tax on a married man with no dependents under the 1918 act and under the pending bill is shown by way of comparison in the following table:

Comparative income-tax table, Revenue Act of 1918 and proposed revenue bill of 1941

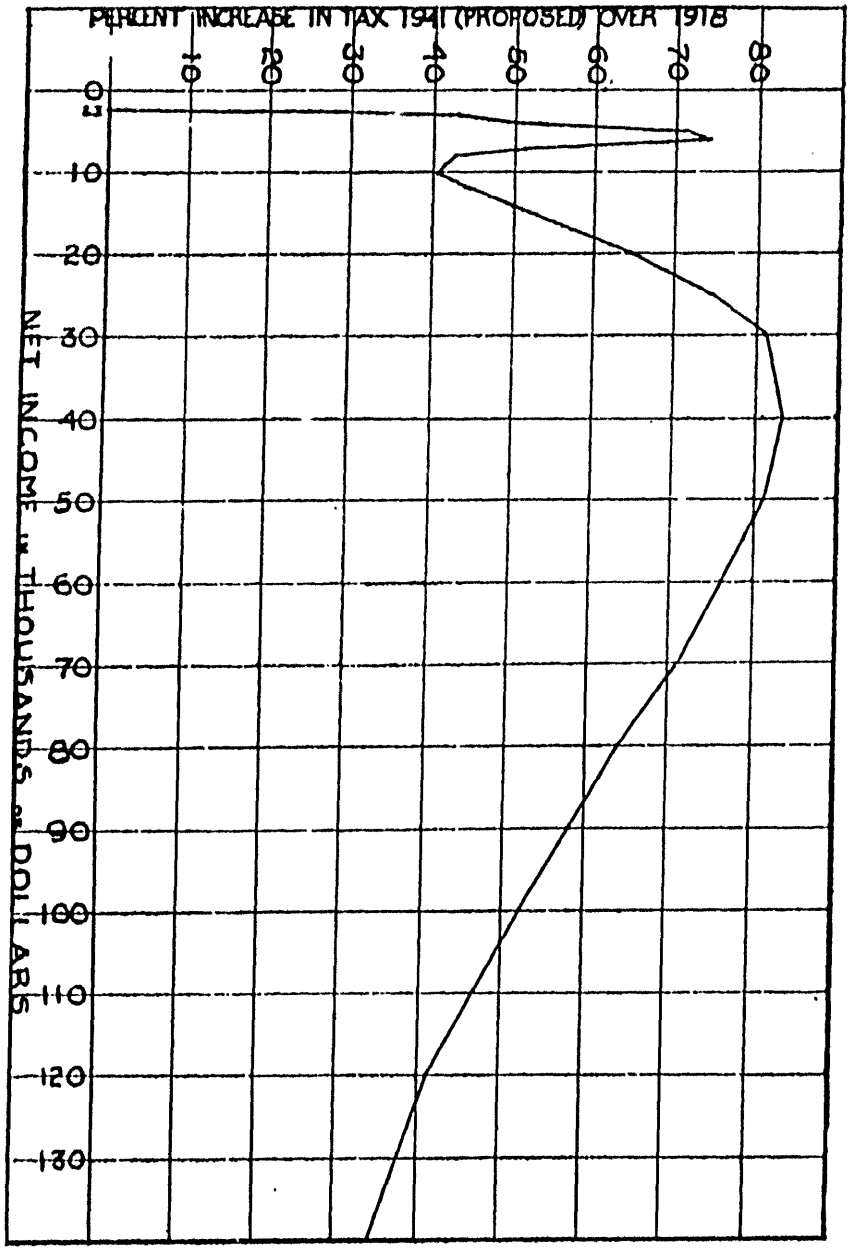
[Married man with no dependents]

Net income	1918	Percent tax to net income	1941 (proposed)	Percent tax to net income	Increase in tax	Percent increase 1941 tax over 1918 tax
$2,500	30	1.2	$38.50	1.5	$8.50	28.3
$3,000	60	2.0	85.80	2.9	25.80	43.0
$4,000	120	3.0	180.40	4.5	60.40	50.3
$5,000	180	3.6	308.00	6.2	128.00	71.1
$6,000	250	4.2	435.60	7.3	185.60	74.0
$7,000	390	5.6	596.20	8.5	206.20	52.9
$8,000	530	6.6	756.80	9.5	226.80	42.8
$9,000	680	7.6	961.40	10.7	281.40	41.4
$10,000	830	8.3	1,166.00	11.7	336.00	40.5
$12,000	1,150	9.6	1,663.20	13.9	513.20	44.6
$15,000	1,670	11.1	2,545.40	17.0	875.40	52.4
$20,000	2,630	13.2	4,338.40	21.7	1,708.40	64.9
$25,000	3,720	14.9	6,505.40	26.0	2,785.40	74.9
$30,000	4,930	16.4	8,936.40	29.8	4,006.40	81.2
$40,000	7,730	19.3	14,194.40	35.5	6,464.40	83.6
$50,000	11,030	22.0	20,002.40	40.0	8,972.40	81.3
$60,000	14,830	24.7	26,206.40	43.7	11,376.40	76.7
$70,000	19,130	27.3	32,652.40	46.6	13,522.40	71.2
$80,000	23,930	29.9	39,318.40	49.1	15,388.40	64.3
$100,000	35,030	35.0	53,310.40	53.3	18,280.40	52.2
$120,000	47,830	39.9	67,479.60	56.2	19,649.60	41.1
$140,000	60,630	43.3	81,359.60	58.1	20,729.60	34.2
$150,000	67,030	44.7	88,299.60	58.9	21,269.60	31.6
$250,000	137,030	54.8	159,013.60	63.6	21,983.60	16.0
$500,000	323,030	64.6	346,805.60	69.4	23,775.60	7.4
$750,000	513,030	68.4	540,537.60	72.1	27,507.60	5.3
$1,000,000	703,030	70.3	736,519.60	73.7	33,489.60	4.7
$2,000,000	1,473,030	73.7	1,529,501.60	76.5	56,471.60	3.8

The figures given can be more readily visualized by the following chart which shows graphically the percentage of increase in taxes proposed in this bill on incomes up to $140,000 over the taxes imposed by the War Revenue Act of 1918.

It is apparent from the table and chart submitted that either the measure of ability to pay was all wrong in 1918 or it is all wrong now, for the increases are entirely inconsistent. From the figures given, it is clear, for example, that a married man with a $6,000 net income under the bill is deemed to be able to stand a tax increase of 74 percent over his 1918 tax, one with a $10,000 net income an increase of only 40½ percent, and one with a $40,000 net income an increase of over 83½ percent.

It is urged, therefore, that the surtax schedule be more carefully studied and the increase made more consistent throughout the whole schedule.



3. *Earned income relief.*—The present law merely retains the principle of a differentiation between the tax on earned income and on investment income without giving any adequate relief. For example, a married man with a net income of $10,000 from salary under the proposed bill pays an income tax of $1,166, while a married man with a net income of $10,000 from investments pays an income tax of $1,196.80, a difference of only $30.80. In fact, the maximum difference in tax on earned income and unearned income is only $48.40, on account

of the provision in the law which stipulates that not more than $14,000 of income shall be considered as earned income. It is believed that this difference in tax is entirely inadequate.

In examining the relative financial status of the man with $10,000, received from salary, and of the man with $10,000 from investment income who does not work, I believe that it is fair to assume that the man with the $10,000 of investment income would have approximately $200,000 of capital. This means that he does not have certain of the out-of-pocket requirements which serve to drain the income of the salaried man. Roughly comparing the two situations, I have calculated that the man with investments has left about $3,000 per year after necessary living expenses, while the salaried man has only $400.

It seems clear from the above that the man on a salary is at a distinct disadvantage compared to the man with investment income, and has substantially less ability to pay. The man with investment income has ample funds to meet emergencies. The man on a salary has no such security. Moreover, and most important, it becomes under the proposed tax rates very difficult for a man starting with no capital and his only income from salary to build up any substantial capital. It is believed, therefore, that consideration should be given to an earned income relief which, at least up to a net income of reasonable size, should reduce surtaxes as well as normal taxes.

4. *Exemptions for dependents.*—The existing law and the proposed bill allow an exemption (that is, a deduction) of $400 for each dependent child under the age of 18 years.

When such a dependent becomes over 18, the exemption is automatically removed. However, it is at this very time in the case of a child attending college that the expenses of the parent in maintaining such child are the greatest. It is believed, therefore, that in the interest of equity, consideration should be given to providing that the exemption of $400 for a child should be allowed up to the age of 21, provided such child is attending college.

5. *Alimony.*—Under existing law and the proposed bill, a spouse who pays alimony is not allowed a deduction for such payment in his or her return. On the other hand, the spouse receiving the alimony pays no tax. This situation leads, under the new rates now proposed, to exceptional hardship. It may be possible, in fact, for a man having a substantial income and paying substantial alimony to have nothing left after payment of the tax. This is, of course, because he has to pay tax on all of the income which he enjoys and also has superimposed upon his income the alimony paid to the wife. It is suggested, therefore, that the committee should provide for the inclusion in gross income of the payee such alimony payments and exclude such payments from the gross income of the payor. As an optional suggestion, if legal questions are raised, it is suggested that a man pay a tax on his own income, reduced by the amount of alimony payments, and then pay a tax on his wife's income insofar as it consists of such alimony payments in an amount computed on the basis that the alimony payments were the entire net income of a single person.

6. *Custodian's fees.*—For many years the Bureau of Internal Revenue allowed custodians' fees, investment counsel fees, and reasonable management expenses in connection with handling personal as well as real property, to be deducted from income in arriving at taxable income. These deductions, in the case of personal property, are now being disallowed as the result of a court decision. It is believed that these expenses should be allowed by the law, since they are as necessary in the production of the income which is taxed as in the case of any other expenses in connection with the production of income.

7. *Excess-profits tax on new or recently formed corporations.*—The Congress has wisely provided, in the law now in force, for two optional methods of computing the excess-profits tax—namely, the invested-capital method and the average-earnings method. Both of those methods are retained in the pending bill. These two methods give reasonable treatment to a great number of corporations which would otherwise suffer exceptional hardship if only one method were provided for.

Neither existing law nor the pending bill, however, provides for any consistent treatment of new or recently formed corporations which have relatively low capital and are either completely or partially denied the use of the average-earnings method because they were not in existence during any or a part of the base period.

Our whole American philosophy demands the encouragement of new businesses and equal rights to them in comparison with rights enjoyed by the old. In fact, many sound reasons can be advanced why new companies should have some special measure of advantage during the first few years of their existence over the rights enjoyed by their seasoned competitors.

Since under existing law and the provisions of the pending bill new or recently formed companies are denied the use of the average earnings method or secure very inadequate treatment thereunder, it is suggested that such companies be entitled to compute their average earnings base by using the first 4 years of their existence as a criterion or such lesser number of years (including the taxable year) if they have not been in existence for 4 years. If it is thought this might open the door to profiteering, then it could be provided that only a certain percentage of the average earnings be allowed in computing the average earnings credit.

Much is said about taking the profit out of war and out of the defense program. This is meritorious to a certain extent, and still we must keep alive the profit motive. For example, everyone knows that nothing is more important than supremacy in the air, and yet what is the use of asking a man to put money into a new airplane plant if he takes all the risk but can only receive negligible profits after taxes?

In my judgment the developing aviation manufacturing industry is so important to this country in many ways that it should be especially classified and opportunity deliberately afforded the struggling smaller units to retain a substantial portion of their present abnormal earnings for purposes of future development.

8. *Reversal of excess-profits credit.*—I have prepared and submitted a special memorandum on this and the following point in behalf of Republic Steel Corporation. I respectfully refer the committee to this memorandum for my strong views on these points.

I strongly urge that the proposal to reverse credits be eliminated.

9. *Special 10-percent tax.*—The pending bill imposes a special 10-percent penalty tax on corporations using the invested-capital method of computing excess-profits tax. (See memorandum in behalf of Republic Steel Corporation.)

I strongly urge that this tax be eliminated.

10. *Qualified component corporation.*—On account of a technicality in the law which is believed to have been left in by mistake when the Senate revised the House bill (second revenue bill of 1940), a corporation which forms a wholly owned subsidiary during the base-period years and then dissolves it during the base period cannot include the subsidiary's earnings with its own in computing its average earnings during the base period. Inasmuch as this treatment seems inconsistent and is believed to have resulted from a mistake, it is hoped that the committee will see fit at this time to remedy the matter by changing the definition of a qualified component corporation so that the date specified in the law would be January 1, 1940. (See sec. 740 (c).)

11. *Personal holding companies.*—The purpose of the high rates imposed upon personal holding companies is obviously to get at those cases where profits are deliberately not distributed in order to permit an individual to escape high surtaxes. Examination, however, proves that the provision, as now contained in the law, works inequity in a number of situations which do not have this characteristic. It seems clear that it should be rewritten. For example, situations arise where a corporation's net income is taxed at the 75-percent rate applicable to net incomes of personal holding companies, in spite of the fact that the total amount of this net income is distributed to the stockholders. It would also seem equitable that a parent company holding practically all the stock of a subsidiary company and receiving practically all its income therefrom should not be considered to be a personal holding company, regardless of the fact that it possesses the legal characteristics, since it is really an operating company. There are actual cases where for legal reasons the holding company cannot be dissolved or where practical reasons prevent dissolution, such as financial inability to retire outstanding bond issues. It will be noted that there is no special tax on closely held operating companies.

12. *Capital stock tax.*—It is extremely difficult for corporations during this emergency period to make any accurate predictions as to their future earnings and still such predictions are necessary in setting their capital stock tax value. It is believed, therefore, that for the next 3 years corporations should either be given the right to revalue every year or at least, following the precedent

established in the past, should be allowed at their option to increase their declared value annually.

13. *Excise taxes.*—It would seem that some of the small excise taxes which return little revenue and which apply to articles not interfering with the national defense program, might well be omitted when such taxes decrease the taxable net income of the industries affected and thus hardly pay for the cost of administration. For example, a number of taxes, such as those on sporting goods, commercial washing machines, outdoor advertising, and the increased tax on safety deposit boxes, could be eliminated, among others, with very little loss of revenue.

Conclusion.—This memorandum is only intended to point out some of the general and special features which it is believed the committee might well consider in the pending bill. We are strongly of the opinion that our whole tax system needs careful revision. High rates make it imperative that the tax base be fair and be so designed as to prevent discrimination between industries or between different corporations in the same industry.

Respectfully submitted.

LOVELL H. PARKER,
Tax Associate, Gulp & Brookes, Washington, D. C.

The CHAIRMAN. Dr. Townsend.

STATEMENT OF DR. FRANCIS E. TOWNSEND, WASHINGTON, D. C., FOUNDER OF THE TOWNSEND NATIONAL RECOVERY PLAN

The CHAIRMAN. Dr. Townsend, you are appearing for the Townsend National Recovery Plan, or just generally on the question of the gross-income tax?

Dr. TOWNSEND. On the gross-income tax. Of course, I represent an organization that is vastly interested in taxation for a specific purpose but, I believe, gentlemen, that, a serious consideration of the gross-income tax at this time, when it is so obvious that the Government must raise enormous volumes of money, will be most profitable, and I want to cite you to the result of a gross-income tax as practiced in the Hawaiian Islands and in the State of Indiana.

Perhaps as good a presentation of the working of the tax as I could give is in the report of Hawaii's gross-income tax, as presented by their tax commissioner of the Territory of Hawaii. So, with your permission, I will read a couple of pages from that report. It is entitled "The Hawaii Gross Income Tax Law From the Standpoint of the Taxing Official."

We, who are the administrators of the various tax laws handed down by the legislature from time to time, fully realize the importance of a tax law such as our gross-income tax law. The numerous complexities and inability to adapt the requirements of each law to the machinery of the tax office, often present a complicated procedure, not only from the administrative standpoint, but also from the taxpayers' angle. Often the requirements of the law are such that the procedure demanded of the taxpayer is confusing to him. Further, it requires considerable time for the average bookkeeper to understand what is desired of him, thereby necessitating additional work and time to familiarize himself with the pertinent information in order that he may intelligently file the necessary reports for his employer.

In cases of this nature, it is obvious that this additional burden placed on the taxpayer is not received with open and outstretched arms. The taxpayer has his own problems in conducting the affairs of his business and more important to him is the worry of making his business pay and be in a sound financial position to meet his bills. Consequently, when additional requirements are demanded of him to comply with tax laws, the seed of antagonism is planted and the spirit of cooperation and good will so vitally essential in

the administration of our tax laws becomes a loss factor. In the administration of tax laws handed down to us, our ultimate goal is not only the assessment and collection of taxes but also a desire to retain the good will and cooperation of the taxpayer—and to this end we exert our efforts in our daily contact with the taxpayer.

In our experience we have found that the machinery of the gross-income tax law permits what we have often looked forward to—the ideal tax law, providing, as it were, the connecting link between the tax office and the taxpayers. It permits a program of direct contact with the taxpayers, which results in a "tax conscious" attitude on the part of the taxpayers. Unlike our net income and real property tax laws (which bring us in contact with the taxpayers in the case of real property approximately 3 times a year, and in the case of net income approximately 5 times a year) the gross-income tax affords contact with the taxpayers some 12 to 15 times during the year.

Let me just suggest here that one of the most valuable things in my estimation that could possibly be expected from any system of taxation would be the importance of knowing, the country knowing definitely every 30 days what the volume of business is, and who is carrying on that business.

We have no information available to us now, except about every 10 years when we have our census. It would be extremely valuable to the country to know every 30 days what the volume of business is.

Senator BAILEY. Doctor, does not the Federal Reserve Bank report monthly? Do not you get that in the Federal Reserve report?

Dr. TOWNSEND. Beg pardon?

Senator BAILEY. Do we not get a statement of the volume of business each month from the Federal Reserve report?

Dr. TOWNSEND. A great deal of that is merely an estimate. For instance, there is a tremendous volume of business done that is not recorded, and could not be any other way except as a report on the gross-income tax.

I will proceed for another page:

Again it is obvious from this standpoint that the frequent visits of the taxpayers to the tax office further provide an opportunity to acquaint them with features of other tax laws and the administration of this branch of our Government. It opens the door to the taxpayer to problems which we are confronted with in our daily routine, and leaves an impression in his mind that the taxing official, after all, is human—just as he is—and that the taxing official is not only carrying out the mandates, so to speak, of the law, but is endeavoring to perform the duties of his desk to the best of his ability as a public servant and for the compensation that the taxpayer himself indirectly contributes to.

Under the gross-income-tax law there is no intricate plan of assessing that calls for a specification beyond the mental scope of the average taxpayer. Instead, simplicity in forms and method of reporting gross receipts and computing taxes at the various rates require only a primary education. In prescribing our forms we have endeavored to remain within the bounds of simplicity. It is not necessary that one must have attended any our our higher institutions of learning to understand the method of filing.

The matter of licensing and registering is a simple process. The taxpayer applies at the local office, pays his $1, for which he receives a license granting him the privilege authorized under the law and a book of returns covering each month of the calendar year.

The returns follow the same trend. Here we have grouped the activities of the taxpayers under 14 classifications with applicable rates for his convenience. From here on, it becomes a matter for the average businessman, keeping even the simplest of records, to arrive at the total receipts or sales, during the month of operation, and to transfer the said sum to his return. Final computation of the tax completes the job of reporting and the assessment, indirectly made by the taxpayer. Payment of the tax at the collector's office (in the same building and on the same floor as the office of the assessor) is a matter of minutes.

From this point the routine affecting the said return is a matter of internal procedure for the tax office, which we have endeavored to keep on a basis of simple bookkeeping in order that the average employee on our personnel roster shall not be puzzled with complicated forms and entries. A decided advantage is gained by the Government through this monthly reporting and payment of taxes—it reduces that ever-dreaded delinquency roll. The taxpayers, soon enough realize that prompt monthly payments of their tax liability eliminate future worries and burdens.

Our law further permits a steady flow into the coffers of our Government of an average sum of approximately $375,000 monthly and is a barometer of the business trend of our territory in its various activities. The flow of moneys into the Treasury from this source has been so satisfactory that the gross-income-tax law is now commonly referred to as the "balancing tax law" of the Territory.

Its worth is known to our legislators, Government officials and businessmen who have the true interest of the community at heart. We quote herewith statement by our Territorial treasurer, William C. McGonagle, to one of our local papers—

"I only wish to comment on one phase of the gross-income tax which is of great benefit to the Territory. It is collected every month. This has eliminated the need of borrowing from the banks. The last time we borrowed against tax collections was in December 1935, and we have not had to pay any interest since that time."

I would like to insert it in the record, if possible.

On the Indiana gross-income-tax law, the report on which is found in A Study of Recent Tax Trends in Indiana, October 1940, by the Indiana Department of Treasury Board, gives a short summary to this effect:

Mr. Hoosier Citizen can look to the gross-income-tax collections, the property-tax rates, and the gasoline-tax revenue and account for approximately 90 percent of his tax burden. Contrast this with the myriad of tax laws in other States where countless factors determine the volume of receipts. Compare the collections year by year (if you can spare the time to visit a dozen different tax-collecting bureaus), and try to explain why your taxes are higher or lower. This situation is true in many other States which are rambling down Hodge-Podge Highway. To date, Indiana has elected to travel Simplicity Boulevard, and the great bulk of her citizens can see the open-book tax costs by following the trend of the three taxes—gross income, property, and gasoline.

If we do not simplify the taxing principle of government, gentlemen, we are going to arrive at a state of confusion, in fact, we have already arrived there, where the average citizen knows nothing about taxation and is disgusted with the whole procedure.

Now, you cannot have a Government supported loyally by its people who fancy themselves terribly abused continually. Today the Government is seeking every avenue of additional things to tax, when it could all be obviated, I believe, and reduced to a very simple procedure.

If we would look upon taxation and the necessity of taxation from the point of view of our market, of our public market, I think we would have a fairer conception of how best to maintain the revenues of government without any embarassment or confusion on the part of the taxpayer.

Since all of us, in our purchasing create the public market, why not say that is a public function, or a public possession, the market itself? Why not simply levy a rate of tax necessary to carry on Government functions, applied to everybody who uses the public market, and that is all of us, if we are making a living?

Say at the present emergency, we wanted to put a 5-percent tax on the gross revenues of all individuals and institutions, private institutions throughout the country, there could be little objection to the millionaires having to pay a thousand times as much as the $1,000-a-year-income man, if the rate were the same everywhere.

The gross income tax collected every month would have the tremendous advantage of telling us almost immediately where the tax was too heavily imposed, if such a condition prevailed.

I believe, gentlemen, that the taxing system will have as much to do—if we can simplify it, if we can bring it to an understandable attitude on the part of the general public—it will have as much to do as anything else in building up a loyalty to our Government which the hodgepodge system of taxation is destroying.

Now, let us see if we cannot simplify this one important function.

These two members of our United States have indicated the tremendous importance of this to themselves in the matter of raising revenue. The Hawaiian people demonstrated that they raised very considerably more revenue from the rate that they first adopted. They were going into debt at a tremendous rate and they had reduced the pay to State employees, they had done everything they could, and yet the revenues were constantly diminishing, until they adopted this simple procedure of imposing a tax upon everyone who used the public market.

In fact, they call it over there a "market privilege tax," and it is applied to everybody who engages in any kind of business, even the women who make the wreathes, they call "leis" to present to the visitors, all make their returns.

It is simplicity, indeed. All you have to do is take your cash register reports, or your books, state the amount of money that you have received in your business, and attach your check representing the rate that is applied to that business.

It has met with universal approval wherever tried. Even the big businesses of the Islands are ardently in favor of it, the pineapple industry and sugar industry. They say it simplifies matters and it broadens the tax base so that everybody is bearing proportionately his just share of the taxation.

I fear, greatly fear, the total collapse of the taxing system in this country if we cannot make it more intelligible to the people. This thing of constantly seeking new things to tax and imposing a higher rate upon the necessities of life, as well as the small luxuries, is going to end in utter chaos for our country.

I think one of the most beneficient things that this tax body could possibly do would be to simplify taxation so that the average man could understand it.

Now, I am not a tax expert; I do not know just what effect a gross-income tax would have upon the business of this country. I have my idea of how it might vastly build the business of the country, build the wealth that we produce, but of course, it is not your function to go into that here, and I am simply advocating the gross-income tax from the point of view of the average taxpayer who would hail it with acclaim, I know if it could be presented to him, and a lot of the tax forms abolished that we are cursed with today.

I do not want to attempt to go into the possibilities of revenue raising that a tax of this kind would produce, but I do want to say

that in this time of emergency, when tremendous taxes are going to be imposed upon the people, that if you wanted to have the population freely and willingly supporting their government, you have got to demonstrate to them that everybody is paying his proportionate share.

This plan of taxation was proposed by Adam Smith 200 years ago. I wonder why other nations have never undertaken it. He said at that time, the duty of every citizen of a country is to support his country in proportion to his ability to do so. That is in proportion to the revenue he enjoys under the protection of the State.

As you know, it is the general belief that the wealthy people of the country have opportunities of escaping their just taxation, that the imposition of the burden of taxation falls upon those least able to carry it. That is the general belief that is going to prevail. It is going to be intensified until we can make taxation an understandable thing by the common people. I believe that is the most important thing we can consider.

Now, as to how it might be made to produce an ever-increasing abundance of wealth, well if you will permit me to digress a little bit, I would like to say that if we could attempt this on a small scale, say, impose a low rate of tax on a gross income, and apply that to one important thing, the building in every community of an increase in the business done there—business is only done through the transfer of money from hand to hand—and if we could devise some way of taking out of the gross profit of the country the gross business, we will say, a certain specified rate and distributing that in all of the communities of the land—and we are proposing it as pensions, of course—that would immediately build a tremendous increase in the volume of business done throughout the entire country. That is what we all want.

I submit these reports, gentlemen, in the hope that this committee may go into an intensive study of the benefits that would accrue from a gross-income tax universally applied.

Now, in the bill that we have before the Congress, we exempt the low-income groups from this tax, but that would be only temporary. As the volume of business grew in the United States, the payment of wages would inevitably grow. When the average citizen is getting a decent standard of living, as suggested by the Brookings Institution, and other great fact-finding agencies, when we get the revenue of the individual up to a reasonable state, I would say that this form of tax should be applied to everybody, no matter how small an income.

If we had a decent standard of living, say of $100 a month, for each family, everybody would be quite willing to pay his pro rata share of the cost of government. Inevitably, the cost of government is going to continue to rise. The functions of government are broadening all the time. We may expect a constantly accelerating rate of tax imposed upon the public.

Let us get it down to a point where everybody can understand it and everybody will be willing to pay.

I think that is all I have to say.

The CHAIRMAN. Thank you very much.

Are there any question from the Doctor?

(No response.)

The CHAIRMAN. Thank you very much, Doctor.

Mr. Hushing? Mr. Hushing, you are chairman of the legislative committee of the American Federation of Labor?

Mr. HUSHING. Yes. Mr. Chairman, I have been smoking quite a bit and I notice the messenger passing around refreshments; I would appreciate a glass of water.

The CHAIRMAN. Yes.

STATEMENT OF W. C. HUSHING, WASHINGTON, D. C., CHAIRMAN, LEGISLATIVE COMMITTEE, AMERICAN FEDERATION OF LABOR

Mr. HUSHING. Mr. Chairman and members of the committee: Certainly some of the high officials of the American Federation of Labor appreciate the situation this committee is in and the situation the country is in generally. We are in favor of all the enormous expenditures that are being made for national-defense purposes, for aid to the democracies. We realize, too, that the normal functions of government must continue. We have a further realization that these enormous expenditures must be met, and I, for one, as a representative of labor, am doing everything possible to make our people realize the burden that will be placed upon them and which they will be obliged to bear. I want them to understand the necessity of it, and I believe if they do understand it, they will be willing to bear their full share without question.

It is my understanding that this Congress has made available for expenditures over $51,000,000,000; that the national debt is in excess of that amount, and that there is in the offing an additional appropriation of many billions of dollars for national-defense purposes and for further aid to the democracies.

Senator BAILEY. They have figures indicating that in 2½ years the national debt will be $110,000,000,000. You will find that in Mr. Kent's statement in the Washington Star, yesterday afternoon.

Mr. HUSHING. I was greatly interested in a statement which was inserted in the Congressional Record, I think it was the 14th of this month, by Congressman Taber, the ranking member of the House Committee on Appropriations. I have considerable confidence in his integrity and I believe he knows what is going on, and I quote from his figures. I shall insert in the record, if there is no objection, the Congressional page number, because I think his statement is worth checking. He gives the detail of all the obligations incurred by this Congress so far and they are in excess of $51,000,000,000.

Now then, as I said before, it is my intent, at least, to endeavor to educate our membership up to the facts that they must aid in meeting these tremendous expenditures. We do, however, want to see them levied in the proper way. We want to pay our proportionate share. As an individual I have always been glad to pay my taxes because I appreciate the things that the Federal Government, the State, and municipal government, have done for me; the protection I have enjoyed under them; the grand roads I drive over, the sewerage facilities, and other facilities, but it does gripe me sometimes to see people who are deriving benefits from this national program and who are otherwise well able to pay their taxes, evading them by a fake transfer of stock, which is, of course, legal.

Now, the executive council of the American Federation of Labor, when the Ways and Means Committee of the House had this bill under consideration, issued, under date of May 22, 1941, the following statement:

Taxes that would hit the pay envelopes of workers and cripple the buying power of the great mass of American people are the wrong way to finance the national-defense program.

We ask the House Ways and Means Committee, which is now considering a new tax bill to raise $3,500,000,000 in additional revenue, to reject any and all forms of sales-tax and pay-roll tax.

And I would ask and am now asking this committee to reject any form of sales-tax or pay-roll tax.

It is obvious that greater revenues must be raised to cover the cost of the vast defense program, but this money should not be taken away from those who do not earn enough now to maintain a decent standard of living for themselves and their families.

The minimum income which the average American family needs for decent food, shelter, clothing, and health care has been fixed by Government analysts at $2,000 a year. Yet official statistics show that two-thirds of American families receive less than $2,000 a year in income. In fact, more than one-fourth of the families in this country have total earnings of less than $1,250 a year, which is far below the income needed for bare subsistence.

American wage earners are already hard hit by taxes which directly and indirectly drain off a considerable portion of their income. These existent taxes, together with the rapidly rising cost of living, are making it increasingly difficult to maintain even present standards.

On the other side of the picture, we see that American industry is expanding on a vast scale and is reaping huge profits from the defense program. We believe that industry is entitled to a fair profit, but there is a absolutely no justification for the creation of a single new defense millionaire. Congress should revise the structure of corporate taxes accordingly.

Furthermore, there is need for even wider expansion of industry, not only for defense production, but for civilian needs. Unless this is done, serious shortages will be created in vital products needed in our everyday life.

We believe that the expansion of our modern production system, with the construction of thousands of new factories and the creation of many new industries, will provide a fertile source of additional revenue.

These fields and others should be thoroughly explored before Congress attempts to resort to heavier consumer taxes. The main burden of taxation is on the wage earner already. It would be economic folly to increase this load.

Mr. Chairman, we are opposed to a pay-roll tax such as has been suggested to this committee.

Senator CONNALLY. You don't mean a pay-roll tax for social insurance purposes?

Mr. HUSHING. Oh, no; I mean for general purposes. We are opposed to a sales tax; we are likewise opposed to the lowering of income-tax exemptions. It has been suggested that the exemption for single people, for examp' , ' e lowered to $700 per annum, so that those poor devils that make less than $13.50 a week will have to pay an income tax. We do not feel that that can be justified. I realize—I have been representing labor here at the Capital of the United States for almost 24 years, and I have a very high regard for the membership of the Congress. I don't agree with some of the things that are said in the newspapers about them. I believe the Congress at the present time, generally speaking, is considering this and other questions before it without any partisanship, and that is the way it ought to be now, and if there are any in Congress who are indulging in politics, they ought to change their ways, so I absolve anyone, especially in this committee, for any political motive, in any proposal they may make.

Now, I know that my very good friend, Senator La Follette, has year in and year out proposed amendments to lower the income-tax exemption. I am certain that friends may hold a difference of opinion without their taking offense and I believe that is the case insofar as Senator La Follette and I are concerned.

I know he has no political motive in mind, because he has offered these amendments, regardless of which political party was in power, but nevertheless there is a political implication there and if any member of the minority cared to use that as a political motive, if he could successfully, in prevailing upon the majority to adopt such a proposal, or a sales tax, which I understand Senator Vandenberg kind of likes, with certain exemptions, I believe it would change possibly the political complexion of the House and the Senate.

Senator VANDENBERG. That might be a good thing.

Senator CONNALLY. Senator Vandenberg didn't advocate a general sales tax; it was only in certain products, as I recall it; I am not committed to it, but I just say that in fairness to him.

Mr. HUSHING. I haven't seen the plan; I only know of it from what I have read in the newspapers. Now, we are a nonpartisan organization, and have no interest in the partisan phase of the situation, but we do believe that these poor devils earning meager salaries should not be taxed with an income tax. Of course they are taxed indirectly; they must bear a great burden indirectly.

Senator BAILEY. In that connection, excise taxes in this bill will probably be $2,000,000,000. What would you say would be the proportion paid by people of small income of that amount?

Mr. HUSHING. I don't know, but I do know this: It is the custom for the owner of real estate and for the proprietors of stores to pass on down in an indirect way the taxes levied on them. Now, from the political viewpoint that has been and is all very well. The fellow pays the tax; he doesn't know about it, but the moment he is directly assessed and told he must pay an income tax he is going to have his mind disabused of the idea that the Government simply reaches into the air and gets the money and gives it to him. Too many people in this country have that opinion now, and that is one reason I am trying to do in my small way what I can to educate our members. So, we object to that sort of taxation, and we will oppose it if we can secure friends on the floor to make our proposals, in case this committee does incorporate such type of taxation in the bill.

Senator VANDENBERG. May I call your attention to the fact, as Senator Bailey has indicated, that there are many, many sales taxes in that bill?

Mr. HUSHING. Yes; I understand that.

Senator VANDENBERG. And may I call your attention further to the fact that a general manufacturers' sales tax, to which I have given some favorable consideration, exempts food, clothing, and medicine, and only touches, according to your own statistics, 20 percent of the average wage earner's expenditures, and it is my opinion that the excises in the bill still will probably reach 20 percent of the earner's income, so we are only talking about an alternative method of raising this revenue.

Mr HUSHING. I read the entire bill over in a more or less casual way and I noticed there are plenty of articles with a sales tax on them. We are opposed, however, to a general sales tax.

Senator VANDENBERG. Then I suppose you would be opposed to the taxes in this bill?

Mr. HUSHING. Many of the items in the bill some would consider necessities, others are what would be considered luxuries which certainly none of the wage-earners would be able to purchase. For instance, refrigerators and radios——

Senator VANDENBERG. Wouldn't you think a general manufacturers' sales tax which had appropriate exemptions would be fairer to the wage earners than a reduced income tax level?

Mr. HUSHING. Yes; because a reduced income tax level would reach the masses more so than your proposal.

Now then, I come to a subject in the bill which I want to speak on specifically——

The CHAIRMAN. Your time is about up.

Mr. HUSHING. I notice there was no hitch in the people who preceded me.

The CHAIRMAN. We have not enforced the limit, but there are quite a few more to be heard.

Mr. HUSHING. I shall be as expeditious as possible. Now we come to title 6 in the bill—the radio tax.

The American Federation of Labor's executive council, in its meeting held this month in Chicago, adopted the following motion:

> While labor believes that the United States Government should levy extra taxes on the people to pay for defense work we do not believe in punitive or discriminatory taxation as a special levy on radio advertising broadcasts.

Now, this proposed tax, Mr. Chairman, is exactly the type of tax the American Federation of Labor executive council objects to in that statement. I had no intention of mentioning or referring to in any way those arguments made for or the organizations who advocate this tax, but their names are all in the record. Four of them are affiliates of the American Federation of Labor, and have joined with one organization not an affiliate of the American Federation of Labor in advocating this tax. None of the organizations advocating it have a single member employed by the radio stations. It is simply an attempt to deprive the radio industry, a new industry, of some of the work or some of their income and transfer it to an older industry where those who advocate the tax do have members employed.

On the other hand, we have four organizations directly employed by the radio stations. The radio stations employ approximately 40,000 people. The total membership of the organizations advocating this tax is but 85,000, and it is an interesting thing to note the main point of their contention, which, as I get it, is that it will deprive them of work.

Of course, they do mention the exorbitant profits made by radio stations, but it is not my intent to go into that phase of the question, because I believe that should be and will be taken care of by the excess-profits tax.

Their main idea, apparently, is to transfer work that is secured now by the radio stations, to the newspaper business, and, they contend that their members will lose work as a result.

Now then, according to the official figures submitted by those who advocate the tax, to the American Federation of Labor, since radio stations have come into existence, in the last 16 years, one of those

organizations has increased its membership 11.7 percent, another 9.25 percent, still another 37.5 percent, still another 45.8 percent, and still another 23.5 percent.

This is not a new question to us by any means. In the middle 1890's there was another new industry coming into existence, and, in one of the central labor unions on the west coast, which was located in the largest west-coast city, there was an organization which came in with a proposal that no member of the organization, of organized labor, ride in an automobile, even to a funeral, and the motion was adopted. This proposal here is on all-fours with and is made for the same reason that that motion was passed through that central body over 45 years ago; and in the future you will probably look back on this proposal in the same manner that you do on the one which I have just mentioned.

Senator VANDENBERG. Isn't it true that these unions who are suggesting these punitive taxes at the present time may be opening the way for a tax on all advertising by suggesting such a dangerous precedent?

Mr. HUSHING. That is true; there is some advertising, outboard advertising, also being taxed, but I have left those organizations to speak about that.

Now, a new industry does make what may be called excess profits, because the pioneers in the field have things pretty much to themselves, but as others see that it is a good thing, they enter into that field and competition becomes great with profits correspondingly decreased. That happened, I think, in the automobile industry. This proposal in this bill could well have been made against electric lights, because they put the manufacturers of oil lamps out of business, or could have been made by the candlemakers with the same force when the oil lamp came into use.

Now, that is our view in regard to this section, and we hope you will wipe it out of existence when you report the bill.

I appreciate the extra time, and your courtesy in listening to me.

The CHAIRMAN. Any questions?

Senator DANAHER. I would like to have inserted in the record here a communication received from the Associated Broadcast Technicians, which is a unit of the International Brotherhood of Electric Workers of the American Federation of Labor.

They asked specifically that our attention be invited to it, to sustain the position of the previous witness.

The CHAIRMAN. It will be entered in the record.

(The letter referred to is as follows:)

AMERICAN BROADCAST TECHNICIANS, LOCAL NO. 1230,
Bridgeport, Conn., August 16, 1941.

Hon. JOHN A. DANAHER,
United States Senator from the State of Connecticut,
Senate Finance Committee, Washington, D. C.

HONORABLE SIR: In the name of the Associated Broadcast Technician's Unit of the International Brotherhood of Electrical Workers of the American Federation of Labor, Bridgeport, Conn., Local No. 1230, I write you this communication

We, the members of Local 1230, wish to be recorded as very strongly opposed to the proposed tax on time sales of radio stations (H. R. 5417), scheduled for hearing on August 18, 1941.

Our stand on the matter is as follows:

The nature of this bill is discriminatory. If one form of advertising is taxed, then all should be taxed. Protecting the printing and publishing business from

the everyday risk of competition at the expense of the radio-broadcasting industry would not serve the public purpose and would also be contrary to the democratic principle of equality under law.

By virtue of existing Federal restrain on radio broadcasting and the absence of restraint on irresponsible publishers, the ethics of radio advertising are higher than those of any other form of advertising. Radio broadcasting has followed very closely to the narrow path of fair play and made freedom of speech an actuality during the critical and controversial times of our present history. The Senate should reward these virtues rather than penalize them.

The men engaged in the radio broadcasting field should have equal job opportunities with the men working in other advertising fields.

It is respectfully requested that our views in this matter be communicated to the other members of the committee.

Respectfully yours,

THOMAS DOYLE, *Recording Secretary.*

The CHAIRMAN. Mr. Beesley.

STATEMENT OF THOMAS QUINN BEESLEY, WASHINGTON, D. C., REPRESENTING THE NATIONAL COUNCIL ON BUSINESS MAIL

Mr. BEESLEY. I represent in Washington the National Council on Business Mail, the organization which represents the larger customers, patrons, and users of the post office, and the 14 trade and professional associations interested in the use of the mails for business and educational purposes.

Our purpose, this morning, is to draw to your attention the provisions of H. R. 5417, pages 79 to 82, which have to do with the use of motor vehicles and boats, the tax on them; a provision that places on the Post Office Department, at the request of the Commissioner of Internal Revenue, the duty of collecting this tax, the language of which provision in the House bill runs counter to previous practice of the Senate, and this committee, in all other bills which have been before the Congress, where the Post Office Department was called on for nonpostal services. The late Senator Harrison, our good friend, sponsored the language that I wish to bring to the committee's attention in the Social Security Act; the act providing for the sale of baby bonds; and other legislation wherein the Post Office Department was called on for nonpostal services by another department of the Government; in all of which cases the Post Office Department was compensated in cash by the particular department calling for the rendition of such services.

That has resulted in the recovery by the Post Office Department of quite a few millions of dollars in the past 6 years.

The first amendment was adopted in 1935. You will find the record of it, and the action on the Senate floor with respect thereto in the Congressional Record for 1935. The amendment was introduced by Senator O'Mahoney, seconded by Senator Harrison and adopted.

Senator CONNALLY. What page is that?

Mr. BEESLEY. Sir?

Senator CONNALLY. What page is that?

Mr. BEESLEY. Pages 82 and 83. The matter referred to in section G, here, requires even more serious attention than similar proposals in other bills, for the reason that the language of the bill requires the Post Office Department to keep on hand for sale by postmasters throughout the United States, stamps, stickers, or tags, which are

evidence of the payment of the $5 use tax on vehicles. That means a minimum of 29,000,000 transactions to be handled by the Post Office Department. It is not just one transaction in the handling of 29,000,000 stamps, stickers, or tags, but there is a long involved process in the transfer of the funds involved, at least 5 additional transactions for the keeping of accounts, making of reports to the Post Office Department, reports back by the Post Office Department to the local postmasters, and reports to the Treasury Department.

In many cases the postmaster will be at considerable expense out of his own pocket for the reason that the act provides that the Postmaster General may require the postmaster to give either additional or increased bond for the privilege of doing this additional work.

Now, who is going to pay the premium on that bond isn't set forth in the act. I won't go into that further, but I merely invite the committee's attention to it and feel the committee will question the fairness of the provision.

Senator CONNALLY. How are you interested in this matter?

Mr. BEESLEY. We are trying to reduce the cash cost of the operation of the Postal Service in order to bring postal revenues and expenditures into balance. We have appeared on all these bills in the last 5 or 6 years to advocate that principle, and it has resulted in the reduction of postal expenses materially, year after year, and in bringing the expenditures of the Department more nearly into balance. It may interest the committee to know that the apparent revenues for the fiscal year 1941 will be $812,000,000 in income and its cash deficit the lowest in history. I should judge that the cash deficit will be brought down to $25,000,000 this year.

Senator CONNALLY. You are wrong in that: The nearest the Post Office came to balancing its cash revenue and expenses was under Postmaster General Albert Burleson.

Mr. BEESLEY. I should have qualified that by saying, "with relation to volume."

Senator CONNALLY. The reason I interjected that is because Mr. Burleson was a very dear friend of mine and a great Postmaster General. That statement I made is true, isn't it?

Mr. BEESLEY. It is practically true.

Senator CONNALLY. Well, it is true or it isn't true?

Mr. BEESLEY. I can answer the Senator by saying there has been a change in accounting methods since that time, and there is some question as to whether the actual cash profits of the Post Office at that time were real or merely apparent. I don't want to get into that, because that is a question of bookkeeping.

Senator BROWN. There is a good deal of objection to this tax, and if we don't put the job on the Post Office, we have to put it some place else and I don't know of any agency of the Government, the set-up of which is such that it can do it as well. As I recall, we pay our duck-stamp tax through the Post Office. They are using it for the purpose of selling baby bonds and a good many other things that the Government requires, so if you are going to oppose it, unless you can suggest some other method more economical, I don't see why the Post Office shouldn't handle it.

Mr. BEESLEY. I don't object to having the Post Office handling it.

Senator BROWN. What do you want; do you want an appropriation?

Mr. BEESLEY. I think there should be inserted in this section of the act, or somewhere else, a provision requiring the Treasury Department to pay the Post Office for the service performed. That has been in all the other acts for the last 5 years. The language is almost standard; it has appeared in all the bills, and I should be glad to submit for the committee the language which is appropriate, and where it may be inserted.

Senator VANDENBERG. Do you feel the same way about it as the President, that the postmaster be called upon to help small taxpayers with their preparation of income-tax returns?

Mr. BEESLEY. If the system in making them out is to be simple enough so that it doesn't require more than the merest routine, there would seem to be no objection; but, if they have to become tax experts, as they had to become fingerprint experts in connection with alien registration, that would be something different.

Senator VANDENBERG. I am referring to the simplified form.

Mr. BEESLEY. Yes; I would see no objection to that.

(Thereupon Mr. Beesley submitted the following draft of a proposed amendment in connection with the above testimony.)

We offer to the committee, either as an amendment to this section, or as a special section separately of its own, the following text as it has appeared in previous acts of Congress:

The expenditures incurred by the Post Office Department in the District of Columbia and elsewhere in performing the duties herein imposed upon said Department shall be reimbursed to said Department by the Treasury Department, and the Secretary of the Treasury is hereby authorized and directed to advance from time to time to the credit of the Post Office Department from appropriations made for the collection and payment of taxes provided in this act such sums as may be required for such additional expenditures incurred by the Post Office Department in the performance of the duties and functions required of the Postal Service by this act.

The CHAIRMAN. Thank you, Mr. Beesley, for your appearance and your testimony.

Mr. Walton C. Ament.

Mr. Ament, you represent the newsreel companies?

Mr. AMENT. The five newsreel companies—Fox Movietone News, News of the Day, Paramount News, Pathé News, and Universal Newsreel.

STATEMENT OF WALTON C. AMENT, NEW YORK, N. Y., REPRESENTING THE NEWS REEL COMPANIES

Mr. AMENT. There is included in H. R. 5417 an excise tax of 10 percent on raw film, raw motion-picture film. As the bill is presently written this would impose a tax on news-reel film.

I don't think that was intended, nor do I think you will regard it as desirable, because such a tax would be a tax on dissemination of news.

There are five news reels operating in the United States. Their business is to present the news from here and abroad in motion pictures. They produce two issues per week for showing in all the motion-picture theaters in the country. Each issue consists of 1 reel running between 9 and 10 subjects—subjects of the same nature as those carried in the Nation's press.

The newspaper prints its news on paper, the news reel prints its news on film.

The news reel is a member of the press—a disseminator of news, and has been for 30 years.

A tax on the raw stock used by news reels would be similar to a tax on the newsprint paper used by newspapers, or a tax on leased wires used by press associations and radio-broadcasting companies.

Because a news reel's content is news it must be presented to the public through the country's theaters while its content is still news, otherwise the news-reel is of no value to the public.

To accomplish this thousands of prints or copies of a news reel issue must be made for immediate distribution throughout the country. The cost of these thousands of prints represents roughly 50 percent of the cost of a news-reel company's doing business.

Senator CONNALLY. You are talking about the film?

Mr. AMENT. Yes; I am. Within 3 weeks of such distribution that issue of the news reel has reached its maximum audience, and therefore its value as a source of income is lost.

This is not true of feature pictures where a print of such pictures continues in use as entertainment and as a source of income for a period well over a year.

On the average feature production, for instance, the cost of the raw film used in making prints does not run more than 3 percent of the total cost of production.

Yet the news reels are but a small portion of the large motion-picture industry. The raw film used by the news reels amounts to approximately 200,000,000 feet annually. The raw film used by the whole industry amounts to approximately 2,100,000,000 feet annually. Exemption of the news reels from the proposed 10-percent tax would reduce the revenue to be derived from the proposed tax by only $250,000 at the most.

The manufacturers of raw film have stated that they will pass the cost of the tax on to the newsreel companies. But a newsreel company cannot recover the cost of the tax from its customers because a newsreel is sold on a long-term flat rental contract.

War coverage has increased the cost of our business. Because of the war, we have lost the majority of our foreign income. This income cannot be recovered elsewhere because additional markets simply do not exist.

Because the cost of film is about 50 percent of the cost of a newsreel's doing business, because a newsreel cannot pass the proposed 10-percent tax on to its consumer, because exception of the raw film used by newsreels from the proposed tax on film would reduce the tax revenue by only $250,000; and finally because a tax on newsreel film would be a tax on the dissemination of news, we respectfully request that newsreel film be exempt from the proposed tax on raw film as outlined in paragraph 4, page 65, House bill, H. R. 5417. Newsreel film is film used by newsreels issued twice a week.

The CHAIRMAN. The newsreel business is done on a basis of future contracts?

Mr. AMENT. It is.

The CHAIRMAN. So that you couldn't pass it on; you have to make your contracts for a number of months in advance?

Mr. AMENT. A minimum of a year, and some contracts run longer.

The CHAIRMAN. Any questions?

Senator CONNALLY. As I understand you, this tax that you are talking about is not a tax on income but on the film itself?

Mr. AMENT. It is a tax on the film itself?

Senator CONNALLY. On the newsreel film; not a feature, just the news of the day that we see in the theaters?

Mr. AMENT. Exactly; I am talking only about the film used in newsreels.

Senator CONNALLY. Do you suggest an amendment as to how that can be effected?

The CHAIRMAN. It could be done very simply. The language reads this way:

Cameras and lenses; unexposed photographic films (including motion-picture films, but not including X-ray film or newsreel films shown biweekly).

Mr. AMENT. Semiweekly; biweekly, I think, means every 2 weeks, semiweekly, twice a week.

Senator CONNALLY. You don't tax newspapers; that is your argument?

Mr. AMENT. We regard ourselves, and we believe we are so regarded, as disseminators of news. We are members of the Press Gallery of the House and Senate. We regard ourselves, and I think are so regarded, as members of the press.

Senator CONNALY. If we don't adopt this tax, will you be rather generous in playing up some of the members in the newsreels?

The CHAIRMAN. Thank you very much.

Madeline Ross, Miss Madeline Ross? Are you appearing for the Consumers Union of the United States?

Miss ROSS. Yes; I am.

The CHAIRMAN. You may proceed.

STATEMENT OF MISS MADELINE ROSS, NEW YORK, N. Y., REPRESENTING CONSUMERS UNION OF UNITED STATES

Miss ROSS. I represent Consumers Union of United States, a nonprofit organization of consumers, with about 80,000 members throughout the United States. One purpose of Consumers Union, as stated in its charter, is—

to give information and assistance on all matter relating to the expenditure of earnings and the family income * * * to initiate and to cooperate with * * * efforts to * * * maintain decent living standards for consumers.

We feel that many of the tax proposals being made to this committee are a serious and unnecessary threat to the living standards of low-income consumers. Even families in the very lowest income category—who, even now, are not getting enough of the bare necessities of life—food, clothing, and shelter—are being seriously threatened by unfair tax proposals.

We know, of course, that defense efforts must be paid for; that there must be additional taxes to provide needed revenue. The people will not oppose any necessary sacrifices. But they must first be convinced that those better able to do so are bearing their share

of the burden. They must be sure that they are not being called upon to make enormous sacrifices, while wealthy individuals and corporations are allowed to keep grossly excessive profits.

Proposals now being considered, particularly those suggested by business groups, disregard entirely the enormous share of the tax-load already being carried by the poorest section of the population. Back of these suggestions would seem to be the notion that the biggest corporations and the wealthiest people should profit from the defense effort, while the little man pays the costs.

A study made for the Temporary National Economic Committee—Monograph No. 3: Who Pays the Taxes?--shows that in the 1938-39 period, because of the numerous regressive taxes, persons and families with incomes of less than $500 a year had 21.9 percent of their total income taken away from them as taxes.

Senator BROWN. I presume that is all taxes; Federal, State, and all other taxes?

Miss ROSS. Yes; that is all taxes.

Remember that this 21.9 percent slice out of their resources meant that they had actually less than $400 left, with which to maintain life for a year. Now compare this 21.9 percent with a total of 17.6 percent of income paid as taxes by people in the $3,000-to-$5,000-income group, and 17.9 percent for the $5,000-to-$10,000 group. It is not until we reach the level of $10,000 to $15,000 that we find families paying as high a percentage of their income for taxes as those in the very lowest income category.

How much of a burden were these taxes to the $10,000-to-$15,000 group? Data in the same monograph show that, in spite of the taxes, they were able to put aside as savings an average of 32.3 percent of their incomes. The poor families, on the other hand, were not so fortunate. Far from saving, they had to go into debt to the extent of 24.3 percent of their incomes in order to maintain themselves. It should be noted that the amount they had to borrow was just about equal to the taxes levied on them. Those who urged a broadening of the tax base, should look carefully at these figures. The trouble is that the base is already too broad.

We strongly urge the committee to reject such typical big-business proposals as those made here by a representative of the Investment Bankers' Association, who would put a 5- to 10-percent sales tax on all purchases except "absolute necessities."

This, we submit, is a discriminatory tax, directed against the poor, for the poor family must spend all it can earn or borrow, while the rich are putting big parts of their income into savings. This is not taxation based on ability to pay; it is taxation designed to wring the last possible penny out of the needy so that the rich can have more profits and more savings. Sales taxes and other taxes on consumer goods seem to be a favorite means of raising money, because they become part of the price of goods and are easily concealed from the taxpayer. But this kind of taxation, which is supposed to provide money for defense, actually strikes at the very foundations of our defense effort by injuring health and morale. Our public-health officials have been talking about the dangerous "hidden hunger" which is undermining the health of millions. Congress must not add to that hidden hunger by imposing more hidden taxes.

Proposals for new sales taxes become a brazen affront to the small man when they are offered as a substitute for the joint tax return for wealthy couples. Separate returns by families in the upper-income brackets are nothing more than a loophole for the evasion of taxes. Should this $300,000,000 loophole be again legalized by Congress, we shall be forced to conclude that Congress is willing to soak the poor in order to help the rich evade their just share of the tax burden.

And this is by no means the only evasion for which low-income families are asked to compensate. Ingenious deductions and bookkeeping devices known to corporate lawyers and accountants have played their part in reducing tax revenue received from corporations. An individual can sell securities at prices below the often inflated values at which he inherited them, and claim a capital loss, even though he may have received dividends on them for years and his loss is purely a paper one.

As another evasion, wealthy individuals often run their country estates as "farms," and thus can deduct so-called "operating expenses" from their taxable incomes. But is there any similar dodge for the poor? Has there been a single voice from the ranks of big business to suggest that the expenses of the workers' ancient and dilapidated car be deductible, even though it may be the only means he has of getting to and from the job that provides his small and overtaxed income? Has there ever been a suggestion by business that the worker be allowed to deduct his medical expenses—paid so that he can go on working—as "operating costs"? We know of none.

We are opposed, then, to any sales taxes, on the ground that they tax the poor disproportionately, that they are directed against the people who are already paying more than their just share of taxes.

We are opposed, too, to any lowering of the minimum income exemption, until every other means of raising the necessary taxes has been exhausted, until those who are profiteering from the defense effort have paid their share, and until the loopholes which the rich use to dodge taxes have been plugged.

We endorse the principle of a simplified tax return suggested by Secretary of the Treasury Morgenthau, in which tax is based solely on income, but we would propose extending the system to the rich, so that what the rich pay will be determined by their incomes and not by the cleverness of their lawyers.

After my statement, I will file for your consideration, a series of recommendations for a tax bill, which Consumers Union has drawn up.

I should like to emphasize two of the recommendations:

We urge that families with incomes over $5,000 a year be required to file a single joint income-tax return; that the legalized form of tax evasion through separate return be stopped.

In place of the present excess-profits tax, which permits corporations to make exorbitant profits without paying any excess-profits tax, simply because they have been able to gouge the public in previous years, we propose a steeply graduated excess-profits tax on all corporation profits about 6 percent of invested capital. At a time when sacrifices are being demanded of every one, should not big business be willing to sacrifice to the extent of accepting 6 percent, plus a share of the excess, as a fair return on its investments?

These are among the proposals we are filing. For the benefit of

millions of American consumers, we urge their adoption.

I should like to file this with the clerk at this time.

The CHAIRMAN. Yes; you may file it with the clerk.

(The document referred to is as follows:)

[Vol. No. 23, July 31, 1941]

BREAD & BUTTER—"FACTS YOU NEED BEFORE YOU BUY"

Published weekly and copyright, 1941, by Consumers Union of United States, Inc., a nonprofit organization. Subscription rates: $1 a year; in combination with Consumers Union Reports and Buying Guide, $4; single copies, 5 cents. Address all correspondence to Consumers Union, 17 Union Square, New York City (time does not permit answers to inquiries for special information).

Bread & Butter is issued to help consumers protect living standards by providing them with up-to-date, reliable information on what is happening to prices and quality of products. The information is compiled from all available sources; the trade press, commodity and wholesale markets, Government and industrial reports, interviews with trade specialists.

All information has been carefully checked, but it can make no claim to be infallible. Brand recommendations are based on tests and examinations made by Consumers Union and taken from Consumers Union Reports.

THE TAX BILL; BREAD & BUTTER'S PROPOSALS

The tax bill now being wrangled over in Congress can, with a single scratch of the President's pen, plough deeply into the health and general welfare of America's millions of low-income families.

The cost of defense, growing terrifically toward an estimated fifty to one hundred billion dollars, has to be paid for out of taxes. Everybody agrees to that. But living standards will be crippled unnecessarily in the process unless the burden is distributed according to ability to pay.

And last week Bread & Butter demonstrated that the tax program taking shape in Congress doesn't come within miles of that principle.

That's bad enough for consumers. But that's not all.

For whatever tax proposals are put into force now will serve as a model for future additional tax increases—and President Roosevelt has expressed the view that new taxes will be needed every year as defense costs mount up.

So an unfair tax program now may mean more and more of the same in the future. A fair program now might go far to help make tomorrow's steeper taxes bearable.

What can consumers do about the situation? They can do this. They can put all their weight, all their pressure, all their individual and organized efforts into a drive to make Congress adopt tax proposals which distribute the burden fairly.

Here and now, to get that drive started, Bread and Butter lists seven specific proposals designed to put the tax burden where it belongs, while bringing in the needed revenue. Reasons for each recommendation follow on the next page.

1. Corporation profits above 6 percent of invested capital should be considered excess profits, and excess profits should be taxed on a graduated scale beginning at 50 percent and going up to at least 80 percent.

2. Undivided-profits taxes should be written to prevent corporations from increasing their already enormous surpluses, which ultimately means smaller tax payments.

3. The proposed 6-percent surtax on corporation earnings above $25,000 should be put into force.

4. The income from all Government securities, issued in the past or present, should be taxed.

5. Any transfer of wealth—whether by gift, inheritance, or insurance—should be covered by a single tax (with a rising rate); transfers of any kind totaling above $25,000 should be taxed.

6. Upper-bracket incomes should be taxed more sharply (and loopholes available to these incomes should be closed) before increasing either the rates on incomes of $2,000 to $5,000 or taxes on consumer goods.

7. Families should be required to file a single joint tax return.

Why these proposals?

Here are the reasons for Bread & Butter's recommendations:

1. Why so much attention to excess corporation profits?

Because the handful of corporate giants who get the bulk of defense orders are cashing in heavily today; a strong excess-profits tax should therefore be the heart of any good tax bill.

As Federal Reserve Board Chairman Marriner Eccles has said: "The first source of defense revenue should be the corporation tax and excess-profits tax because, generally speaking, corporations are the greatest beneficiaries, directly and indirectly, from defense expenditures."

Today corporations can figure their normal profits either as 8 per cent of their invested capital (which is too high) or as 95 percent of the average profit they made from 1936 to 1939. A company which cashed in during those years could make exorbitant profits indefinitely and never pay any excess-profits tax.

The present law helps entrenched monopolies, since new firms have to pay excess-profits taxes on the same income which an established and profitable competitor can consider normal.

An excess-profits tax of the type advocated by Bread & Butter raised $2,500,000,000 in 1918; today it could certainly bring in far more than the $600,000,000 expected from the plan of the House Ways and Means Committee.

2. Why an undivided-profits tax?

Because corporations are building up enormous surpluses to pay out in dividends after the war, when income-tax rates will probably be reduced. Thus persons with large incomes from dividends evade paying their just share of defense.

3. Why a 6-percent surtax on corporations' earnings above $25,000?

Because, as with individuals, corporations with large incomes should pay a heavier tax than corporations with small incomes. And from the point of view of the national welfare, additional surtaxes might well be aimed at entrenched monopolies in any field.

4. Why tax the income from Government securities?

Because billions of dollars worth of these securities are tax exempt today, and their interest makes up a large part of the income of many wealthy persons.

The Government issues no more tax-exempt bonds; but if those issued in the past were taxed, the Treasury—which has proposed such a tax—estimates that as much as $300,000,000 of additional revenue could be secured annually.

5. Why a uniform tax for any transfer of wealth?

As indicated in last week's Bread & Butter, a wealthy man today can give $40,000 to his heirs, leave another $40,000 worth of insurance, and still another $40,000 in his will—before incurring any taxes whatever.

Not only is the gift-tax rate lower than the inheritance tax, but by giving away half his estate and leaving the other half in his will, a millionaire can pay both gift and inheritance taxes at a far lower rate.

Any transfer of more than $25,000 should be taxed, with the tax becoming progressively steeper as the amount increases—regardless of the method of transfer used.

Bread & Butter agrees wholeheartedly with President Roosevelt's statement: "The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals of the American people."

6. Why increase taxes on upper incomes?

Because not only are the rates too low, but there are so many loopholes that wealthy men almost never pay the full rate. Last week's Bread and Butter explained in detail some of the loopholes which should be plugged, in addition to the increase in rates.

7. Why a single joint income tax return for families?

Because wealthy husbands and wives with separate incomes, by filing separate returns as allowed today, have turned the privilege into a device to avoid paying full tax rates.

If there are to be any exemptions, they should be for families making less than $5,000 because of the added household expenses when the wife is working.

Break up the horse trading

If all the loopholes in present tax laws were sealed, there would be little necessity for the proposed tripling of income taxes in the lower brackets, and for new or increased commodity taxes on automobiles, tires, liquor, household appliances, theater admissions, etc.

These proposed commodity taxes would take an extra billion dollars per year from consumers. And they will surely be followed by even higher ones unless consumers work fast.

Bread and Butter's proposals are a realistic effort to raise revenue for the Government's mounting expenditures.

But they place the burden where it properly belongs—on the corporations and the large incomes which can best afford to pay higher taxes, and which are benefiting most from defense and speculative profits.

Bread and Butter's proposals, furthermore, are based on the idea that taxation should be used to get revenue—not as a device to prevent inflation by cutting down consumer purchasing power.

There are other, more effective and more legitimate ways of dealing with inflation besides soaking the consumer and increasing the tax load on small incomes. Bread and Butter will discuss some of those ways in the next issue.

But right now consumers must go into action to break up the political horse-trading that is passing for tax discussion in Congress, and to bring the tax program back to a realistic foundation.

Bread and Butter's proposals, carefully worked out and far from extreme, are a starting point.

Write your Congressman and Senators; call these proposals to their attention; urge them to eliminate the glaring loopholes in the present tax structure.

The alternative will be a sacrifice—heavy and unfair and unnecessary to boot—on low-income groups throughout the Nation. And such unnecessary sacrifice, inevitably reflected in the health of the people, is a major blow at the ability of the Nation to defend itself.

BUY THE FOLLOWING NOW, ANTICIPATING FUTURE NEEDS

Keep in mind that your buying should be sensibly guided by your needs and income. Avoid reckless or unplanned buying. Stock up, but don't stock up too heavily. Changes in the war situation or Government action might change the whole price trend.

Fertilizers

Not long ago the United States Department of Agriculture warned that a fertilizer shortage might develop next year. Shipping and power shortages, the need for chemicals in munitions making, and the added demand for food were mentioned as possible causes for the shortages.

It isn't likely that fertilizer production will be hit as hard as it was in the last war, but wholesale prices are rising already and will probably continue on up.

If you have a garden, it is advisable to buy fertilizer now and store it for later use. There's an extra reason for this: with prices of canned vegetables going up drastically, it may pay to raise and can more of your own produce in the next few years.

Antifreeze

Last March Bread & Butter advised the purchase of antifreeze supplies for next winter. If you didn't buy then, better do it now or as early as possible in the fall.

Consumers Union has found that the best type of antifreeze for general use is the ethylene glycol type, which is likely to be in great demand for use with aircraft engines. Eveready Prestone, Zerex, Firestone, Frigitone, Cities Service Permanent, and Perma-Guard are all of this type and all priced about the same.

You can still get ethylene glycol preparations at last year's price ($2.65 a gallon) if you can find a garage or service station which has them.

Sports equipment

Sports equipment of all sorts is going up in price. Some manufacturers have already sold out all their summer goods; and when another season comes around, prices will certainly be higher.

Skis, ice skates, and roller skates have gone up at wholesale. So have sleeping bags, inflatable rubber mattresses, life preservers, camp cots, golf bags, and basketball and football lines.

Buy your equipment for next winter out of last year's stock if you can, and buy now for next summer. This year, especially, as Bread and Butter has advised before, it would be a good thing to buy as many Christmas presents of this type as possible before the summer is over.

Good buys in skis (based on opinions of expert skiers—not on laboratory tests) are: Anderson & Thompson (five grades from $12.50 up); Bean ($8.85 and up); Groswold ($10 and up); Northland ($8 and up—cheaper grades only fair); Sears' (four grades from $4.09 to $17.85, plus postage); Tyrol ($7.50, $12, and $15); Ward's (four grades from $5.89 to $16.89, plus postage). See Consumers Union Reports, January 1941, for details.

Acceptable ice skates (in order of quality) are: CCM Winterclub ($20); CCM Pastime ($15.50); Sears' catalog No. 1034 ($9.04, plus postage); Nestor Johnson ($7.50); Sears' catalog No. 1027 ($7.08, plus postage); Aristocrat ($8.50); Ward's catalog No. 6090 ($9.95, plus postage); Sears' catalog No. 1062 ($4.08, plus postage); Alfred Johnson No. 86 ($7.50); Ward's catalog No. 6017 ($6.98, plus postage). From Consumers Union Reports, November 1940.

Canned fruit

Wholesale prices on canned Hawaiian pineapple from this year's crop are higher than they were for last year's. Any increase in the shipping rates from Honolulu will add still more to the price.

The first prices on the new pack of California cling peaches were so high that they surprised even the trade, which had expected some increase. They were over 50 percent higher than last year's first tentative prices.

Recent prices on new-pack apricots were also higher in spite of the fact that the crop this year is over twice as large as last year's.

New prices on Bartlett pears are the highest in a decade or more.

And the packers are already withdrawing these new price lists, apparently with the intention of pushing prices up still further.

Retail prices have gone up a little. But it will be some weeks before the full effect of the new wholesale advances is felt. Buy now if you can.

Tea

Wholesale prices on some varieties of tea have risen more than 40 percent since the beginning of the war, and the possibility that there won't be shipping space for tea is beginning to worry the trade. Prices have gone up in the exporting countries and shipping rates have gone up a lot.

Buy a supply now before retail prices reflect the full amount of the wholesale increase.

When Consumers Union tested teas, among the good quality black teas were: Tetley Orange Pekoe and Pekoe (4 ounces for 23 cents); Mayfair (Atlantic and Pacific) Orange Pekoe India Ceylon (8 ounces for 39 cents); and Grisdale Flowery Orange Pekoe (4 ounces for 25 cents).

Prices are as of 1939; the ratings are based on the opinions of an expert tea taster. Thirty-one brands were tested; Consumers Union reports, March 1939.

BUY THE FOLLOWING AS NEEDED BUT PROTEST HIGHER PRICES

This does not mean that you should not protest all higher prices. You should, whether you have been able to stock up or not.

Butter and Margarine

New standards for oleomargarine were set up recently by the Food and Drug Administration. The list of permitted ingredients was expanded and there is talk of repealing Federal taxes which discourage the sale of oleomargarine.

No doubt dairy States will still fight the use of margarine within their own borders as they have been doing for some time. But consumers in other parts of the country may have to swing more and more to the use of margarine as the price of butter, supported by the Government, goes on up.

Butter production this spring was high; stocks of butter in storage are high. That doesn't mean, though, that consumers are going to be able to eat more butter in the coming months.

The wholesale price in June was the highest for any June since 1929. And there's every prospect that prices will be still higher later in the year.

But margarine prices will need watching, too. Coconut oil can't be imported now in large quantities and the price of cottonseed, soybean, and other oils from which margarine is made have been shooting up so fast that, unless something is done pretty quickly, even the vegetable-oil products will be out of sight.

When vitamin A is added to margarine, it is a reasonably satisfactory substitute for butter. Read the label carefully, though, before buying. If there's no statement about vitamin A, there won't be any in the margarine.

DON'T BUY UNTIL FURTHER NOTICE

"Low-end" cottons

Prices of cotton textiles of all sorts have increased greatly—as much as 80 percent in some cases. Ceiling prices set recently have already been revised upward.

Furthermore, it seems to be generally true that cheaper qualities of goods have gone up more than better ones. Rising prices are going to take a bigger bite out of the standard of living at the low end than at the high.

Unless you are an expert judge of textile quality, don't buy wash dresses, men's shirts, towels, sheets, and pillowcases at the lowest prices.

In January of this year Consumers Union found that bath towels selling for less than 35 cents, for example, were too low in quality to be economical buys.

Senator BAILEY. I think we should say that if we could get this 10½ or 11 billions from the people able to pay—the wealthy people—we would do it. There is no question but what Congress would do it. Our difficulty is to get the money. If you will show us how we could get it we will be glad to consider it.

Miss Ross. I have filed with you a number of proposals our organization has made to that end, but what I tried to say was we feel that the poor people are willing to make sacrifices, if necessary, but we ask you to explore every method of having those better able to pay do so before asking the less able—poor people—to make these sacrifices.

The CHAIRMAN. Mr. William Shipley.

Mr. SHIPLEY. Mr. Chairman, I want to apologize to you and the other members of the committee for not being here. I was advised erroneously yesterday I was to be the last witness on the calendar and that is why I was not here.

STATEMENT OF WILLIAM S. SHIPLEY, CHAIRMAN OF THE BOARD, YORK ICE MACHINERY CORPORATION, YORK, PA.

I appear before this committee to point out what appears to be misleading language used in section 546 of the proposed revenue bill of 1941.

As I understand this proposed section, it was the intent to tax that part of our business that came under the heading of "Luxury or semi-luxury" apparatus, and not the intent to tax all refrigerating and ice-making apparatus that is manufactured by our industry. However, as the bill is now worded, it could be interpreted to mean taxing all refrigerating and ice-making machinery, regardless of size or use. We cannot believe that it was the intention of this body to single out, of all the durable-goods manufacturers, the refrigerating and ice-making industry to put a special tax upon, especially when it is realized that refrigerating and ice-making apparatus is such a necessity to the welfare and health of the people and also such a vital part of the national-defense program.

Realizing that this committee desires the facts as to how any given tax proposal will unjustly affect the taxpayer, I wish to direct the committee's attention, specifically to section 546 of this revenue bill.

The purpose of section 546, we believe, is to increase the class of products taxed under section 608 of the Revenue Act of 1932, which act levied a tax on mechanical refrigerators of the household type, and the component parts thereof. This 1932 excise tax, directed toward this so-called luxury or semi-luxury article, was held not to include refrigerators or their component parts designed primarily and solely used for commercial purposes.

For the most part, the language used in the House bill is clear and accomplished the purpose. However, I feel that the use of the terms "refrigerators" and "ice-making machines" as used in subsection (a) is too broad and would be misleading, if our interpretation of the intent is correct.

The word "refrigerator," standing alone, is without limitation as to size or use. If it is a fact that refrigerators only used in connection with the small mechanical household refrigerating units are proposed to be taxed, the language now used would include the refrigerators of the large size that might be used by the packing industry and other large cold-storage plants in which food products and other essentials were stored.

It is my opinion that the House Ways and Means Committee did not intend that such a result would follow from the use of this term, but rather intended to limit the tax to those refrigerators which might be used in connection with small refrigerating apparatus.

The term "ice-making machines" is without meaning unless it shall be construed to include only those articles which are of the self-contained or movable type, that is to say, which contain within the unit itself the apparatus necessary to produce ice.

In the interest of clarification, I would recommend that subsection (a) be so worded as to limit the articles sought to be taxed to those of the self-contained or movable type. This would have the advantage of identifying the class of articles taxed and would limit their size to those normally used in commercial operations.

I assume that subsection (b) was intended to tax the component parts which are suitable for use with or as a part of those articles taxed in subsection (a). The language used in subsection (b) wherein, for example, a compressor is taxed, which is suitable for use as a part of, or with a refrigerating plant, or refrigerating system, taxes apparatus used in a large cold-storage plant or large commercial ice plant of any conceivable size. The language used does not limit the type of the component parts which would be suitable for use in connection with those articles taxed in subsection (a).

It is my opinion that the House intended to tax certain specifically named articles and the refrigerating apparatus which are, or could be, used in connection with the operation of those articles. Surely it was not the intent of the House to tax specific articles and open the door wide to the taxation of similar parts, no matter of what size or the use to which they might be placed.

Subsection (b) could be clarified simply by restricting the tax to the refrigerating apparatus which would be suitable for use with, or as a part of, the articles specifically taxed in subsection (a).

I call your attention to the fact that this is exactly what was done in connection with the taxation of our air conditioners and their component parts. In subsection (c) the House taxes our self-contained air conditioning units and in subsection (d), it taxes those component parts which are suitable for use as a part of or with such self-contained air conditioning units.

In my opinion, the administration of section 546 could be simplified, and considerable confusion and uncertainty as to the type and size of the articles sought to be taxed could be eliminated if the suggestion I have offered to you gentlemen could be followed.

It is obvious that the duty of defining the terms "refrigerators" and "ice-making machines" will fall upon the Commissioner of Internal Revenue who will be bound by the language used in the section. It follows then that refrigerators of all sizes and no matter how used would be subject to tax and great difficulty would be encountered as to properly defining the term "ice-making machines." Also consideration must be given to the fact that the Commissioner of Internal Revenue might have a hard time restricting the tax to refrigerating apparatus which is used in connection with, or as part of, the articles specifically enumerated in subsection (a), but might be required to tax all apparatus mentioned in subsection (b), regardless of its size or the application in which used.

I earnestly request your favorable consideration to the suggestions offered so that section 546 might be clarified and a workable tax structure erected.

The CHAIRMAN. Mr. Shipley, under existing law there is a tax on mechanical refrigerators which applies wholly to refrigerators of a household type.

Mr. SHIPLEY. Yes.

The CHAIRMAN. Now, the purpose of this provision was not only to increase that tax but to make it applicable to all refrigerators of this type?

Mr. SHIPLEY. Of that type?

The CHAIRMAN. Yes;

each such article having, or being primarily designed for use with a mechanical refrigerating unit operated by electricity, gas, kerosene, or gasoline.

It applies only to that type?

Mr. SHIPLEY. That would take in all sizes.

Senator CONNALLY. What percentage of your business is Government business?

Mr. SHIPLEY. I should judge at this moment 48 to 50 percent; that is, direct—I don't know how much indirect.

Senator CONNALLY. Do you manufacture the small refrigerators?

Mr. SHIPLEY. We don't manufacture the household, but do manufacture some small units.

Senator CONNALLY. But you don't manufacture this type that is being taxed?

Mr. SHIPLEY. We do; some of it.

Senator CONNALLY. Under the present law, does it touch any that you manufacture?

Mr. SHIPLEY. No; you tax household refrigerators up to 20 cubic feet and we do not get down that small.

Senator CONNALLY. You are not paying any taxes and you are being pretty careful to see that you should not?

Mr. SHIPLEY. No; that is not it.

Senator CONNALLY. You are in favor of extending it to the household refrigerators but not to the items you manufacture?

Mr. SHIPLEY. No, sir; that is not it; I am perfectly willing to pay our share of taxes, but I cannot see why out of all the durable-goods manufacturers we should be singled out.

Senator CLARK. As a matter of fact, your company doesn't manufacture these household units now?

Mr. SHIPLEY. No; not now; we don't manufacture any.

Senator CLARK. You want to put a tax on the household article rather than on the class you manufacture?

Mr. SHIPLEY. No, sir; I only ask, Is it the intent to tax all refrigerating machinery? Is that the intent? Or is it the intent to tax only those which are luxuries or semiluxuries.

Senator CLARK. Do you think it is a luxury to have air-conditioning units in these Government buildings?

Mr. SHIPLEY. Yes.

Senator CLARK. And that they ought to be taxed?

Mr. SHIPLEY. Yes. You are going to tax these room coolers that you speak of. We say that is all right, but we do not believe we should be singled out over the whole durable-goods manufacturing field in this country, and have it said, "We are going to tax you."

Senator CLARK. Any excise tax is singling out some particular industry, isn't it?

Mr. SHIPLEY. No, sir.

Senator CLARK. Any excise tax, gasoline or what not, is a tax on that particular product, isn't it?

Mr. SHIPLEY. But when there are thousands of members of the durable-goods industry all manufacturing durable machinery of some sort, why pick one out and tax him?

Senator CONNALLY. Did you manufacture the apparatus, for instance, for cooling the Mayflower Hotel?

Mr. SHIPLEY. Yes, sir.

Senator CONNALLY. I live across the street in an apartment—it is not air conditioned: If I want a unit for my apartment, you think I should be taxed for that and the Mayflower should not pay a tax?

Mr. SHIPLEY. I said I thought they should.

Senator CONNALLY. Well, that is not a household unit; how can we tax them?

Mr. SHIPLEY. If you said "comfort cooling" that would cover it, because comfort cooling, that gets you away from the idea of industry. For instance, Ford has a big plant in his airplane factory, and that is "industry" not "comfort."

Senator CONNALLY. Thank you.

Senator DANAHER. While the next witness is on her way forward let me submit for the record a letter which has come to me to be submitted to you from the National Catholic Welfare Conference with respect to the exemption of admission tickets. I would like to have it in the record.

The CHAIRMAN. Yes. It will be included.

(The letter referred to is as follows:)

NATIONAL CATHOLIC WELFARE CONFERENCE,
NATIONAL HEADQUARTERS,
Washington, D. C., August 22, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I have been directed by the administrative board of archbishops and bishops of the National Catholic Welfare Conference to inform you, and through you, the Committee on Finance and the United States Senate, of the attitude of the National Catholic Welfare Conference with respect to section 541 (b) of the internal revenue bill (H. R. 5417) now before the Committee on Finance of which you are the chairman.

It is proposed by section 541 (b) to repeal section 1701 of the Internal Revenue Code which has been law since February 26, 1926.

Section 1701 provides in effect that no tax shall be levied under the admissions tax subchapter in respect to any admissions whose proceeds inure exclusively to the benefit of religious, charitable, or educational agencies.

The National Catholic Welfare Conference is deeply sympathetic with the task presently before the Congress in providing revenues with which to meet the heavy demands laid upon the Government by the national defense program.

In revenue laws, State and Federal, theretofore enacted, both before and during the present defense emergency, are embodied provisions which accept and safeguard the tax exempt status of religious, charitable, and educational agencies as inherent under the system of liberty prevailing in the relationship of these agencies to the State.

These agencies render a community service. The Congress understands the importance of this community service. Today that importance is enhanced because of the indispensable contributions these agencies make to the promotion and preservation of national morale.

To enact section 541 (b), as it now stands, would impose a burden upon agencies rendering these important contributions to defense morale which we are convinced the Congress neither wishes nor intends to impose.

It may be argued that admission taxes are paid by the individual, and therefore place no burden upon the organization.

We respectfully submit that, while nominally and technically this is true, it nonetheless remains the fact that the morale-minded citizen who contributes to agencies rendering these services by purchasing admissions to programs and benefits given is forced to pay more than he would have had to pay had the tax not been imposed. The consequent handicapping of the work done by the agency is obvious.

The further fact is that the process results in a duplication of effort that is costly, at a time when the avowed purpose of the bill is to devote all possible effort to defense. The tax would be collected in order to realize revenue to be expended for public purposes. It follows that the tax should not be imposed upon agencies already rendering such services in order that Government might realize moneys to be expended through political agencies in rendering service already provided by voluntary agencies.

In addition, while the tax is on the admission, the responsibility and burden of collecting the tax and paying it to the Government is placed upon the religious, charitable, and educational organization charging the admission. This is the first instance in Federal legislation wherein these organizations would be placed in such a role.

The enactment of section 541 (b) in its present form would constitute a departure by the Congress from a long- and well-established policy of the United States Government.

We, therefore, respectfully submit that section 541 (b) should be stricken from the revenue bill now being considered by your committee.

Faithfully yours,

MICHAEL J. READY, *General Secretary.*

Senator CONNALLY. At this point I would like to insert two briefs in the record. One concerns the subject of joint returns and the other the gasoline tax.

I don't want to read these briefs; I just want to insert them in the record for the consideration of the committee.

The CHAIRMAN. You may put it in, Senator. Hand them to the clerk, please.

(Thereupon two briefs, as above indicated, were handed to the clerk for filing in the record, and are as follows:)

MEMORANDUM BRIEF OF GEORGE DONWORTH, OF SEATTLE, WASH., IN OPPOSITION TO ANY PROPOSAL FOR REQUIRING INCOMES OF HUSBANDS AND WIVES, OR ANY PART THEREOF, TO BE JOINTLY RETURNED OR TAXED

PRELIMINARY STATEMENT

At the time this brief is prepared it is not known to the writer what will be the nature of the proposals that will be made to the Senate committee for a compulsory joining of the incomes of the husband and the wife, or any part thereof.

NOTE.—All italics in this brief are those of the writer.

IT IS UNCONSTITUTIONAL TO REQUIRE ANY TWO INCOMES, OR PARTS THEREOF, TO BE ADDED TOGETHER AND TAXED AND SURTAXED ACCORDINGLY

The case of *Hoeper* v. *Tax Commission of Wisconsin* (284 U. S. 206, 76 L. ed. 248) is conclusive against the constitutionality of measuring the tax of a husband or wife by reference to the income of the other spouse.

Here is a part of the language of the Supreme Court in the *Hoeper case*. The Court said:

"Since, then, in law and in fact, the wife's income is in the fullest degree her separate property and in no sense that of her husband, the question presented is whether the State has power by an income-tax law *to measure his tax*, not by his own income but, *in part*, by that of another. To the problem thus stated, what was said in *Knowlton* v. *Moore* (178 U. S. 41, 77, 44 L. ed. 969, 984, 20 S. Ct. 747), is apposite:

"'It may be doubted by some, aside from express constitutional restrictions, whether the taxation by Congress of the property of one person, accompanied with an arbitrary provision that the rate of tax shall be fixed with reference to the sum of the property of another, thus bringing about the profound inequality which we have noticed, would not transcend the limitations arising from those fundamental conceptions of free government which underlie all constitutional systems.'

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the fourteenth amendment. That which is not in fact *the taxpayer's* income cannot be made such by calling it income."

While the *Hoeper case* involved a State statute which was struck down as being in violation of the fourteenth amendment to the Federal Constitution, it is obvious that the same ground relied upon in that case would render a Federal statute of similar import void under the fifth amendment. The Supreme Court in the case of *Heiner, Collector*, v. *Donnan* (285 U. S. 312, 76 L. ed. 772) (involving a Federal tax under act of Congress) expressly held that the restraint imposed upon Congress by the fifth amendment to the Federal Constitution is the same as that imposed upon the States by the fourteenth amendment so far as this question is concerned. The Court said:

"The restraint imposed upon legislation by the due process clauses of the two amendments is the same."

In the *Heiner case* the Supreme Court relied upon the *Hoeper case*, and used the following language:

"In *Hoeper* v. *Tax Commission* (284 U. S. 206), ante, 248, 52 S. Ct. 120, supra, this court had before it for consideration a statute of Wisconsin which provided that in computing the amount of income taxes payable by persons residing together as members of a family, the income of the wife should be added to that of the husband and assessed to and payable by him. We held that, since in law and in fact the wife's income was her separate property, the State was without power *to measure his tax* in part by the income of his wife. At page 215 we said:

"'We have no doubt, that, because of the fundamental conceptions which underlie our system any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the 14th Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income. Compare *Nichols* v. *Coolidge* (274 U. S. 531, 540, 71 L. ed. 1184, 1192, 52 A. L. R. 1081, 47 S. Ct. 710.)'"

The Supreme Court further said in *Heiner* v. *Donnan:*

"Plainly, this is to measure the tax on A's property by imputing to it in part the value of the property of B, a result which both the Schlesinger and Hoeper cases condemn as arbitrary and a denial of due process of law. Such an exaction is not taxation but spoliation. 'It is not taxation that government should take from one the profits and gains of another. That is taxation which compels one to pay for the support of the government from his own gains and of his own property.' *United States* v. *Baltimore & O. R. Co.*, 17 Wall. 322, 326, 21 L. ed. 597, 599.)"

The dissenting opinion in the *Hoeper case* really emphasizes and makes more pertinent to the pending question the rule laid down by the majority of the Court in that case. The dissent is based upon the ground that the State of Wisconsin *could have reenacted the common law* relationship between husbands and wives, and the dissenting Justices thought that a State income tax could lawfully be measured by the combined income of husband and wife because the State statute could be considered *as reenacting the common law* whereby the husband became the owner of the wife's property. Obviously the dissenting opinion did not suggest that *a Federal statute* could govern the property rights of the spouses as a State statute could. In fact, the Supreme Court has always recognized that marital rights and domestic relations are exclusively within the power of the States (*Ohio* v. *Alger*, 280 U. S., page 379; *Smith* v. *Alabama*, 124 U. S. 465).

That the legislatures of the various States are exclusively vested with the power to determine the effect of the marital relation and the resulting property rights of married persons, is so fundamental a proposition in American law that it would be a waste of time to cite further authority.

COMMENTS ON THE CONTENTION OF THE JOINT STAFF THAT THE HOEPER CASE IS NOT CONTROLLING

At page 7 of its report the Joint Staff on Internal Revenue Taxation attempts to distinguish the *Hoeper case* as follows:

"But even if the *Hoeper case* be taken at its face value, the proposed amendments do not come within its scope. The motivating factor for the decision in that case was the provision that each person whose income was included within the tax computation was liable for the entire tax. It has been pointed out that the legislation here under consideration does not make the spouses jointly and severally liable for the entire tax unless they so elect. Each person is required to pay a tax only upon his own income and not upon the income of any other person. The net effect is merely that the amount of the tax which he is required to pay is conditioned by the fact that he lives in an economic unit which has other income accruing to it."

The above statement fails to give recognition to the facts and issues in the *Hoeper case.*

The Supreme Court did not give any weight in its opinion to the fact that the husband was assessed for the entire tax. Indeed, the Wisconsin statute it quotes, section 71.09 (4) (c), expressly provided that married persons could file separate returns and that "the amount of tax due *shall be paid by each* in the proportion that the average income of each bears to the combined average income."

True, as footnote 1 to the Supreme Court opinion shows, the taxpayer apparently did not elect to insist that the tax be allocated and paid in part by his wife, but since the Wisconsin statute clearly so provided, the ground for distinction set out by the Staff does not exist. This footnote reads as follows:

"'This resulted from the fact that the act provides for surtaxes graduated according to the amount of the taxpayer's net income. While the excess would have been less if returns and assessments had been made under section 71.09 (4) the total would still have been greater than the sum of the husband's and wife's taxes if separately assessed on their individual incomes."

Ordinarily one has to ascertain the "motivating factor" for the decision in the language used. We have already quoted in this brief sufficient of the Court's language to show what the motivating factor was, especially the following language:

"We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the fourteenth amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income."

The court clearly ruled that it would be unconstitutional to measure the tax on the husband's income by using the rate that would apply to the sum of the combined income of himself and wife instead of the rate that would ordinarily apply to the amount of his own income, and held that any such attempted classification was unreasonable and arbitrary.

The ground just mentioned was squarely raised by the second assignment of error presented by the taxpayer in carrying the case to the Supreme Court. That assignment as it appears in the record on file with the Supreme Court today, complains that the Wisconsin court erred:

"In holding that section 71.09 (4) (c) of the Statutes of Wisconsin, pursuant to which a tax was levied on appellant on his own income at a higher rate because his wife also had separate income from her own separate estate than is levied on other persons of like income from like sources as appellant, does not violate the fourteenth amendment to the Constitution of the United States."

Exactly the same arguments with respect to classification and to the right to increase the tax of the husband and wife because of the income earned by the other with consequent reduction of burden were presented by the Tax Commission in the *Hooper case* as by the joint committee here. The arguments were not recognized as persuasive or sound by the Supreme Court.

THERE IS NO DECISION OF THE SUPEME COURT IN ANY WAY WEAKENING THE HOLDING IN THE "HOOPER CASE" THAT THE TAX OF HUSBAND OR WIFE CANNOT BE INCREASED BY USING AS A MEASURING BASIS ANY PART OF THE INCOME OF THE OTHER SPOUSE

In the brief in support of mandatory joint returns submitted to the Committee on Ways and Means a number of decisions of the Supreme Court are cited as supporting the belief that the Supreme Court would uphold a tax based on the joining of the incomes of two persons "where there are sufficient facts so to justify." Every case cited in that brief as supporting the possibility of taxing an income to a person other than the owner of the income was a "grantor" case (the case of a transferor or assignor) where a taxpayer, having been the outright owner of property, undertook to make a transfer and to escape the payment of the income tax. In some of those cases the taxpayer continued to have the beneficial enjoyment of the income. In others of those cases the grantor taxpayer had made a gift of the income though retaining the property on which the income accrued. We proceed to analyze those cases which are cited against us.

In *United States* v. *Hudson* (299 U. S. 498, 81 L. ed. 370) and in *Helvering* v. *Northwest Steel Rolling Mills* (311 U. S. 46, 85 L. ed. 21) neither the taxpayers nor the facts raised any question as to existence of the income nor as to its belonging to the taxpayer. In the first of those two cases (the *Hudson case*) the only question was whether a tax could be made retroactive for a period of 35 days. In the second case (the *Northwest Steel case*) the main question was the interpretation of the statute taxing the undistributed income of a corporation.

Burnet v. *Wells* (289 U. S. 670, 77 L. ed 1439) upheld the taxing of the income of a trust *to a grantor* who had created a life insurance trust and it appeared that in creating the trust the grantor taxpayer had not parted with the full beneficial interest in the trust property. The grantor had been the outright owner and had made a transfer which did not divest him of the full beneficial interest.

Helvering v. *Clifford* (309 U. S. 331, 84 L. ed 788) was also a grantor case. A trust was created by a husband as grantor by declaring himself trustee of certain securities. The Court held the grantor was still liable for the tax on the income because "in substance his control over the corpus was in all essential respects the same after the trust was created as before."

Helvering v. *Horst* (311 U. S. 112, 85 L. ed. 99) is also a grantor case. A grantor owning certain coupon bonds detached and gave to his son certain of the interest coupons thereof, retaining the bonds themselves. It was held that the grantor had *realized* the income.

Helvering v. *Eubank* (311 U. S. 122, 85 L. ed. 104) was another grantor case. A grantor insurance agent, having a contract entitling him to future commissions on insurance already written, assigned the commissions to others after fully earning them. The Court held that the case was ruled by the *Horst case*, the transferring taxpayer having assigned income that was fully earned.

Hormel v. *Helvering* (85 L. ed. 651), was also a grantor case where the grantor taxpayer created a short-term trust retaining certain benefits and controls.

Madden v. *Kentucky* (309 U. S. 83) merely held that a State could lawfully impose a higher rate of taxation on bank deposits kept outside the State than on those kept within the State. There is absolutely nothing in the case giving any color to the proposition of measuring one person's tax by the property or income of another.

Harrison v. *Schaffner* (85 L. ed. 694) is another grantor (donor) case. The Court said:

"It is enough that we find in the present case that the taxpayer, in point of substance, has parted with no substantial interest in the property other than the specified payments of income which, like other gifts of income, are taxable to the donor."

All of these cases cited before the Ways and Means Committee in the brief favoring mandatory joint returns (wherever those cases upheld the taxing of income to a person not presently the owner) were cases where the taxpayer had been the owner and had attempted to divest himself of the property or income. The grantor (assignor, donor, or transferrer) was a taxpayer seeking to avoid liability by making a transfer.

That a taxpayer, who is a transferrer or donor of property, remains liable for the income tax where he does not completely divest himself of all beneficial interest or where in some other manner he realizes the income, is, of course, a holding in accordance with general rules.

The proposal for compulsory joint returns of the incomes of husband and wife or any part thereof and measuring the amount of the tax accordingly has nothing to do with assignments or transfers or gifts. Those are reached in proper cases by other provisions of law.

The Supreme Court itself has expressly and clearly stated the distinction between a grantor (transferrer or assignor) making an insufficient or invalid transfer on the one hand and the case of husband and wife receiving incomes which are theirs by State law. In *Poe* v. *Seaborn* (282 U. S. 101), the Court speaking of *Corliss* v. *Bowers* (281 U. S. 376), expressed itself as follows:

"We held that where *a donor* retains the power at any time to revest himself with the principal of the gift, Congress may declare that he still owns the income. While he has technically parted with title, yet he in fact retains ownership and all its incidents. *But here the husband never has ownership.* That is in the community at the moment of acquisition."

We assert without fear of contradiction that there has been no decision of the Supreme Court in any way weakening its holding in the *Hooper case* where the Court declared unconstitutional the attempt to measure the tax of one person, husband or wife, using as a measure for taxing purposes the income of the other spouse.

INCOME TAXES UNDER THE SIXTEENTH AMENDMENT MAY LAWFULLY BE LEVIED ONLY UPON THE OWNER OF THE INCOME

The Supreme Court has in several cases made this proposition exceedingly plain. In *Eisner* v. *Macomber* (252 U. S. 189), referring to the sixteenth amendment defined the word "incomes." The Court said:

"Here we have the essential matter: * * * a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital, however invested or employed and coming in, being 'derived,' that is received or drawn by the 'recipient' (the taxpayer) for his separate use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description."

Let it be noted that the parenthetical explanatory phrase "the taxpayer" is not the interpolation of the writer of this brief. It is the language of the Court. The Court says that the taxpayer must be the recipient of the income in order to be taxable for it.

In *Bromley* v. *McCaughn* (280 U. S. 124), the Court, in upholding the gift tax as an excise and referring to other cases where excise taxes of various kinds with reference to property had been upheld, said:

"It is true that in each of these cases the tax was imposed upon the assertion of *one* of the numerous rights of property, but each is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property."

In *Taft* v. *Bowers* (278 U. S. 470), the Court upheld the validity of the provisions in the Revenue Act of 1921 which required the donee of a gift to pay an income tax on the capital gain based on the cost of the gift to the donor. In the unanimous opinion the Court said:

"Under former decisions here the settled doctrine is that the sixteenth amendment confers no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income."

It is obvious from these decisions and all other decisions of the Supreme Court relating to Federal income taxes that there is no justification in the Constitution for including the income of one person as a measure of the income tax of another person or for increasing the income tax of one person by reason of the income received by another. Husbands and wives, whose rights are determined purely by State laws, form no exception to the rule. The proposal now made for compulsory joint returns is a startling innovation.

INAPPLICABILITY OF THE ENGLISH PRECEDENT

Those who favor the principle of mandatory joint returns by husband and wife, in whole or in part, attempt to gain support by the statement that such a law has been in effect in England for a number of years. The English precedent can have no force here for a variety of reasons.

(A) In England the British Parliament has jurisdiction over all local affairs and property rights as well as over national affairs. There is no such thing as State rights. Parliament can legislate as to the property rights of husband and wife and change them at will and its legislation cannot be questioned. In the United States the property rights of husband and wife are determined exclusively by laws of the State where the spouses reside. A Federal law cannot in any way change or affect those property rights.

(B) In England the British Parliament is supreme. There is no written constitution. An act of Parliament that has received the royal assent cannot be questioned on any ground whatsoever. No act of Parliament can be held invalid by reason of conflict with any constitution.

(C) It is a matter of common knowledge that in England the position of the husband in the family and in the household is far different from what it is in the United States. There the general custom of society attributes to the husband the dominating influence in the family, and everyone (the wife included) acquiesces in that idea. This principle is largely the result of the English tradition surviving from the common law. Under the common law the wife's personality was merged in that of the husband and her property became his. No such principle would be tolerated in this country.

(D) During the past 60 or 75 years the whole tendency of State legislation in the United States has been to get away from the barbarity of the common law whereby the wife as a result of marriage suffered deprivation of her property in favor of the husband. The whole progress of modern law in the United States has been in the direction of the recognition of the wife's individuality and her separate property rights. The astounding proposal now made is to turn back the clock of progress. It would threaten to deprive married women of recognition of the great advances that they have achieved in the United States as a result of State laws in the several States. These State laws are strongly supported by public opinion. The proposal for any kind of compulsory joint returns is an anachronism. Moreover, it is unjust. Further, the Supreme Court has held it to be a violation of the Federal Constitution.

Respectfully submitted.

DONWORTH, PAUL, DONWORTH & SMITH,
GEORGE DONWORTH,
Counsel for a Group of Married Taxpayers in the State of Washington.

STATEMENT OF FAYETTE B. DOW ON REVENUE REVISION OF 1941

My name is Fayette B. Dow. I am appearing before you today, as I have on previous similar occasions, as a representative of the American Petroleum Industries Committee, the National Petroleum Association, and the Western Petroleum Refiners Association.

The American Petroleum Industries Committee was organized several years ago to study State and Federal taxation of petroleum products and to present information to legislative committees, such as the committee which is conducting this hearing. The gasoline tax, especially when collected at reasonable rates by the States and applied to road building and maintenance, has been a good tax. Like any other tax, it is susceptible of excessive imposition. Our position never has been that of mere opposition to increased taxation. We did not oppose the half-cent increase imposed in the Revenue Act of 1940, but presented the facts surrounding the existing gasoline and automotive taxes, and indicated the proportion of additional revenue which it was proposed to collect from this group. As a matter of fact, when I making my presentation before the House Ways and Means Committee I sensed on the part of some members a feeling that our failure to oppose the increase in the gasoline tax at that time was an exercise of mistaken judgment. In opening that statement I said this:

"Personally, speaking for myself only, I conceive this bill as merely the beginning of taxation and not the last of the tax measures which this committee will consider and discuss. No person who understands the situation which confronts the country could, I think with good grace, oppose a tax measure of this kind or could fail to realize that we have here an emergency which requires us to act quickly and effectively in order that this country may be properly armed to meet whatever contingencies the future may have in store for it. It is for that reason that this statement in no wise opposes the provisions of the bill."

Since that time the situation has changed. Our Government has adopted a vast rearmament program, not only for our own defense but for aid to Britain and other democracies. This program is steadily being enlarged. No one knows how great it will become or how long it will last. But whatever the developments of the war may be, it is safe to predict that the economy of the United States will be a war economy for years to come. It is proposed to pay for two-thirds of the cost of this program out of current taxes, and we are not aware of any substantial disagreement with that policy. Even if that policy is carried out there will be a substantial addition to the public debt which must certainly be serviced, perhaps at some later day reduced, through taxation. Therefore, we think that we only engage in self-deception when we label taxes by such names as "emergency" taxes, or "defense" taxes, or think of them as temporary taxes. We are in the process of placing upon all of the American people very heavy taxes which must be borne for a very long period of time.

If this is so it becomes, I hope, an unobjectionable duty for any group which has studied the tax burdens in any field to place its facts and its views before the members of this committee for their consideration.

Running through the discussions of new taxes before this committee at this hearing are two primary objectives: One, revenue; two, the prevention of inflation. By the prevention of inflation I understand is meant the prevention of a rising spiral of prices and costs due to the fact that in a period of large Government spending for armament the national income available for purchasing consumer goods outgrows the production of those goods. Some persons suggest for this reason that taxation on specific commodities be considered from the standpoint of their competition with defense production.

The first approach to a study of a proposed tax on any commodity is the burden which the purchasers of that commodity already are bearing.

THE PRESENT BURDEN OF STATE AND FEDERAL GASOLINE AND AUTOMOTIVE TAXES

A. *The States.*—Existing gasoline taxes provide, on the average, more than 25 percent of the revenues of the States. Gasoline and other automotive taxes, as a whole, provide nobut 40 percent of the State revenues.

Stated in dollars, the States are now collecting $868,000,000 a year from their taxes on gasoline. From registration fees and other similar levies the States are collecting $450,000,000 annually.

The total annual automotive tax revenues of the States are, therefore, $1,318,000,000.

B. *The Federal Government.*—Under its present tax of 1½ cents per gallon on gasoline the Federal Government is now collecting at the rate of approximately $347,000,000 per year. The current yield of other Federal automotive taxes is about $161,027,000. The total present revenue yield to the Federal Government on an annual basis from these taxes is, therefore, $508,027,000.

The House in passing the revenue bill has increased this tax bill by $302,300,000. Passenger automobiles, parts, and accessories will pay $74,000,000; trucks, busses, and trailers, $16,100,000; tires and tubes, $51,300,000; motor vehicles, under the new "use tax," $160,000,000. This will bring other Federal automotive taxes to a total of about $463,327,000.

C. *Some significant comparisons.*—Since their inception only a little more than two decades ago gasoline and other automotive taxes have yielded $17,000,000,000 in revenue.

The present total annual gasoline tax of $1,215,000,000 is almost equal to $1 a barrel on every barrel of crude oil produced.

The present simple average combined State and Federal tax is 5.0 cents per gallon.

This is more than 100 percent of the average wholesale price of gasoline.

It is a retail sales tax of 47 percent of the average retail price.

On top of this Treasury officials now propose an increase of 1 cent in the gasoline tax. This increase, they state, will yield $255,000,000 additional revenue. But it will make the simple average tax, State and Federal, 6.0 cents per gallon, a 55-percent retail sales tax.

The time has clearly come to ask and to answer two simple questions: What is gasoline? Who pays the gasoline tax?

WHAT IS GASOLINE AND WHO PAYS THE GASOLINE TAX?

Gasoline, in peace and in war, is one of the most fundamentally necessary fuels of the modern world. The days when it was a new, experimental fuel for the new and experimental internal-combustion engine—the days when gasoline was used to drive the hand-made automobile so costly that only the well-to-do could own one—the days when the automobile was chiefly a pleasure car—those days were gone before World War No. 1 began. Since that time automobiles have been made steadily better and cheaper. Their production and sale have been not by the thousands but by the millions. Their predominant ownership is no longer by the rich, or by the so-called middle classes, but by the rank and file of the lower-income groups. In the last two decades they have completely revolutionized passenger transportation. The most recent authoritative statement on this subject was made on May 1, 1941, by Mr. Ralph Budd, president of the Burlington Railroad, and Transportation Commissioner, Advisory Commission to the Council of National Defense, before the American Mining Congress. Mr. Budd said, of all intercity passenger transportation:

"Ninety percent is in private automobiles, 5 percent on railways, about the same on busses, and one-half of 1 percent in airplanes."

In other words in the world of today gasoline is the motor fuel which provides 95 percent of all intercity passenger transportation.

Within the cities, busses and taxicabs are narrowing the field of electric streetcars. The growing use of private automobiles from home to place of work is a matter of everyone's observation.

A revolution, indeed! That 95 percent figure alone is enough to prove gasoline's right to be classed as "one of the most fundamentally necessary fuels of the modern world." Is some passenger-car transportation used for recreation purposes? Of course. That was always true of the railroad coach, of the interurban electric, and the streetcar, all of them concededly essential agencies in the days when they were predominant in passenger transportation.

Let us answer the same questions—What is gasoline? Who pays the gasoline tax?—from a different approach.

There are 131,410,000 people in this country, according to the last census.

There are 20,500,000 private passenger automobiles registered in this country—1 for every 5 persons in the country, of whatever age and of whatever economic position.

A study of automobile ownership by income groups for 1938, taken from Department of Commerce and National Resources Board sources, throws a clear light on this subject.

Income group	Percent of total persons in each group who are car owners	Number of persons owning passenger vehicles	Percent of total car owners	Number of vehicles owned	Percent of total vehicles owned
$10 per week or less	30.3	1,672,000	7.5	1,738,500	7.5
$10 to $20	43.9	4,659,000	20.9	4,769,000	20.5
$20 to $30	60.5	5,350,000	24.0	5,497,000	23.7
$30 to $40	70.8	3,946,000	17.7	4,073,500	17.6
$40 to $60	78.7	3,901,000	17.5	4,071,000	17.5
$60 to $100	86.9	1,806,000	8.1	1,945,000	8.4
$100 per week and over	93.0	958,500	4.3	1,119,000	4.8
Total		22,292,500	100.0	23,213,000	100.0

This table shows that 51.7 percent of the passenger vehicles in use in 1938 were owned by persons having an income of $30 a week or less. Only 12.4 percent of the Nation's car owners had weekly incomes of over $60.

LABOR AND THE MOTOR VEHICLE

The dependence of labor upon a cheap automobile as a means of getting to and from the job now is being brought into bold relief by the industrial expansion.

The shortage of adequate housing facilities in the vicinity of large industrial areas, or new defense industry centers, is increasing this dependence. For example, widespread publicity recently was given to 200 skilled workers living in New York who spend 4 hours each day driving 60 miles each way to and from their jobs in Bridgeport, Conn. Connecticut levies a State tax on gasoline of 8 cents per gallon—an unusually reasonable rate which considerably is below the national average. If these commuting workers purchase all of their gasoline requirements in Connecticut, and if the working year is considered to include only 300 days, State and Federal taxes on gasoline now cost each of those workers who drives his car daily to work about $135 each year. If this situation were duplicated with respect to a worker in a Tennessee aluminum plant, where a 7-cents-per-gallon State tax prevails, gasoline taxes would drain $255 annually from the worker's income. In either State, a 1-cent increase in the Federal gasoline tax would cost this worker an additional $30 annually.

It is true, of course, that the case of the New York-to-Bridgeport commuters is unusual. Nevertheless, it is common for workers to drive 10 or 20 miles each day from home to plant, and an extremely large proportion of all industrial workers drive to work, whatever the distance.

A glance at the acres of parking lots filled with low-priced cars which surround the typical factory is sufficient to suggest that the motor vehicle is indispensable in transporting labor to the job. Recent surveys, furthermore, show clearly the extent to which the private car is used for this purpose. In Midland, Mich., a chemical center, 92 percent of all workers drive to work in their own cars or ride with fellow workers. In a center of aircraft production, Glendale, Calif., 87 percent of the laborers depend on cars to get their jobs. In Youngstown, Ohio, a steel center, the proportion is 82 percent.

Of the 3,412 municipalities in the United States with a population of greater than 2,500, it has been found that 2,130, or approximately four-fifths of the total, possess no system of mass transportation whatsoever. Obviously, the residents of these communities must rely mainly upon their private automobiles for transportation.

New York City is said to possess the finest system of mass transportation in the world. Despite its miles of subways and elevated, its ferries, busses, and railroads, it is said by authorities that more than half a million workers use their cars to get to their jobs in the morning, and, of course, use them to get home again at night. From Brooklyn, and Long Island alone, 144,000 cars cross the East River each morning, carrying office workers to Manhattan. Traffic surveys indicate that more than 100,000 commuters enter New York from New Jersey every morning by private passenger car.

All these workers are buying gasoline, which, to them, is just the same as using the other available arteries of transportation. When they buy gasoline, they are paying the cost of transporting themselves to the job.

THE MOTORTRUCK AND GASOLINE TAXES

There are 4,500,000 trucks in service. To anyone who uses the highways, it is obvious that the motortruck must account for a sizeable proportion—a fair estimate is 25 percent—of all the gasoline consumed. I should like to point out, however, that as the national defense efforts of this Nation are intensified, so will be increased in direct proportion the demands made on the motortruck. Already, it has been suggested in high places that a large portion of the deep-seaworthy bottoms on the Great Lakes be diverted to the Atlantic trade. Little imagination is needed to visualize the increased dependence upon land transportation facilities which the removal of these water carriers would bring in such vast production centers as Detroit, Cleveland, Toledo, or Chicago. Even today, the motortruck is depended upon to correlate the productive efforts of the entire Nation—and as our industrial machine shifts into high gear, trucks, too, must move accordingly.

Now, it is relatively easy for most of us to accept without question the statement that trucks consume 25 percent of all gasoline and therefore would pay about 25 percent of all gasoline taxes. After all, we all can appreciate the importance of the truck in transporting milk or groceries, because this type of transportation takes place every day in every county in every State in the Nation.

But many of us come from agricultural areas, and it may be difficult for us to understand the extent to which the automobile is an indispensable form of transportation for industrial and business workers. Or many of us may have lived in large metropolitan areas all of our lives, and we hardly could be expected to know the extent to which the motor vehicle has become an absolute necessity to the farmer.

THE FARMER AND THE MOTOR VEHICLE

Regarding the farmer, and his dependence upon the motor vehicle, Mr. Knutson, a member of the House Ways and Means Committee, recently made some pertinent observations. He observed that the farmer probably uses more gasoline than any other class. He noted that the farmer has to take his milk to the creamery every morning. The farmer operates tractors and trucks and automobiles, and in many cases has from two to four motor vehicles of one description or another. He noted that the gasoline expense is very large in comparison with the farmer's volume of business, and any increased gasoline tax will be a real burden.

During 1940, one of the Members of the House of Representatives placed in the Congressional Record information indicating that farmers use about 5.5 percent of all the gasoline consumed annually in the United States for tractor and other uses on the land. He said that the farmer pays about 12½ million dollars annually to the Federal Government for every cent of the Federal gasoline tax, and that this tax payment did not take into consideration the farmers' use of gasoline for automobile or truck, but applies solely to nonhighway uses.

In addition to tractors, stationary engines, and other gasoline consuming machinery, about one-third of all motor vehicles are owned by persons living on farms and in unincorporated areas. Nearly 1,000,000 of these vehicles are trucks.

The United States Department of Agriculture estimates that 27 percent of the butter, 39 percent of the eggs, 65 percent of the poultry, 40 percent of the fruit and vegetables, 62 percent of the cattle, 68 percent of the hogs, and 50 percent of the horses and mules are moved by trucks from farm to market. Almost all cereal grains are moved from farm to elevator by truck.

Within my own experience, I know of farm laborers occupying tenant houses who, in addition to wages, receive from the farmer their firewood, pork, potatoes, milk, and a monthly allowance of gasoline.

It is not uncommon for farm laborers, like factory workers, to drive to the farm by automobile from their homes in a nearby village. On other large farms, the cattle are fed from the pick-up truck that drives the range with seed-cake. Many of the chores around the farm, today, involve the use of gasoline, and it is small wonder that agriculture accounts for such a large proportion of gasoline consumption.

The plight of the migratory farm worker is a case in point. Only his second-hand car and a supply of gasoline are his links with economic existence.

A candid consideration of the facts stated in the foregoing paragraphs should effectually and finally dispose of the impression, if it is seriously entertained by anyone, that gasoline is in a class of articles commonly called luxuries. This committee must frankly recognize that the burden of present gasoline taxes is very large and that it falls upon the masses of American people, including especially the very low-income groups.

THE GASOLINE TAX AND FEDERAL AID TO HIGHWAYS

During the hearings held by the House Ways and Means Committee on the revenue bill, it was asked whether Federal revenue from gasoline and automotive taxes had any relation to Federal aid to roads. A table, which I have attached to my statement, will make it clear that on these grounds the automotive taxpayer's account is more than square.

The Federal gasoline tax, historically speaking, never has been considered a tax for roads. Unlike State gasoline taxes, which are actually road "tolls," the purpose of the Federal gasoline tax is to raise money for national defense. Any comparison with Federal aid to roads is pure afterthought. If, however, such a comparison must be made, one might test its validity by asking why ships have not been required to pay for improvements to rivers and harbors?

On the whole subject of public aids to transportation reference should be made to the painstaking study in four large printed volumes by Coordinator Joseph B. Eastman which showed that highway users are the only persons engaged in any form of transportation who pay their way and more. In that study the Federal gasoline and other automotive excise taxes were not even credited as highway contributions by motor-vehicle operators. The Federal gasoline tax was considered a general tax levied for the general purposes of government.

In passing it may be proper to quote from Mr. Eastman's report, volume 1, page 26, the following:

"*Conclusions as to whether or not there has been public aid to motor-vehicle users as a class, 1921–37.*—Motor-vehicle user payments, consisting of State gasoline taxes and registration fees, miscellaneous State taxes and estimated municipal and county and local motor-vehicle taxes, were found to have aggregated $6,132,933,000 in the period 1921–32 and $4,751,773,000 in the period 1933–37, or $138,170,000 and $387,906,000 more than the assigned costs. * * *"

It is only for the sake of the record, therefore, that I am offering the attached table, compiled from Government sources, which shows clearly that the revenue from the Federal gasoline and other automotive taxes, since such taxes first were imposed in 1918, actually exceeds the amount of Federal funds expended upon the highways of America. These statistics of Federal road expenditures include not only regular Federal highway aid but also the expenditures of emergency relief funds on roads, which were primarily for the purpose of providing employment and not for the benefit of highway users.

CONCLUSIONS

1. As I have previously said, some suggest that the type of excise tax which is called for today is a tax on articles "which compete very heavily for materials, productive facilities, and skills for defense production." While not in accord with the principle that taxation is needed to do what agreements between the Government and manufacturers can quickly and satisfactorily accomplish, it should be pointed out that gasoline does not fall into that class. Several recent surveys show that the petroleum industry is in position to supply all normal commercial requirements and all war needs without difficulty. We have the necessary supplies of crude oil and the necessary refining capacity. Our one problem at the moment is to adjust transportation facilities that supply will meet demand. Gasoline, in fact, is "among the goods of mass consumption which in no way compete with the defense program." The Government official whose description is quoted expressed the view that the taxes on such articles are "deflationary, unnecessary, and highly inequitable."

Revenue from Federal gasoline and automotive excise taxes compared with Federal expenditures on highways, 1917–40

A. FEDERAL AUTOMOTIVE TAX REVENUES

Fiscal year	Gasoline tax [1]	Automotive excise taxes [2]	Total
1918		$23,981,000	$23,981,000
1919		49,342,000	49,342,000
1920		145,963,000	145,963,000
1921		117,323,000	117,323,000
1922		106,219,000	106,219,000
1923		146,198,000	146,198,000
1924		160,028,000	160,028,000
1925		126,552,000	126,552,000
1926		139,802,000	139,802,000
1927		66,438,000	66,438,000
1928		51,628,000	51,628,000
1929		5,546,000	5,546,000
1930		2,320,000	2,320,000
1931			
1932			
1933	$124,929,000	42,544,000	167,473,000
1934	202,575,000	86,054,000	288,629,000
1935	161,532,000	101,061,000	262,593,000
1936	177,340,000	128,032,000	305,372,000
1937	196,533,000	142,705,000	339,238,000
1938	203,557,000	87,944,000	291,501,000
1939	207,019,000	111,272,000	318,291,000
1940	220,197,000	146,225,000	366,412,000
Total	1,499,672,000	1,981,177,000	3,480,849,000

[1] Automotive consumption approximately 89 percent of total.
[2] Includes manufacturers' excise taxes on lubricating oil (automotive share only), automobile and truck chassis and bodies; other automobiles and motorcycles; parts and accessories for automobiles; and tires and inner tubes.

Authority: Bureau of Internal Revenue.

B. FEDERAL EXPENDITURES ON HIGHWAYS, 1917–40 [1]

Fiscal year	Regular Federal aid expenditures	Emergency and public works expenditures	Fiscal year	Regular Federal aid expenditures	Emergency and public works expenditures
1917	$34,388		1930	$77,892,192	
1918	574,816		1931	135,591,373	$20,928,000
1919	2,915,283		1932	129,805,187	58,907,453
1920	20,340,774		1933	103,741,125	62,131,961
1921	57,462,768		1934	43,469,422	181,019,392
1922	89,946,604		1935	13,289,614	264,408,936
1923	71,604,709		1936	27,188,043	201,593,976
1924	80,447,824		1937	78,875,136	264,666,020
1925	97,472,506		1938	142,785,989	81,717,299
1926	89,362,111		1939	161,011,461	32,661,616
1927	82,977,566		1940	147,045,642	13,359,142
1928	82,513,831				
1929	84,006,619		Total	1,820,354,936	1,181,483,861

Total expenditures, regular Federal aid	$1,820,354,936
Total expenditures, emergency and public works	1,181,483,861
Total	3,001,838,797

[1] Statistics represent actual expenditures only not authorizations or appropriations.

Authority: Hearings before the Committee on Roads, House of Representatives, 76th Cong., 3d sess., on H. R. 7891, p. 34. Annual report, Federal Works Agency, Public Roads Administration, 1940, p. 280.

SUMMARY

Federal automotive tax revenue $479,010,000 greater than Federal highway expenditures

Total Federal gasoline and automotive excise-tax revenue, 1918–40	$3,480,849,000
Total regular Federal aid and emergency and public-works expenditures on highways, 1917–40	3,001,838,797
Excess, Federal automotive taxes over Federal highway expenditures	479,010,203

Senator GUFFEY. I would like to insert something on the inheritance-tax amendment.

I haven't it here; I will bring it.

The CHAIRMAN. Yes, Senator; you may do that.

(The data referred to by Senator Guffey is as follows:)

WRIGHT & RUNDLE,
Pittsburgh, Pa., June 24, 1941.

Hon. JOSEPH F. GUFFEY,
United States Senator,
Senate Building, Washington, D. C.

In re proposed Revenue Act, 1941.

MY DEAR SENATOR GUFFEY: On April 28, 1941, the Supreme Court of the United States in an opinion by Mr. Justice Black decided two cases of great and far-reaching importance to charitable organizations: *The United States* v. *Pyne et al., executors of Pyne* and held that the executors were not entitled to deduct against income of the estate for the year 1934 attorney fees and other expenses paid by the executors for advice concerning the administration of the estate; and

City Bank Farmers Trust Co., trustee of Duke *Under the Will of Duke* v. *Helvering, Commissioner*, and held that the trustee was not entitled to deduct as against income of the estate the reasonable ordinary commissions to which a trustee is entitled for the management of the trust estate.

Both of these decisions followed the case of *Higgins* v. *Commissioner*, decided by the Supreme Court on February 3, 1941, which held that Higgins was not engaged in carrying on any trade or business in looking after his investments, collecting the income, managing his real estate, etc., as would entitle him to deduct as against his income expenses of managing his business, such as rent, stenographers' salaries, etc.

As a result of these three decisions, the Commissioner of Internal Revenue is now holding that neither an individual, an estate during the period of administration, nor the trustee of an estate, whether created by will, inter vivos agreement, or otherwise, or whether the beneficiaries are individuals or a charity, is entitled to deduct the reasonable and ordinary expenses in managing the estates, such as commissions, office expenses, including rent, telephone, stationery, stenographic help, etc., because allegedly not engaged in carrying on a business. In other words, the Commissioner admits it is necessary for a trustee to incur and pay various expenses in the management of an estate, but denies to the trustee or to the beneficiaries the right to deduct as against income any of these necessary expenses.

If the Commissioner persists in following this procedure, it will be disastrous and expensive not only to individual beneficiaries but to charitable organizations.

As you know, I represent a number of trust estates in Pittsburgh, beneficiaries of which are many charitable organizations in Pittsburgh. The trustees collect the income from the trust funds, pay the expenses of the trust, including their own commissions, and remit the balance of the income to the charities.

If the trustee is not entitled to deduct these expenses from its gross income, then the trustee must pay a tax on the amount of commissions retained and deduct the tax from the amount payable to the charitable beneficiaries, and, hence, the charity will get that much less income. It is conceivable that ultimately, this method of procedure, year in and year out, will result in an increasingly diminished income to beneficiaries.

I cannot believe that either the courts or the Commissioner realize the effect of these decisions and of the rulings of the Commissioner.

It seems very unfair that the Commissioner refuses to recognize as a legitimate expense deductible as against income the necessary clerical help, etc., required to manage a trust estate, collect the income and disburse the same.

Under the laws as exist today, the sole relief or remedy seems to be with the Congress, which should insert a provision in the new revenue act which will allow as deductions to trustees, executors, guardians, etc., a reasonable amount for office expenses and commissions during the administration of estates or the period of the trusts.

I am sending an additional copy of this letter to you, thinking perhaps that you may pass it along to the Finance Committee of the Senate when it considers the proposed revenue legislation.

It is needless for me to tell you that anything you can do to help this situation will be greatly appreciated by many of the worthy charities in Pittsburgh of which you have knowledge.

Thank you very much.

Very sincerely yours,

J. M. WRIGHT.

The CHAIRMAN. Miss Curtis.

Miss CURTIS. I don't know whether I am the last witness or not——

The CHAIRMAN. No; there are two additional witnesses.

Miss CURTIS. Then we can't say that the women are having the last word with the committee.

STATEMENT OF CATHRINE CURTIS, NATIONAL DIRECTOR, WOMEN'S INVESTORS IN AMERICA, INC., NEW YORK, N. Y.

Miss CURTIS. My name is Cathrine Curtis. I am speaking as National Director of Women's Investors in America Inc., whose headquarters are at 535 Fifth Avenue, New York City.

We are an educational nonprofit making membership organization incorporated in 1935 for the primary purpose of financial education for women, for financial fact finding of importance to women, and to defend and protect the property rights of women. We do not give investment counsel.

Women of all types, from all walks of life, from many professions, and those representing a wide range of income brackets are included in our membership.

Many of our members are just average housewives dependent upon the earnings of the husband or family, and upon the estate saved by that family for its future security in case of death.

Some of our women supplement the family income by earnings of their own. In many instances this additional income is derived from home industry.

Many of them also have an independent income from the earnings of stock, bonds, mortgages, or insurance which they own, purchased with hard-earned savings or inherited from loved ones.

I think our membership is a typical cross section of intelligent American womanhood which at present is frightfully alarmed and concerned with the policies and problems of government and their direct effect upon the future and security of their husbands' jobs, their homes, and the welfare of their children.

In addition to speaking for the members of Women Investors in America, Inc., I also speak on behalf of countless women throughout the country with whom I am in continual correspondence—mothers,

employees, teachers, etc., but who are not active members of the organization which I am officially representing today. These women are stockholders, jobholders, home owners, and taxpayers.

From various surveys which our organization has made, during the 7 years since its incorporation, we know that women own the greatest financial stake in the private enterprise system and in the constitutional representative government upon which that private enterprise was founded and has prospered.

About 50 percent of the corporate stock of industry is owned by women. In many cases this ownership is in units of 10 shares or less; in some cases it runs considerably higher. Therefore, any Government program, whether it deals with legislation, taxation, or labor that affects the earnings and security of corporate assets directly affects their welfare in the broadest sense of the word.

More than 75 percent of the life-insurance policies are made payable to women. The assets behind these policies are invested in stocks, bonds, mortgages, and real estate.

About 60 percent of the savings accounts of this country are also in the names of women. This money, to earn interest, must of necessity be reinvested in the private enterprise system. Because of this American women are not only the world's greatest capitalists but are more vitally affected than any one group in Government policies, tax programs, and all legislative connivance which seeks to destroy our capitalistic system and impose in its stead one of Fabian socialism or Marxism.

In addition women spend about 85 percent of the consumer money and I do not have to go into details with the members of this committee as to what part of our tax bill is paid by the consumer.

Because of the foregoing you can readily understand why the women are interested in this tax bill and greatly concerned over many of its features.

I have heard or read much of the testimony given before the House Ways and Means Committee and before this committee on this bill.

Testimony given before this committee by Treasury officials states that this fiscal year's expenditures will be $22,000,000,000. And in order to raise two-thirds of this by taxation they suggest that $15,000,000,000 in taxes be raised in 1 year.

In making this request, the Treasury officials did not give to either the House Ways and Means Committee or this committee any analysis, detailed or otherwise, of the needs of the Government for—

(*a*) The ordinary expenses of Government,

(*b*) The defense program, or

(*c*) The lend-lease program.

In other words, the Congress is asked to sign, on behalf of the American taxpayer, a check for $15,000,000,000 without giving the taxpayers any concrete ideas as to what this huge sum will be spent for.

Neither has the Congress had from the Comptroller General any statement of the assets and liabilities of the United States. The committees hearing testimony on this bill have not been reminded that the national debt, including contingent obligations of the Government, already exceeds $65,000,000,000, or that since the first of this year alone new appropriations, authorizations, and commitments

exceed $51,395,000,000. The sum of these two items exceeds by $5,000,000,000 the assessed valuation of all property in the 48 States. And, further, the $51,000,000,000, which this Congress has authorized or appropriated in the 7½ months of this session, exceeds by $28,000,000,000 the total amount this country spent for prosecuting its share of the World War including loans to Allies which have not been repaid.

Challenges to the committee.—We challenge the Government's fantastic program of appropriations, authorizations, and recommendations.

We challenge the free-for-all lend-lease program as jeopardizing both our national defense and our economic life.

We challenge the validity of the one-third two-thirds formula in financing our emergency-defense program.

We challenge the ability of the Members of this Congress to convince the people of the United States of the wisdom or the necessity of draining the lifeblood of this Nation to satiate the bloodthirst of any and every nation including Communist Russia.

We challenge our ability to maintain our way of life if we permit the destruction of our entire economic system by policies which the proposed revenue act attempts to underwrite.

We challenge the desirability, the need, or the legality of using the taxing power granted government by the people as a means of supplying a needed restraint upon inflationary tendencies which the House claims is one of the objectives of this bill.

We challenge the rights and authority of this committee to ask the people of these United States for more tax money when this Congress has not yet compelled the Comptroller General to comply with the law and to file a report on the financial condition of this Government.

Joint income tax.—In addition, we wish specifically to oppose the proposal of the Secretary of the Treasury Henry Morgenthau relative to the mandatory joint income-tax return for husband and wife.

To familiarize you with the history of this proposal—it was recommended by Leon Henderson when he testified before the House Ways and Means Committee. That committee wrote the joint income-tax provision into the House bill after public hearings were closed thereby barring women from expressing their views. However, the women did express their views directly to House Members and the mandatory joint tax return was removed from the bill by a 3-to-2 vote in the House.

Secretary Morgenthau asks you to ignore the will of the House and to restore this obnoxious provision. He seeks to make this proposal palatable by exempting married women who work outside the home from such a joint return by permitting them to file individual returns. What this actually suggests, it seems to us, is offering a premium to women to desert the home and home industry.

It should be remembered that it was home industry started by colonial women that enabled this country to found its industrial capitalistic system and break away from the military capitalistic system of Europe.

The joint-tax proposal tends to destroy the home as a self-generating source of national wealth. It further tends to smother women

as a generating power. It should be remembered that home-making made this country prosper—not natural resources.

It has been stated before this committee that the joint tax proposal affects only 153,000 families. Our research has established that actually it affects approximately 17½ million families, and I would like permission to insert in the record data and statistics we have gathered relative to the far-flung effect of this proposal on the homes and family life of the Nation.

May I do so, Mr. Chairman?

The CHAIRMAN. Yes; it may be entered in the record.

Miss CURTIS. If the mandatory joint income-tax return—which the House Ways and Means Committee inserted in the bill in secret sessions behind closed doors, without giving the women of the country any opportunity to voice their opinions—becomes law, married women in the United States will be returned to the old common-law status of chattels of their husbands—the position married women have occupied in Europe for centuries.

If the mandatory joint return is adopted—its effects on the family life of the country and on the income, savings, capital, and assets of wives cannot be estimated. If the Government can merge the incomes of husband and wife for tax purposes—will that make the wife's income attachable for her husband's business and bankruptcy debts? And, if the Government can merge their income—cannot it also merge their capital and assets—again making everything the wife may have liable for attachment in case her husband is forced into bankruptcy?

Women are aroused.—Our mail indicates that the women of the country are thoroughly aroused over the unjust treatment accorded them by the Ways and Means Committee and the manner in which it adopted this proposal for mandatory joint income-tax returns.

Committee misinformed.—It would appear, from statements by members of the committee, there is a complete misunderstanding about the number and type of families which will be seriously affected, the principles which are involved, and the far-reaching social consequences of this family disrupting legislation—should it become law.

A careful study of available Government statistics establishes that this proposal will affect at least 17,500,000 families—not about 153,000 as has been announced. Further, it will bear most heavily upon the families of small incomes, not upon the wealthy as has been claimed by proponents of the measure.

Hits small families.—In addition, it will bring within the income-tax law approximately 8,400,000 families whose incomes are so small they now are not taxable under present income-tax laws, the majority of them being small suburban and farm families.

These are a few of the facts that would have been made available to the committee by the women, had we been accorded the same consideration extended by the committee to representatives of business and industry.

The printed record of the hearings discloses that the committee listened to the protests of 110 representatives of the tobacco industry, 73 from the gasoline industry, 8 from musical instrument manufacturers, 8 representatives of the carbonated beverage industry, 9 from

candy manufacturers, as well as 7 from the liquor distillers and 10 from the beer brewers.

Women receive no consideration.—Yet not one woman, nor one women's organization was extended the courtesy or opportunity to voice their opinion or to speak in defense of their rights as individuals or in defense of the American home.

Whoever produced the estimate of 153,000 families to be affected by this tax proposal gave consideration only to statistics relative to present independent tax filings of husbands and wives. No consideration, apparently, was given to the vast number of families—now tax exempt—who will be brought into the tax collector's net by this proposed mandatory joint-income return.

The following statistics relative to families and their income are found in the United States Statistical Abstract. This table reveals that about 80 percent of the families earned less than $2,000 per year in 1935. The present chaotic condition of Government statistics makes accurate analysis impossible, but applying the family group ratios of the 1935-36 table to the family unit figure for 1940 which is quoted by the Bureau of the Census, we find the following:

Family income groups.—

Family income	Number of families	Percent of all families	Cumulative, percent
Under $250 to $750	9,457,959	27.13	27.13
$750 to $1,250	9,674,100	27.75	54.88
$1,250 to $2,000	8,426,055	24.17	79.05
$2,000 to $3,000	4,479,719	12.85	91.90
$3,000 to $5,000	1,879,042	5.39	97.29
Over $5,000	944,750	2.71	100.00
Total	34,861,625		

Considering the above table—it reveals about 15 million families fall within the family income band from $1,250 to $5,000 per year. To this should be added another 2½ million families in the $750 to $2,000 band who unquestionably will be affected by this proposal.

If official statements relative to increased earnings for workers are correct—then a large percentage in the $750 to $2,000 band in 1935-36 are now above the $2,000 joint-income figure. It must be recognized that the families in this band who—according to official statements—have benefited in the past 6 years by increased earnings—are those of the farmers and mechanical and industrial workers.

Incidental earnings become taxable.—By forcing even the small, incidental earnings of women—as well as the earnings of all minors—into the joint return, the incomes of million of families will exceed the $2,000 exemption allowed for husband and wife, and $100 for each dependent, and therefore will be subject to Federal income tax.

The women of these families have experienced economic hardships during the past several years, but now—due to increased demands for industrial and mechanical workers—are receiving their first real pay envelopes in years. These pay envelopes will be taxed 16½ cents out of every dollar in them over the $2,000 exemption base, if thi joint-return proposal is adopted, whereas under the present law, they would not be reached other than by the existing innumerable hidden taxes which all of us now pay.

Some of the earnings of women that would become taxable under the joint-tax proposal would come from such varied sources as:

Salaries.	Tourist.	Raising chickens.
Wages.	Summer boarders.	Nursing.
Business.	Sewing.	Cleaning.
Investments.	Baking and canning.	Teaching.
Real estate.	Washing.	Clerical work.
Annuities.	Gardening.	Clerking, etc.

Penalizes happy marriage.—Summing up, the proposal, which was adopted in secret session of the committee, will affect not only the incomes of a comparatively small number of wealthy couples, as has been suggested, but also will place a heavy and unnecessary tax burden on the families of workers with small incomes.

Further than this—it will destroy the independence of women and wipe out benefits of wills, trust funds, individual property ownership and legacies. It will return women—free-born American women—to the primitive status of being the chattels of their husbands.

Women's independence in this country—as an individual—is threatened by this mandatory joint income-tax proposal. Her basic property rights are at stake.

The penalizing of happy married life—by levying a discriminatory tax burden thereon—and the subsidizing, by Government, of separation and divorce—by way of lesser tax burdens, is something to which no Member of Congress should be a party.

If there is no intent to penalize marriage—why is this proposal designed to apply only to those married couples living together? If living under the same roof is used as an excuse to join their incomes for tax purposes—why should it not also apply to brothers and sisters who live together—or to any group of relatives who jointly occupy the same household and benefit by the joint income of all who live under the same roof?

In addition there are specific features now in the bill to which the women object.

Among these are:

I. *Proposal to increase estate taxes.*—This proposal tends to strike at the security of millions of homes. What is an estate? It is that portion of income set aside either through savings, investments, or insurance in order to provide security for the family and dependents after the death of the wage earner of the family. Do the increases in estate taxes proposed by this bill reveal any desire to protect this form of home security? An examination of the proposed increases tends to establish the contrary.

Under this bill it is proposed to increase taxes on the net taxable estates as follows:

	Percent increase
From $1 to $5,000	50
From $5,000 to $10,000	350
From $10,000 to $20,000	250
From $20,000 to $30,000	116⅔
From $30,000 to $40,000	200
From $40,000 to $50,000	200

A net taxable estate of more than $100,000 will pay, under this bill, the same percentage of increased tax as demanded from a net taxable estate of less than $5,000—that is, 50 percent. From net taxable estates of more than $100,000 the percentage of increase goes steadily down-

ward—and the public is being led to believe this proposed tax program is designed to make war profiteers pay the major part of the defense load to protect the masses.

Actually, however, it would appear to be designed to destroy the great middle class, which constitutes the very backbone of our Nation, and to establish here only two classes—the bureaucrats and the enslaved workers—the only two classes permitted to exist in any centralized government.

I subscribe to the remarks by Mr. Roy Osgood made before this committee relative to the estate-tax problem and strongly urge the committee to develop some program that will provide a stable tax rate for estate or death taxes.

II. *Excess-profits tax.*—It is generally claimed that the proposed increase in excess-profits tax is for the purpose of reaching profits attributable to the defense program.

The proposed schedule will:

(*a*) Through the 10-percent increase in all brackets of the excess-profits tax reach:

1. A vast number of nondefense industries,
2. A large volume of normal profits, and
3. Will affect the earnings and assets of approximately 15,000,000 stockholders.

(*b*) By tapping of all profits in so-called profitable years—business and industry will be unable to provide the reserves needed to tide them over periods of hard times—signs of which already are ominously apparent, and

(*c*) Make impossible normal expansion and even necessary modernization and replacements in industry.

If one were asked to devise a sure way of turning the tide of economic progress in this country into a certain decline, no more effective method could be devised for the accomplishment of this objective than to take away all returns of business and industry—above wages and salaries—and popularly spoken of as profits, thereby providing no means of maintaining, let alone expanding, economic enterprise in this country. Such a system further would prevent the normal provision of new jobs for young men and women who grow up to seek gainful employment.

From the point of view of future revenue—this policy means the destruction of the free enterprise system out of which taxes can be paid.

Nowhere in the proposed revenue act is there a more vicious provision than that which requires the computation of the excess-profits tax upon th amount paid as income tax. This is accomplished by the requirement that the excess-profits tax be computed before the computation and deduction of the income tax computation and deduction of the income tax. By what possible reasoning can earnings of a business enterprise—paid out in income taxes—be considered taxable income?

Under the existing law, the income tax is allowed as a deduction in the computation of the excess-profits tax.

This feature of the bill seems like a deliberate attempt to penalize private enterprise for the crime of producing wealth and creating gainful opportunities to make a living for millions of American men and women.

If you deprive industry of the opportunity to build reserves, what will happen when we face the transition from a war economy to a peace economy? Surely you must recall the attempts to turn this country from a republic to a sovietized Government immediately following the World War. There is ample evidence in the files of congressional and State legislature committees to establish that Bolshevists had counted heavily upon the economic shock following from such a transition with its resultant millions of unemployed.

However, the record shows that through reserves built during the war period industry was able quickly to change over to a peacetime economy, expand its plants, create new industries, and cut heavily into unemployment.

Those same records further establish that Sidney Hillman, present Associate Director General of the Office of Production Management of our defense program was very active in the 1919 Bolshevist plot in this country.

Is there intent concealed in this bill—under the guise of preventing war profits—to bar industry from creating the reserves that will be needed for the coming war-to-peace transition?

It would seem to be the duty of Congress to decrease excess-profits taxes, thereby aiding industry to create the reserves that will be needed to protect free enterprise in that transition period from war to peace rather than through this proposed increase in excess-profits tax to aid those who would destroy our free enterprise system.

III. *Radio broadcasting and network tax.*—The provision in the bill (title VI) covering the radio broadcasting and network tax runs counter to the maximum revenue principle found throughout most of the tax bill. Three brackets of taxable earnings are set up:

	Percent
(*a*) $100,000 to $500,000, tax rate	5
(*b*) $500,000 to $1,000,000, tax rate	10
(*c*) In excess of $1,000,000, tax rate	15

The lump-sum rates set up in the bill, however, permit broadcasting stations and networks to obtain lower rates than those specified above by holding their time sales down to certain levels.

For example, on time sales in excess of $1,000,000, the tax is specified at the rate of 15 percent. Accordingly a station or network selling $1,000,000 worth of time would pay a tax of $150,000, and a station or network selling $1,010,000 worth of time would pay a tax of $151,500, according to the explanation of this title in the report on the bill put out by the House Ways and Means Committee.

Actually, however, the bill contains lump-sum payment provisions that place a great premium upon the curtailment of radio time sales. Thus a station or network selling $1,010,000 worth of time would pay not $151,500 but only $110,000, because the bill states that in this case the tax shall be computed as follows:

> If the net time sales exceed $1,000,000—an amount equal to 15 percent of the net time sales—or an amount equal to $100,000 plus the amount of the net time sales in excess of $1,000,000, whichever is the lesser.

Similar provisions are found on each of the other two brackets—waiving the possibility of obtaining the full rates specified on the bill—on condition that the time sales are held near the bracket minimum in each instance.

Why did the Ways and Means Committee of the House hold out this premium for restricting time sales on the air? Did the committee deliberately forego the opportunity of collecting the full rate of taxation specified in the bill in order to accomplish the "plowing under" of radio time and station and network facilities?

This possible explanation of the House committee's intent is given added weight through the fact that the committee's report on the bill omits any mention of the lump-sum payments by which this end is accomplished.

We have become accustomed to plowing under pigs, plowing under corn, plowing under cotton, plowing under profits, even plowing under reputations, but will the public peacefully accept the plowing under of radio time?

What is the real purpose behind this provision? Is it to deliberately curtail paid entertainment time on the air and thereby allow more sustaining time for war propaganda and the promotion of Government programs?

This committee must surely realize that if this tax principle can be applied to spoken advertising it can also be applied to printed advertisements of newspapers and other publications.

Further, commercial programs are used to promote and increase sales of manufactured products of our private enterprise system. Curtail that promotional advertising and you decrease sales, cut production, reduce earnings, increase unemployment, and generally wreck the normal functioning of our industrial economy.

Furthermore, these would lead to a material reduction in the anticipated national income, thereby greatly decreasing the revenues this bill is supposed to raise.

Every housewife knows full well that her family cannot continue to support indefinitely the ever-increasing tax burden placed upon it. If they know this—certainly the businessmen of this country know it also and it goes without saying that you intelligent men serving on this committee must be quite aware of the deplorable state of this country's finances and the unsound tax patchwork quilt which has been thrown over our national economy.

With our ever-increasing debt, our reduced earnings, our skyrocketing cost of living, and our increased taxes, the citizens of this country are in a sorry plight. They are quite conscious of the fact that due to bad management of Government and the imposition of socialistic theories and legislation in Government promoted by starry-eyed dreamers, this country has been unable to properly support itself since the depression.

Regardless of the millions of dollars appropriated they also know we have as yet no adequate national-defense equipment. In spite of all this we now find ourselves in the amazing situation of being called upon to support and even finance foreign countries and to continue to deprive ourselves of our own national defense while we scatter it to the four winds—from Africa to China—and now Russia.

You and I both know that this riotous unbridled spending—supposedly in the name of national defense—actually can result only in national bankruptcy.

Every economist, every statistician, every businessman, and the public generally, know perfectly well that the international defense

program recommended and planned by the British Government and Mr. Roosevelt can never in heaven's name be maintained by our economy, and sooner or later it is going to blow up. As far as we are concerned it might just as well blow up now while we women still have a small stake left in the private enterprise system, a small stake which we intend to protect and preserve by every means at our disposal.

The CHAIRMAN. Any questions?

(No response.)

The CHAIRMAN. Thank you.

Mr. Burton G. Daw. Will you give the committee your name?

Mr. DAW. Burton G. Daw.

STATEMENT OF BURTON G. DAW, REPRESENTING LASALCO, INC., ST. LOUIS, MO.

Mr. DAW. I am just a small manufacturer, trying to get along.

The CHAIRMAN. Are you from St. Louis?

Mr. DAW. Yes. I will try and make this as snappy as possible.

The trick seems to be to evolve a method of taxation which will result in revenue for the Government without breaking or making crooks of all the people.

Senator CONNALLY. You have something there.

Mr. DAW. *The incentive plan.*—The progress of the United States can be laid to equality of opportunities and responsibilities called democracy. During the last few years the trend has been toward inequalities with privileged classes, through Federal and State laws. These inequalities have destroyed the ambition and incentive of thousands, causing them to turn from hard work and striving, to a resigned attitude of letting the Government take from those that have and support those that have not.

Many believe it impossible to put more people to work, and eliminate Government projects to feed our citizens, but nothing is impossible and it can be done and the following is a brief outline of the recommended plan. Please note that there is no favoritism in this plan. All have the same chance.

The incentive plan consists of two distinct parts, both requiring each other for success, so before attempting to pass judgment on one part of the plan, study the other part, and the relation of one to the other.

I. *Equal distribution of profits.*—We can agree, I think, that both capital and labor require a definite understanding as to what they may expect from each other and the Government in particular.

(*a*) As an incentive to investors and capital, one-third of net earnings of all business should be paid in cash to the stockholders. This insures the investor of cash profits, if any are made. In other words, immediate returns.

(*b*) The employed should be given one-sixth of net profits as a cash bonus, giving them incentive for cutting costs and better work.

(*c*) One-sixth of net earnings should be used for unemployment insurance, health and sick benefits, old-age pension, and so forth, for employees.

(*d*) One-sixth of net earnings should be used as a reserve.

(*e*) One-sixth of net earnings should be used for expansion or new developments.

Conclusion:

Investors benefited by (*a*) exclusively.

Employee benefits by (*b*) and (*c*), exclusively.

While (*d*) and (*e*) are of equal benefit to both labor and capital.

Probably one of the most disheartening and unfair efforts of democracy is that of our present methods of taxation.

Luxury and sales taxes together with gasoline, automobile, and cigarette taxes take probably two to three times the percentage of a poor man's income as it does of a man in the middle brackets.

What logical reason have we for taxing gasoline for automobiles when we do not tax hay and oats for horses? Why should a beer drinker pay a tax while a soft drink goes untaxed? Why should we put a tax on cigarettes and not on gum or candy? Because a father wants to leave his children a million dollars, why should the inheritance tax take most of it and kill his desire to accumulate $1,000,000, when we know he can't possibly make $1,000,000 without first spending $10,000,000 somewhere along the line?

II. *Revised taxation.*—A. Eliminate all present taxes—personal, real estate, sales, gasoline, cigarette, income, business, corporation, inheritance, automobile, and so forth.

(*a*) Without taxes there would be no farm or railroad problems. The rents would be less.

(*b*) Homes and farms paid for and not mortgaged could not be taken from owners.

(*c*) We would all drive bigger and better automobiles if they and gasoline were not taxed.

(*d*) There would be an incentive to accumulate homes, better cars, furniture, and real property, knowing that after they were paid for no more rent or taxes would have to be paid to keep them.

(*e*) Cigarettes, 5 cents; beer, 5 cents.

(*f*) The poorer people could afford to move out from the slums to places of their own if they were not penalized by excessive taxes—most of which are hidden—in proportion to their incomes.

(*g*) Business not being taxed would pay bigger dividends and could build more automatic equipment for competing with cheap foreign labor for export.

(*h*) Eliminating taxation of railroads and other methods of transportation would reduce the freight and passenger rates so that the Middle West could be more thickly populated and compete with the East on export and long-haul shipments.

(*i*) Old or unfortunate people unable to work would not be taxed and they could not be thrown out of their own environment if their homes were paid for; therefore, an incentive for home ownership.

(*j*) The realization that ownership insures security is an incentive for accumulation and takes the problem away from Government.

(*k*) This is not the old single-tax plan when land was the basis of taxation.

(*l*) While we can earn we can pay our taxes, but when taxes take from us everything we have worked to accumulate, because we cannot earn enough for the taxes, we lose our incentive.

(*m*) There are no favorites or inequalities in arriving at taxation on a basis of a percentage of ones earnings, either from labor or investments and the unfortunate are protected.

B. Replace all present taxes with an incentive tax which would be, say 30 percent of the earnings of individuals from labor and investments, with no exemptions.

(*a*) Salaries and dividends would be paid after 30 percent had been sent to the State capitals to be divided between Federal, State, and local governments.

(*b*) The minute a person stopped working, the tax would stop.

(*c*) A person might accumulate money or land but as long as it didn't earn anything for him he would not pay a tax but the profit made on the sale of land would be automatically taxed.

(*d*) To raise or lower taxes no special class of people would have to be considered. Just change the percentage and all would be treated alike.

(*e*) Anybody living without working would be subject to investigation as there would be no taxes received from them. So racketeers, thieves, and those making a living illegally would be carefully checked, thus reducing crime.

(*f*) A referendum vote would be necessary to put the incentive plan in operation, but, when you stop to think of those who would benefit directly, it does not seem impossible:

1. People unfortunate and unable to work.
2. People who are ambitious and desire to accumulate great wealth realize that after the 30 percent is paid, the rest is definitely theirs.
3. Cigarette smokers.
4. Automobile drivers.
5. Home owners.
6. Hourly workers.
7. Labor, who would be assured of sharing the earnings.
8. Investors, interested in prompt returns.
9. Business, which would expand if it were not for heavy taxes ever after.
10. Young men and young women who want to get ahead in the world can build slowly.
11. Farmers.
12. Those interested in eliminating hidden taxes and knowing the truth about the costs of Government.

If there are any questions the committee would like to ask, I should be glad to answer them, if I can.

Senator CONNALLY. Or if you have a further statement, you may put it in the record.

The CHAIRMAN. Any further questions?

(No response.)

The CHAIRMAN. Mr. MacKenzie. You are from Salt Lake City, Utah?

Mr. MACKENZIE. Yes.

The CHAIRMAN. You may proceed.

STATEMENT OF A. G. MacKENZIE, SALT LAKE CITY, UTAH

Mr. MACKENZIE. I am A. G. MacKenzie, of Salt Lake City, Utah, where I am engaged in the mining business. I am here as a spokesmen for metal-mine operators of our region. I have not the knowl-

edge or the disposition to enter into the technicalities of this bill. My desire is merely to tell you how we in the western part of the country feel about some of the provisions of this excess-profits-tax law as it stands, or as it will be, if the bill is passed in its present form.

This bill proposes to apply the excess-profits tax to income before deducting the income tax, thus requiring us to pay an excess-profits tax on the income tax we have to pay the Government. We do not see how money paid as taxes can be deemed excess profits.

As I understand it, the allowances made on invested capital under this bill will be only about 5 percent. The present 8 percent is bad enough, but 5 percent is out of the question as a normal return on mining investments as money will not go into the business on that basis. As I understand it, the bill recognizes this as to new money going into the business and proposes to allow $1.25 for each $1 of new money invested. We cannot understand why such a roundabout method is employed when it would be so much simpler and more equitable to allow a reasonable rate of return in the first place instead of fixing too low a rate and then applying that to more than the amount actually involved. People who put their money and faith and efforts into making a mine out of a prospect are certainly entitled to equal consideration with those who do not come in until the mine is made.

This bill has a new form of excess-profits tax in the amount of 10 percent on those who have been unfortunate enough not to have earned a reasonable return on their capital during the base period. I do not understand precisely how this formula will work, but we do regard it as unjust to lay a special tax on people because they have had some hard luck in the recent past.

We do not understand the philosophy of determining the credit allowance based on earnings for the years 1936 to 1939. We do not understand why, after it has been determined, the amount is taken at 95 percent instead of what it actually is. These years 1936 to 1939 do not at all constitute a normal period of the industry in my part of the country. The best of them were not too good, and the others were pretty bad. Then, we find a provision to eliminate 1 year of loss so that only 3 of the years are taken into the calculation, but they have to be divided by 4 to get the average. That is not the kind of arithmetic we use and have always used. We divide the sum of three items by 3 to get the average.

The best approximation of normal profits you can get out of this 4-year period for our business is to take 2 of the years and ascertain their average. This would not be too good for the industry, but it would be much more nearly fair than the present requirement.

Generally, those 2 years would be 1936 and 1937, but that would not be true in all cases. For mines which were just getting into production in the first years there should be an opportunity to use the later years. And if a mine were particularly unfortunate in one of the earlier years it ought to be allowed to take another. Actually, in order to get even approximately the normal profits of this period our mines should have the privilege of adding the profits of any 2 of the years and divide the sum by 2.

We have another situation which bothers us greatly and which may not suggest itself to those not familiar with our kind of business, although I believe it has been alluded to in these hearings. We are asked for all the metal we can produce, and, of course, we are trying to get it out.

If we mined at the normal rate year after year, and realized no more than a normal profit per ton of ore or pound of metal, we should expect to have no excess-profits tax to pay. But if in any year we increased the rate of production we should probably have the excess-profits to pay on the increased income, even though the profit per unit was no more than normal or in some cases even less than normal. We do not object to paying excess-profits tax when we are making more than normal profits, but it is hard to be asked to increase production from a wasting asset this year, for instance, and then find that although we have made only normal or perhaps less-than-normal profits on the volume produced we have to pay an excess-profits tax that may run as high as 60 percent. We feel there ought to be some way provided so that excess-profits taxes would not be placed on normal profits of production.

We have always had trouble in connection with taxation of our industry to find where we stand with respect to invested capital and prior earnings. Many of our mines have been developed by men who did not have much capital. Sometimes a valuable mine is made in this way, so that the actual cash investment is comparatively small but the investment of time, sacrifice, effort, skill, and perseverance is great. If such a mine were fortunate in the base period specified in this bill, and if the method of calculation were reasonable, it would have treatment comparable with that of mines developed through direct application of large amounts of cash.

If, however, it was one of the unfortunate mines which were compelled to shut down or operate at a low rate during part or all of the base period due to low metal prices or low demand it may show no reasonable amount of base-period income. We understand there are some provisions in the law which are intended to give a fair allowance for those so unfortunate as not to have either a reasonable invested capital or income allowance. Such provisions are essential, but we understand relief is expressly denied to those who have suffered through low metal prices or low demand. Yet these were the prime causes of our troubles in the years 1930–39, and both are matters which were and are beyond our power to control. Low prices and low demand should be specifically recognized as grounds for relief in such cases.

I have refrained from discussion of peculiar conditions of our industry or from expression of our desire to make our utmost contribution to the general welfare of the country. I assume that you have been told of our physical problems previously and that you take it for granted, as you can, that we are bending all our efforts to obtain maximum production. And that we, like other industries, have our worries with respect to priorities and other unfamiliar problems. Yet in our minds most prominently all the time is the specter of a tax program which we do not understand and with implications that overshadow all we are doing and hope to do. We greatly fear that, unless changed in many respects, it may actually impede what we

regard as the country's greatest demand on us and as our own most urgent obligation—maximum production of essential metals.

We wish we could have the assurance from those who understand and create these bills that the excess-profits tax has been put on a fair basis so that we could go ahead with one of our most important problems so clarified that we could make provision for it and devote more of our thought and energy to production. We, therefore, sincerely trust that you can, at this time and in this bill, get at least some of these matters straightened out so that we can proceed with the conviction that we have a tax law that is really fair to us and that will enable us to do all possible in the way of production.

The CHAIRMAN. Thank you.

Senator BAILEY. Have you some amendments along the line of the last paragraph there?

Mr. MACKENZIE. No, sir; would you want any? As I said, I am not a tax expert.

The CHAIRMAN. We endeavored in the last supplemental excess-profits tax bill to take care of some of your problems; all were not covered, and you have an industry that really ought to be separately treated, in my opinion.

I don't think, however, you can have an excess-profits tax that would deal with your mineral interests in this country, unless you could give it special treatment, because there are so many different problems identified with it.

If we could have gotten in a general relief provision that would have enabled the Treasury to consider abnormalities, both in income and capital investment, you could have been relieved. The Treasury didn't want that because it would have put a great burden on the Treasury and led to a complicated system of determining what was a reasonable return to the industry under given conditions. I frankly do not see how you are going to be greatly relieved, unless you can get a general relief provision, because special relief provisions all meet some but obviously not all the cases that arise in the industry.

Mr. MACKENZIE. Something of that nature I think would be very helpful, and if we could know that such a rule would be invoked in all deserving cases.

Of course, where a thing is not set out specifically in the law, there often occurs a conflict of opinion as to its application.

The CHAIRMAN. That is true; there was a great deal of litigation under the old excess-profits tax, and the Treasury is trying to avoid that and it is understandable they should, but at the same time I don't see any way that you are going to meet particular situations in particular industries, like mines.

Any questions?

Senator DANAHER. Not of this witness.

On August 14, Mr. William C. Warren, of the firm of Milbank, Tweed & Hope, appeared here as attorney for some companies engaged in advertising in transportation facilities, and at the time of his appearance I asked him certain questions as to his view of the legal effect of our right to impose certain taxes.

At that time he was directed to submit a memorandum for the committe. (See p. 473.)

I now have it in my hand and would like to have it incorporated in the record. I would like to have a copy submitted to the Treasury, in the hope that they will consider the legal problems involved and be prepared to advise us when we reach that phase of the bill.

(The memorandum is as follows:)

MEMORANDUM TO SENATOR JOHN A. DANAHER, SUBMITTED BY ATTORNEY WM. C. WARREN OF THE FIRM OF MILBANK TWEED & HOPE

Section 3269 of the revenue bill of 1941 as passed by the House of Representatives imposes a graduated excise tax on lessors of outdoor billboards, the tax being based on the number of square feet of each billboard. During my appearance before the Senate Finance Committee in opposition to this excise tax on behalf of those companies having advertising displays on properties of common carriers you asked me whether the Federal Government, in order to keep the highways attractive and safe, could impose a tax on lessors of gasoline filling stations and lessors of roadside stands along the highways in the same manner as section 3269 imposes a tax on the lessors of outdoor advertising.

Your question indicates extremely clear thinking because if the purpose of this excise tax is to keep the highways attractive and safe it will never be achieved by legislation such as that proposed. Although this Federal excise tax would tend to discourage advertising through lessors of outdoor billboards, it would, in no way, affect the great bulk of outdoor advertising—that which is owned and considerably more objectionable. Undoubtedly, the effect of such a Federal excise tax, if enacted into law, would be to discourage outdoor advertising through lessors because the apparent discrimination would create an unfair competitive advantage to magazines and newspapers. Most of the bill boards along the highways are owned and not leased and, therefore, would not be subject to the tax imposed by section 3269. Those billboards which are owned and leased are usually not maintained and serviced with any degree of regularity.

For that reason the billboards are often extremely unattractive and in a state of disrepair. Then, too, with few exceptions all of the small billboards along the highway are owned and not leased. Some companies keep no actual record of the location of their small outdoor billboards along the highway, usually make no consistent effort to maintain and keep them attractive after the small billboards have been erected. The result is that after a few months these small owned billboards present an untidy appearance, and definitely detract from the natural beauty of the countryside; as time goes on, these conditions become progressively worse. These billboards should be contrasted with the regularly serviced outdoor billboards of the advertising lessor companies all of which are well located, well constructed, well maintained, and usually add considerable interest to our highways. The great number of gasoline filling stations and roadside stands along the highway which you mention, together with their several small billboards and neon signs, presents a greater problem in maintaining the beauty of the highway and its safety than do the large outdoor billboards, including those owned as well as leased. In most instances, these gasoline filling stations and roadside stands are owned and not leased. For these reasons any legislation having as its purpose the safety and preservation of the attractiveness of highways which taxes only lessors of outdoor billboards utterly and completely fails its purpose. Any legislative attempt by Congress to tax the owners of outdoor billboards, gasoline filling stations, and roadside stands would seem to require apportionment of the tax among the States according to their respective numbers because such a tax would appear to be a direct property tax. This constitutional limitation makes such a tax impossible.

Evidently your opinion is the same as mine, that someone interested in the beautification and safety of the highway has proposed this excise tax and has caused it to be incorporated into the revenue bill of 1941. You, therefore, asked, in substance, the question whether the features of section 3269 could be incorporated into Federal tax legislation so as to reach other structures and activities along the highways which are equally if not more damaging to their attractiveness and safety. If the purpose of such a Federal excise tax were to raise revenue, then it would seem that, if section 3269 is constitutional a similar

excise tax applied to lessors of gasoline filling stations and roadside stands would be constitutional. However, if the tax legislation had an ulterior purpose—to eliminate leased gasoline filling stations and leased roadside stands—a wholly different constitutional question is presented. Such a Federal excise tax, with high rates, might be held to constitute a penalty by the Supreme Court of the United States and therefore unconstitutional.

Article I, section 8, clause 1, of the United States Constitution declares that—

"The Congress shall have power to lay and collect Taxes, Duties, Imposts, and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts, and Excises shall be uniform throughout the United States;"

The only limitation expressly contained in that clause of the Federal Constitution is that any Federal excise tax must be uniform, which has been interpreted to mean geographical uniformity. *Knowlton* v. *Moore* (178 U. S. 41 (1900)). As long as any Federal excise tax is levied solely for the purpose of raising revenue and with no ulterior purpose, it seems that such a Federal tax would be constitutional. However, when the power to levy excise taxes is resorted to in order to accomplish other purposes than the raising of revenue a difficult constitutional question is always presented. The tenth amendment of the United States Constitution is a definite limitation on the power of Congress to levy excise taxes. This amendment provides that—

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Federal excise taxes may be and are levied for regulatory purposes. When Federal taxes are thus employed the controlling right to levy them must be derived from the authority of Congress as set forth in the United States Constitution to regulate the matter in question. Of course, in such instances a Federal excise tax carrying into effect one of the delegated powers of Congress can successfully withstand constitutional attack of that ground. However, a different constitutional question is presented when Congress enacts an excess tax which has for its major and presumably intended effect the regulation of a matter that Congress has no constitutional authority to regulate.

The Federal Government is not granted a general police power by the United States Constitution—the power directly to regulate the affairs of men for the purpose of advancing the general safety, health, morals, and welfare. However, the Supreme Court of the United States has from time to time held that Congress does have such police power as is incidental to the exercise of its delegated powers. The question then is directly raised: To what extent, if at all, may the Federal Government employ its taxing power for the ulterior purpose of regulating matters not within its special competence? It is necessary to turn to the cases. In one of the earliest cases we find that a Federal excise tax of 10 percent on the amount of State bank notes paid out by any bank was sustained in *Veazie Bank* v. *Fenno* (8 Wall. (U. S.) 533 (1860)), even though the purpose and effect of the tax was to drive such notes out of circulation. See also *Hampton* v. *United States* (276 U. S. 394 (1928)). In *In re Kollock* (165 U. S. 526 (1897)) and *McCray* v. *United States* (195 U. S. 27 (1904)) slightly different situations existed because the ulterior purposes concerned matters not within the direct domain of the Federal Government. The first decision involved a Federal excise tax of 2 cents a pound on oleomargarine and other butter substitutes. The exaction was unanimously sustained by the Supreme Court. Congress thereupon increased the tax to 10 cents a pound on the oleous substitute when colored to look like butter. The tax law was attacked not only as an infringement on the police power reserved to the several States but also because the high rate of tax destroyed the appellant's business and so allegedly deprived him of his property without due process of law. Again in the Supreme Court sustained the tax. In *Sonzinsky* v. *United States* (300 U. S. 506 (1937)) the Supreme Court sustained a Federal excise tax of $200 on each sale of machine guns and sawed-off shotguns against the charges that the enactment was a regulatory and not a revenue measure.

The use of an ostensible taxing power to achieve control of matters not within direct congressional competence has not, however, been entirely unchecked. In *Bailey* v. *Drexel Furniture Company* (259 U. S. 20 (1922)) the Supreme Court held unconstitutional a purported Federal tax of 10 percent of the net profits of certain described industries employing child labor. On the same day in *Hill* v. *Wallace* (259 U. S. 44 (1922)) the Supreme Court held

unconstitutional a Federal tax of 20 cents a bushel on all sales of grain of a future delivery but exempted from the tax, sales or exchanges, which received a license from the Secretary of Agriculture and complied with the detailed regulations prescribed by the law for the conduct of trading on the exchange. In *United States* v. *Constantine* (296 U. S. 287 (1935)) a Federal law taxing those dealing in intoxicating liquor contrary to the provisions of the State law, $1,000 for the privilege of carrying on such illegal business, was held invalid. Again the Court found in intent to regulate matters beyond the scope of the Federal power. Then in *Carter* v. *Carter Coal Co.* (298 U. S. 238 (1936)) the Supreme Court declared unconstitutional a 15-percent sales tax on bituminous coal, but exempted operators who accepted codes of fair competition prescribed by the act. The court attempted to distinguish *Veazie Bank* v. *Fenno, supra, McCray* v. *United States, supra*, and similar cases because in those cases the contention that the imposition was a penalty rather than a tax rested solely on the amount of the tax. Here the Supreme Court indicated that the very "face of the act" disclosed its regulatory purpose.

These cases and others that the Court has not crystallized definite criteria in this field. It would seem that the distinction might be one of degree rather than of kind. Then too, the Court seems not to favor any devise labeled as a tax which, if sustained, would easily lead to extension of Federal power into all realms of human activity. The Court evidently appreciates its quasi-political responsibility of maintaining the traditional separation of powers between the several States and the Federal Government. Chief Justice Taft appropriately said in the *Drexel Furniture case:*

"Grant the validity of this law, and all that Congress would need to do, hereafter, in seeking to take over to its control any one of the great number of subjects of public interest, jurisdiction of which the States have never parted with, and which are reserved to them by the tenth amendment, would be to enact a detailed measure of complete regulation of the subject and enforce it by a so-called tax upon departures from it. To give such magic to the word 'tax' would be to break down all constitutional limitation of the powers of Congress and completely wipe out the sovereignty of the States." (U. S. Reports, vol. 259, p. 38.)

It does seem that a Federal excise tax designed to eliminate leased gasoline filling stations and leased roadside stands would have many constitutional difficulties to overcome. Whether the Supreme Court would try to sustain it as in pursuance of the "commerce power" is problematical. But it does seem that the supervision and control of these local activities belong solely to the States and any invasion by the Federal Government as to the supervision and control of these activities should be invalidated even though it be ostensibly a taxing act. For the Court to do otherwise would seem to open the door to any regulation of local activities which Congress should deem proper and would completely break down the sovereignty of the several States.

The CHAIRMAN. That completes the schedule of witnesses, and the public hearings; therefore it will be closed.

The committee will meet in executive session at 10 o'clock on Monday, with representatives of the Treasury.

Senator BAILEY. Will it be possible for the Treasury to have at that time a bill to meet some of these objections?

The CHAIRMAN. I suppose the Treasury will be ready to report on specific items; I imagine they would not be able to draw a bill in accordance with the objections we have received here.

Well, thank you very much, gentlemen, for your attendance here for these 2 weeks.

(Additional material ordered inserted in the record is as follows:)

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D. C., August 20, 1941.

Hon. WALTER F. GEORGE,
Chairman of Senate Finance Committee
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: After having devoted several months of study to the tax question, I want to take this means of placing before your committee some of my thoughts in connection with the increasingly important problem of

providing the necessary money to meet our prevailing Government expenditures.

I made this study with the thought of suggesting amendments to the tax bill when the legislation was before the House, but despite the negative votes of a substantial number of us, the tax bill was brought in under a closed rule which barred any amendments being made on the floor of the House. It is for this reason that I am writing you my thoughts on the tax question with the hope that you will bring these views before the members of your committee, or insert them as part of your printed hearings, as you deem best.

My study has been devoted to the specific problem of how best to distribute the burden of Federal taxation so as to—

1. Help avert inflation;

2. Raise as large a proportion of our current expenditures as possible from current revenues; and

3. Apply the heaviest taxes, insofar as possible, at the point where they can be most easily and equitably paid.

I believe that these objectives can be best approximated under present conditions by the addition of some form of tax on "abnormal increments" which grow out of the large profits being made by certain individuals and corporations benefiting primarily from defense activities. The suggestion I wish to propose is entirely apart from such measures as were contained in the tax legislation which passed the House with regard to taxing so-called excess profits; the suggestion which I propose is aimed at achieving the enunciated objective of practically all Government officials to the end that excessive profits may be eliminated from all defense activities.

In brief, I seriously recommend that your committee assign its experts to making a careful study of the revenue-raising possibilities of a special tax on "abnormal increments." In my opinion, this tax could be easily computed, equitably levied, and conveniently paid since it would be levied only on net revenue increments which were definitely in excess of the average returns from previous years. If this proposal were adopted, next year's income-tax blanks would provide space in which the taxpayer would report "net income of taxpayer after all taxes were paid in 1940, $_____." Following that would be a line reading "Net income of taxpayer after all taxes are paid for 1941, $_____." After that a line reading "Increase in net income of taxpayer after all taxes are paid $_____."

This additional income, where it exists in a substantial amount, will usually be a direct or indirect result of our defense spending; it will be a net excess return over the previous average; it will in most cases be beyond the income which the taxpayer had planned on receiving in preparing his yearly budget and should therefore be an item on which a schedule of taxes could be levied which will bring rich returns to the Government without working a hardship upon the taxpayer.

I think it will come as close to the objective of taxing the profit out of wartime activities as any approach which has yet been developed.

May I point out to your committee that England has been using a tax developed along these lines practically since the beginning of the war. The first system used by England was to levy a 100-percent tax against this abnormal increment, but it was soon discovered to be unwise to take the whole amount since that discouraged initiative. The present English system is to levy a 100-percent tax with a stipulation that 20 percent of this "take" is to be returned to the taxpayer after the war is over. I do not think it is necessary in this country to levy a tax anywhere near as large as that levied by the English on these "abnormal increments." I also believe that certain exemptions can be provided in the lower brackets, and that an equitable formula can be developed to establish an average base to use as a normal return instead of the single year of 1940. All of this is a matter to be worked out in detail by tax experts as they apply various formula to the statistics of income average through the office of the United States Treasury Department. I simply want to take this opportunity of presenting the suggestion to the committee with the sincere recommendation that it be carefully explored as a possible device for providing a substantial increase in our national revenue without seriously crippling business or impairing the ability of any individual to meet his tax load.

I would like to offer one further suggestion. Inasmuch as the House of Representatives struck out the provisions inserted by the House Ways and Means Committee providing for mandatory joint income-tax returns by married couples, the tax bill as it is now written will raise approximately $300,000,000 less than was originally contemplated. To the extent that the elimination of the manda-

tory joint income-tax returns provides an opportunity for legal tax avoidance by married couples with substantial incomes, I am sure that a device can be inserted in the tax bill which will tax these incomes to the same extent as they would be subject to were the joint income tax made mandatory. This can be worked out without incurring the objections raised by women's groups that joint income-tax returns allegedly tend to subjugate the status of women to that of men. I think you will agree that something along these lines is necessary to prevent the obvious inequalities which now exist in 8 of our States where our married taxpayers enjoy the tax concessions and legal means of evasion which are not universal throughout the other 4 States. I hope that your committee will appoint a group of experts to study available methods for equalizing tax burdens among married couples in all 48 States so that existing injustices and inequalities may be eliminated while at the same time maintaining the rights of women to maintain an independent status where they choose to do so.

With all good wishes, I am

Cordially yours,

KARL MUNDT, *M. C.*

STATEMENT BY HON. CHARLES R. ROBERTSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Chairman George and Members of the Committee:

I am advised that efforts are being made to revive and have written into the 1941 revenue bill the Treasury proposal calling for a 1-cent per gallon increase in the Federal tax on gasoline. That proposal was advanced when the revenue bill was under consideration by the Ways and Means Committee of the House. I opposed it then and I desire now to reemphasize that opposition.

In this critical period, when billions of dollars are being poured out to strengthen our national defense and protect our internal economy, it is, of course, inevitable that all of us must pay higher taxes. I think the Nation as a whole is reconciled to that fact and is willing to bear that increased burden so long as it is levied on a fair and equitable basis.

I believe that increasing the Federal tax on gasoline from 1½ cents to 2½ cents per gallon is neither fair nor equitable and is a violation of the very fundamental taxation principle that taxes should be levied on the ability to pay.

Taxes on motor-vehicle operation in this country have already reached far beyond the bounds of reason. Many of these taxes are carry-overs from the day when motor vehicles were a luxury. Automotive transportation continues to be taxed at luxury rates despite the fact that it is now one of our most major and essential industries. The very fact that people continue to use motor cars and trucks, notwithstanding these unreasonable special taxes, shows what a necessary part they have become in our daily lives.

An increase in Federal gasoline tax will increase the burdens of those least able to bear it and constitute a tax upon those people who are already bearing a disproportionate share of the load. One of the hardest hit by such an increase would be our great agricultural industry. It will be a tax on the tools with which our farmers feed the Nation.

In my State, for example, it is estimated that the farmers pay 75 percent of the gasoline tax. An increase of 1 cent in the Federal gasoline tax will cost the consumers of North Dakota more than a million and a half dollars a year and this will be in addition to the nearly two and one-half million dollars which they already pay.

This committee well knows the efforts that have been made in the past few years to achieve parity for agriculture. We are at last in sight of that goal and to impose an increased tax on gasoline, which is an absolute necessity in modern farming, seems to me both illogical and unwise. It is as though we were to deliberately set up an obstacle to keep agriculture from reaching a position of parity after we have had that goal as an objective all these years; it is undoing with one hand what we are trying to do with the other. The cost of transportation is probably the biggest single service charge that agriculture has to pay.

Today, our farmers are being told that food will win the war and are being urged to increase their production as a means of aiding the democracies in their struggle against aggression. Since Congress already increased the Federal tax on gasoline by 40 percent in 1940, certainly an additional increase cannot be justified at this time on a commodity which is so absolutely essential in the

production of food and in the production of other necessities in our defense program.

In addition to the tax on gasoline levied by the Federal Government, the various States also collect a heavy tax on this commodity. Farmers, however, are generally exempt from paying this State tax on gasoline used for agricultural purposes. This is not true with the Federal tax. No exemption is made and the farmer must pay the Federal tax on every gallon of gasoline used in the raising of his crops. Furthermore, State gasoline taxes are used for building and maintaining highways, but the Federal gasoline tax goes toward the general operating revenues of the Government.

It is not only the farmer who would be hit if this proposed increase in Federal gasoline tax is authorized but such a tax would also be a hardship upon millions of workers and their families who use the family car in going to and from their jobs. Such an increase will also handicap the great truck transportation industry and this will affect adversely the businessman and consumers generally in towns and cities. Such an increased tax, therefore, is chiefly an additional burden upon the efforts of millions of men and women to earn a living.

Taxes are not abstract things. They must be considered from the standpoint of those who will be called upon to pay them. For that reason, I would like to call the attention of the committee to excerpts from various letters I have received on the subject of automotive taxes in general. The first is from S. W. Corwin, one of the largest automobile dealers in North Dakota:

"Thank you very much for your good letter of the 28th. It's quite a relief to hear from someone in Congress who doesn't believe it proper to pile a disproportionate share of the tax load on the automobile business and everything connected with it. The automobile dealers, as a rule, are a pretty liberal-minded class of merchants who have paid more than their share of the overhead for so many years. They don't squawk when they're faced with more. However, Congress might as well realize that these tremendous automobile taxes the country has been using will soon cease if it becomes impossible for the public to either buy or operate cars.

"You and I have known each other for a great many years and you are aware that at both Fargo and Bismarck, N. Dak., we have operated a good average automobile distributing business. For 27 years we have developed this business. Our profits have degenerated until now we are only able to show a net gain of about 2 percent on our gross. It just isn't in the picture for merchants to have the very large investment we do and to take the tremendous chances we do financially to show a trifling profit of 2 percent. If Congress sees fit to make it even more difficult for us to make money, it will be impossible for us to continue.

"I admit that if our Government continues to push us into this war, which is unwanted by most of the population, someone has to pay the bill and the merchant seems to be the easiest place to get it. In that case, we will have to pay our share without making too much trouble over it. I already have a son who is voluntarily an officer in the Army and I have another son who will be 21 this fall and who expects to enter the same way. I have no other children. It's bad enough to have to give your family to the Government if after this is done Congress also deprives us of our business. I cannot feel that we have the right people in office at Washington."

The second quotation is from a letter written by Leo A. Winter, executive secretary of the Northwest Truck and Bus Association:

"Motor transportation has fixed tariffs. It will also be paying far in excess in special taxes if the proposed increase in the Federal tax on gasoline is carried out. Thus, this great American industry may fall short of doing the job it could have done in the interest of national defense had it been assisted, rather than penalized, through excessive taxation."

The trend in recent years to single out the automobile industry for numerous special taxes is also attacked in a letter I have received from Dave Kelley, president of the Grand Forks Automobile Dealers Association, he states:

"As you know, all of North Dakota, except the valley counties, have had almost continuous and total crop failures for the past 12 years. The residents of these areas have of necessity neglected replacement and repair of their cars and trucks. This year, with the first prospect of a crop and the first sharp increase in haulage requirements, they would be forced to replace and repair their transportation equipment at a price 20 percent higher than other areas which have enjoyed better conditions.

"In this day and age no one can consider the automobile or truck a luxury. Most farmer-owned automobiles are used both to carry agricultural products, such as butter, eggs, cream, etc., and to pull trailers in which are moved grain and livestock. This activity most certainly is a vital part of any defense program."

In opposing further increases in the Federal tax on gasoline and higher special taxes on the motor-transportation and automotive industry generally, I am not unmindful of the fact that this Committee is confronted with a very, very difficult problem in drafting legislation for raising the additional revenues that will be needed to finance the great appropriations that have been made.

I respectfully submit, however, that need alone can in no way justify the placing of an additional tax upon a commodity and an industry where the rate of tax is already exorbitant.

WASHINGTON, *August 23, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: On behalf of those who have advised me of their views on the proposed revenue bill of 1941, I am including below a brief digest of the chief contentions against the proposed measure which have been brought to my attention by constituents. It is submitted for the attention of the committee.

1. Many persons have expressed alarm at the possibility that the past average-earning basis of computing excess-profits taxes may be supplanted entirely by the capital investment criterion. They view such a decision as a change of rules in the middle of the game. It seems to many to be a decision fraught with the danger of losing their game entirely.

2. At the same time, they are concerned about the possibility of extending capital-stock valuations for 3 years at a time when business conditions are generally unsettled.

3. On the other hand, others are concerned about the proposed 10-percent surtax on income over and above that derived during the basic period of 1936 to 1939 by companies using the invested capital formula of computing excess-profits tax. In the case of mergers since that time, a company is placed at a discriminatory disadvantage by subnormal profits resulting from less competence on the part of its predecessor subsidiaries. Coal companies, for example, realized little or no return on investment during that period.

4. Others have charged with apparent plausibility that the Treasury-suggested elimination of the percentage depletion allowance would discourage exploration and new supplies of minerals at a time when this particular type of expansion is a vital necessity.

5. Still others have viewed the proposed tax upon radio and outdoor advertising as an opening wedge for subsequent taxation of newspaper advertising, and for the attendant threat to freedom of the press. It is viewed also as the advance guard of a wave of increased cost of all consumer goods. They condemn the proposed partial exemptions of radio advertising when no early exemption is similarly granted for outdoor advertising. There is the case of one side-line outdoor advertiser whose annual net profit would be face to face with a fatal $400 tax under the proposed provision. Another medium for the presentation of the Government's defense program would be eliminated.

6. Fur merchants have complained bitterly against a proposed fur tax which would be made applicable to sales prior to September 1, or applicable to payments on installment or conditional sales contracts made prior to the date upon which the act would become effective. Even the fur dressers themselves agree with these merchants that the tax should be placed with the dresser rather than with the retailer.

7. Producers of commercial refrigerating mechanisms have noted that a 10-percent tax on their equipment, vital to the transfer of perishable foods, would bring hardship either to small food merchants or to the 130,000,000 food consumers, or to both.

8. Still others have expressed concern with the proposed 10-percent blanket tax upon all electrical appliances. They insist that electric ranges have long since ceased to warrant a luxury classification, and therefore should not be discriminated against by a tax which does not touch gas and fuel-oil ranges. They point out that more than 100,000 electric ranges are in use in each of 9 States, while only 23 States claim more than 100,000 nonelectric ranges.

9. Independent dealers in tires and tubes condemn a tax on inventories of these commodities if, as some charge, the large chain-store dealers will at the same time be permitted to postpone tax payment on tires and tubes until sold.

10. It is also charged that further increases in Federal gasoline tax would have a harmful effect upon agriculture; that the "defense" effort would be further curtailed in view of the fact that (e. g., in Indiana) 39 percent of Indiana communities have neither rail nor air service, and that citizens of Indiana already spend more than a week's salary each year in gasoline tax.

11. Users of photographic equipment have complained that the proposed tax on the tools of their trade is discriminatory in that it draws no distinction between amateur and professional photographers.

12. Symphony orchestras and civic theaters, which already depend largely upon subsidy and sacrifice to maintain their services to the community, are discouraged at the prospect of an additional 10-percent admissions tax, which would extend to their groups.

13. It is further charged that the proposed tax on bank checks can, in the light of previous experience, add little or nothing in revenue when the expense of collection has rivaled the revenue collected. Furthermore, it is asserted that the tax would reduce the number of checks written and further curtail the source of revenue by reducing collections of taxes on deposits and service-charge income.

14. Many persons who use fuel oil, additional tax upon which is proposed in the revenue act, have been forced to do so in many cases by antismoke legislation and campaigns.

These are some of the contentions which have reached my desk, and I shall be grateful to you if you can find it possible to grant them review by your committee.

Most sincerely,

RAYMOND E. WILLIS.

rew/cn

KIRKLAND, FLEMING, GREEN, MARTIN & ELLIS,
Washington, D. C., August 23, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Committee on Finance, Washington, D. C.

MY DEAR SENATOR GEORGE: This letter is submitted to you in behalf of Mutual Broadcasting System, pursuant to leave which I understand was accorded by your committee for the filing of briefs and statements with reference to H. R. 5417 by Saturday, August 23, 1941.

Mutual subscribes to and supports the position taken in behalf of the broadcasting industry by counsel representing the National Association of Broadcasters at the hearing held before your committee Monday, August 18, and urges that the tax on radio broadcasting stations and networks be completely eliminated from the bill for the reasons urged by Mr. Alvord.

Because of its form of organization and method of operation, Mutual feels that an additional word may be in order to direct attention to the manner in which the tax will affect it, as well as organizations which are integral parts of its network. While in form a corporation for profit, Mutual, as you probably already know, is in reality a cooperative enterprise operated on a nonprofit basis. Its stockholders are a number of stations and regional networks and, in addition, of course, a number of other stations and regional networks are affiliated with it, including many low-powered stations in small communities.

Mutual's expenses, including the maintenance of a Nation-wide wire-line system, and a further substantial sum to meet the cost of operating a network, are met out of (*a*) small commissions retained by it from the amounts received for time sales over its affiliated stations, (*b*) contributions to wire-line costs by affiliated stations, and (*c*) underwriting of the remainder by its stockholders. Thus all revenues from advertising are paid over to the stations and are not retained by the Mutual corporation. Mutual's primary purpose is, through its cooperative organization, to preserve a maximum of independence in the stations, combined with the advantages of network programs, and to assure the stations the maximum proportion of their card rates on network advertising, to the end that the profits of network operation will go to the stations composing the network.

Because of this method of operation, the proposed tax does not appear to impose on Mutual as large a burden as on other networks having a different form of organization. Actually, the burden will be proportionately just as heavy and its

consequences perhaps even more harmful. A correspondingly greater burden will fall on the stations and regional networks constituting the Mutual System, with an eventual impairment of their ability to maintain and contribute to Mutual the high standard of program service heretofore made available. With minor exceptions, all Mutual programs are produced by and exchanged between the Mutual stations. Stations receive no compensation for the elaborate and expensive sustaining-program service they furnish to the network.

According to trustworthy information from its affiliated stations and regional networks, the proposed tax will mean the difference between profitable and unprofitable operation for many of them. This point has perhaps been adequately developed in the testimony you have already heard, so far as individual stations are concerned, but does not seem to have been fully explained with reference to regional networks. There are over 30 regional networks in operation in the United States, varying greatly in size, territory covered, permanence of organization, and financial stability. Several such networks are affiliated with Mutual and comprise a very important part of its Nation-wide system, including the New England States, Texas, and the Pacific coast.

To a large extent, in fact generally, a regional network consists of an aggregation of smaller stations in a region, connected by wire in order effectively to compete with one or more high-powered stations serving approximately the same territory. Obviously, in this process regional networks have expenses which their competitors do not have, consisting of wire-line cost and cost of network operation. The proposed tax will impose an inequitably large burden on them because, in addition to the reasons you have already heard, they will not be permitted to deduct these very considerable expenses which their competitors do not have, with a resulting impairment of their ability to give good service and, in the case of those affiliated with Mutual, to contribute to Mutual's program service, and their continued underwriting of an independent and station-owned Nation-wide network.

Respectfully submitted.

LOUIS G. CALDWELL,
Counsel for Mutual Broadcasting System, Inc.

AUTOMOBILE MANUFACTURERS ASSOCIATION,
Detroit, Mich., August 20, 1941.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR MR. GEORGE: As the Senate Finance Committee has under consideration H. R. 5417, the members of the Automobile Manufacturers Association submit for its attention the attached statement relative to automotive taxation.

This brief was first presented to the members of the House Ways and Means Committee, but was submitted too late for inclusion in the record of the hearings before that committee.

Since the issues covered remain, we respectfully request that the statement be made part of the record of the hearings of the Finance Committee, which are being held at present.

Very truly yours,

ALVAN MACAULEY, *President.*

STATEMENT OF THE AUTOMOBILE MANUFACTURERS ASSOCIATION ON PENDING PROPOSALS FOR CHANGES IN FEDERAL AUTOMOTIVE TAXATION, BY AUTOMOBILE MANUFACTURERS ASSOCIATION, DETROIT, MICH.

Conscious of the tremendous task confronting your committee in raising additional revenue, the members of the Automobile Manufacturers Association desire to present certain principles bearing on Federal automotive excise taxes which they believe should be considered in the formulation of every tax measure.

The leading manufacturers of automobiles and motortrucks in the United States, as represented by the association, are in accord with the underlying objective of the Ways and Means Committee in seeking to raise sufficient additional revenue from taxation so that a larger proportion of our necessary defense program costs may be placed on a pay-as-you-go basis, especially since the industry concurs in the suggestions made by Secretary Morgenthau and

numerous other witnesses that every effort should be made to afford all possible savings in nondefense expenditures.

The membership of this association, as always, stands ready to pay its fair share of the taxes necessary to finance the gigantic expenditures for which the program calls.

Following are the facts for which we ask consideration:

1. It should be recognized that the automotive excise tax which is levied is paid by the consuming public. Although designated as a manufacturers' excise tax, it is a sales tax which falls upon all purchasers regardless of income level. Fully one-half of the Nation's automobiles are owned by persons who earn less than $30 a week. This fact should be especially noted in connection with the proposal to levy a $5 annual tax on car use.

2. It is most important in this special period that if repressive taxes are imposed, they shall be recognized for what they are, so that they may be removed promptly and completely the moment that the country again looks to domestic trade and to production for employment and a well-spread prosperity.

3. Suggestions that heavy taxes be placed on automotive products to curtail the production of consumer durable goods in order to further defense will fail of the desired result unless comparable taxation is applied to all goods and products coming in the same category.

4. The assumption that a heavy tax on automotive items would result in deferred spending and in savings, and would be an anti-inflationary force is invalid unless integrated in a program of economic control designed to curtail natural demand to the level of available supply of all products affected by the defense situation.

Standing alone, on the other hand, such a tax merely would tend to substitute governmental dictation of expenditures for the public's right of free choice in selecting goods to meet its needs and wants.

5. The objective of the Ways and Means Committee is taxation to produce revenue. High rates of taxation on motor products are advocated by their sponsors for the purpose of discouraging the purchase of cars and would, therefore, tend to extinguish this source of revenue—already affected by necessary defense curtailment—especially so if automotive products were singled out for such burdens as the consumer demand would turn from autmotive to other durable goods left free of tax.

6. The owners and operators of motor vehicles are already subject, not simply to double but treble and quadruple, taxation. They are now paying more than two score special taxes to State and local governments in addition to general taxes paid in common by all taxpayers. Automotive taxes paid by users amount to over one-third of the State revenues.

7. States rely almost entirely on revenues from automotive products to meet the payments on highway bonds and other highway costs of maintenance which are fixed obligations. Further extension of Federal taxation in this revenue field would seriously affect the ability of the States to meet these fixed charges and to expand their highway system in the future—an expansion vitally necessary.

8. Manufacturers' excises were originally imposed as "emergency" taxes on articles deemed to be luxuries, or at least dispensable conveniences. Automotive products, because of the use to which they have been put by the public, are clearly in the category of necessities today. The extent of the necessity of the private passenger car is indicated in some detail in the appended newly completed report: A Factual Survey of Automotive Usage, which is drawn from data collected in the highway planning surveys of the United States Public Roads Administration and the several States.

9. The facts presented with regard to the incidence of automotive taxes and their effect on the American people apply with full force to proposals made for imposing an excise tax on used cars. In addition, no machinery exists at the present time within the Federal Government for the collection of such a tax, making it of doubtful aid in raising revenue.

10. The President of the United States recognized the urgent need of highway transportation in the defense period by asking funds for access roads to industrial plants, military cantonments, and other centers of defense activity. If the facilities for use must increase, it is because the traffic must increase. Motor vehicle operation, not only by the Army, but by freight carriers and by individuals driving to and from their work, is a growing necessity, not a shrinking one. It will soon be apparent that placing an adequate supply of

private vehicles in the hands of those who will need them to carry on their work will constitute an increasing problem during the period of curtailed production. A similar and possibly more serious situation will exist in regard to motortrucks and busses.

Many industrial plants engaged in the production of goods for the defense program depend on automobilse as means for their employees moving to and from work, and would be unable to increase their forces as required if automobile ownership did not supply the new workers with transportation. Many new defense factories have been built in locations miles away from centers of population because those who planned their erection counted on private automobiles to get men to the factories. It is no longer unusual for employees to drive 20 miles to work.

The critical housing problem which exists in certain defense areas today is being solved in many instances by a reliance on the use of motor transportation, and much of the hope for the development of low-cost housing depends on the utilization of inexpensive land areas accessible only by motor transportation.

The dependence of defense plants upon the motortruck for movement of supplies is too well known to need recounting here. (A memorandum on this subject, recently filed with the Office of Production Management, is appended.)

11. Motor-vehicle taxes constitute a tax on transportation—on the most used form of passenger transportation—in the United States.

Imposition of a punitive and repressive tax on one form of transportation alone would amount to a subsidy to other forms of transportation. A tax on passenger cars is basically no different from a tax on locomotives, day coaches, streetcars, ships, and airplanes. A tax on trucks is no different from a tax on any other freight-carrying unit. A tax on gasoline (other than for defraying highway costs) is equivalent to a tax on locomotive fuel.

We hold that all of the statements we have made above are fully consistent with the present requirement for the widest sharing of a greatly increased tax burden. We further believe that they are fully in keeping with orderly and effective execution, in the most rapid way possible, of the national-defense program which this industry seeks to serve.

Respectfully submitted.

ALVAN MACAULEY, *President.*

APPENDIX

TECHNICAL CORRECTION SOUGHT IN LAW

We wish to call attention to a long-standing situation which discriminates against a type of vehicle which is of particular importance to a large portion of the population: Under Treasury rulings based on language written into law when the industry was young, and motorbusses as used today were unknown, these carriers are taxed at the same rate as private passenger cars.

The Ways and Means Committee has recognized the need for curing this discrimination, and it is hoped that its recommendations on this point will be accepted by the Congress.

AUTOMOBILE MANUFACTURERS ASSOCIATION,
Detroit, Mich., June 1941.

Mr. LEON HENDERSON,
Administrator, Office of Price Administration and Civilian Supply, Washington, D. C.

DEAR MR. HENDERSON: In anticipation of the problems in civilian transportation that the defense effort would bring to the motor-vehicle user, to business and industry, and to Government, the Automobile Manufacturers Association in the fall of 1940 undertook a factual survey of passenger-car use, with a view to assembling information that would be helpful to all concerned in dealing with the subject.

Through the United States Public Roads Administration and the highway authorities of several States, the association obtained permission to analyze in detail a group of reports which constitute the most important data yet collected concerning the day-by-day use of automobiles by the public. This was supplemented by a later study undertaken specifically for the association.

As a result of this cooperation, we are privileged to submit herewith a report of the major findings.

Among the subjects dealt with in this report are these:

For what principal purposes are most of the country's 26,000,000 passenger cars operated?

To what extent is industrial production, including defense, dependent upon their operaton?

What proportion of the cars, and how much of their mileage, are employed for going to work or on business?

What problems of maintenance, repair, and replacement are indicated for the older cars?

Which occupational groups use the newer cars?

We believe the data presented in this report will be of interest and assistance to you and your associates in the Government who have to do with problems of civilian supply as they relate to automobile use.

Very truly yours,

ALVAN MACAULEY, *President.*

A FACTUAL SURVEY OF AUTOMOBILE USAGE

By AUTOMOBILE MANUFACTURERS ASSOCIATION, Detroit, Mich.

WHERE THE FACTS WERE OBTAINED

This report embraces findings from three sources:

1. The principal survey covered 76,000 car owners, representing a cross section of 3,400,000 motorists in 6 representative States.

The information was gathered on questionnaires during the years 1936-38 by the highway departments of these States, while they were engaged, in cooperation with the United States Public Roads Administration, in making the great highway planning surveys out of which the master plan for future highway development has evolved.

The planning surveys comprehend the whole range of highway transport problems—planning, financing, construction, and use. They are continuing projects, supplying the facts needed to make possible an orderly and efficient development of facilities adequate to the long-range demands of the Nation's highway traffic.

The data analyzed in the present report comprise only one segment of the road-use section of the studies, which in turn represent but one phase of the planning surveys as a whole.

The six States which were selected in consultation with the Public Roads Administration are Connecticut, Georgia, Indiana, Michigan, Nebraska, and Oregon.

These were chosen, first, to be as representative as possible of the Nation as a whole; and second, to offer the most complete and comparable material for detailed analysis.

Facts were gathered by the State authorities themselves. Information from the State compilations was tabulated and analyzed especially for this report by the Automobile Manufacturers Association. All statistical summaries were submitted for review to the State authorities and to the United States Public Roads Administration. The conclusions drawn in this report are the industry's own.

2. The second survey dealt with in this report was conducted during the winter of 1940-41 by the Opinion Research Corporation. It covered the entire country, with a much smaller but nevertheless scientifically controlled sample.

Because of a different method of inquiry, the second survey was able to go further in developing details of numerous driving habits, yielding answers not duplicated in the State reports. The two add up to the same general result. Minor discrepancies, where they exist, are primarily attributable to the fact the Opinion Research poll was made in mid-December, when recreational driving probably was somewhat below average.

3. Supplementing the two special surveys were road-use reports from 29 States, in addition to the 6 covered by the detailed analysis. (See fig. 1.) These 29 reports, while not analyzed in the same close manner as the 6, have produced a broad segregation of automobile driving into business-necessity purposes, on the one hand, and social-recreational, on the other.

Close agreement on major findings was reached through these three sources, indicating that a perspective of considerable accuracy has been obtained.

I. THE WORK CARS DO

Over city streets and the network of roads and highways covering the United States, automobiles last year made approximately 15,000,000,000 round trips, for a total of 498,000,000,000 of passenger-miles of travel.

From the road use reports of 35 States, from analysis of questionnaires in 6 regionally typical States, and from a survey made by the Opinion Research Corporation, emerges evidence that—

1. More than half of that mileage, and three-fourths of those trips, were for purposes connected with earning a livelihood, or closely related economic pursuits, which this report classifies as "necessity driving."

2. Ninety-six percent of the 26,000,000 passenger cars in the country are engaged in that necessity driving.

3. Applied to the estimates of total travel in 1940, this means that private-car owners amassed 274,000,000,000 passenger-miles of necessity usage last year, in more than 11,000,000,000 round trips.

These 274,000,000,000 passenger-miles, exclusive of recreational driving, are equivalent to almost three and one-half times the total passenger mileage of all other forms of transportation combined. (See fig. 2.) The 73,000,000,000 estimated for railroads, busses, Pullman cars, airplanes, and electric railways, furthermore, include all kinds of travel, recreational as well as business.

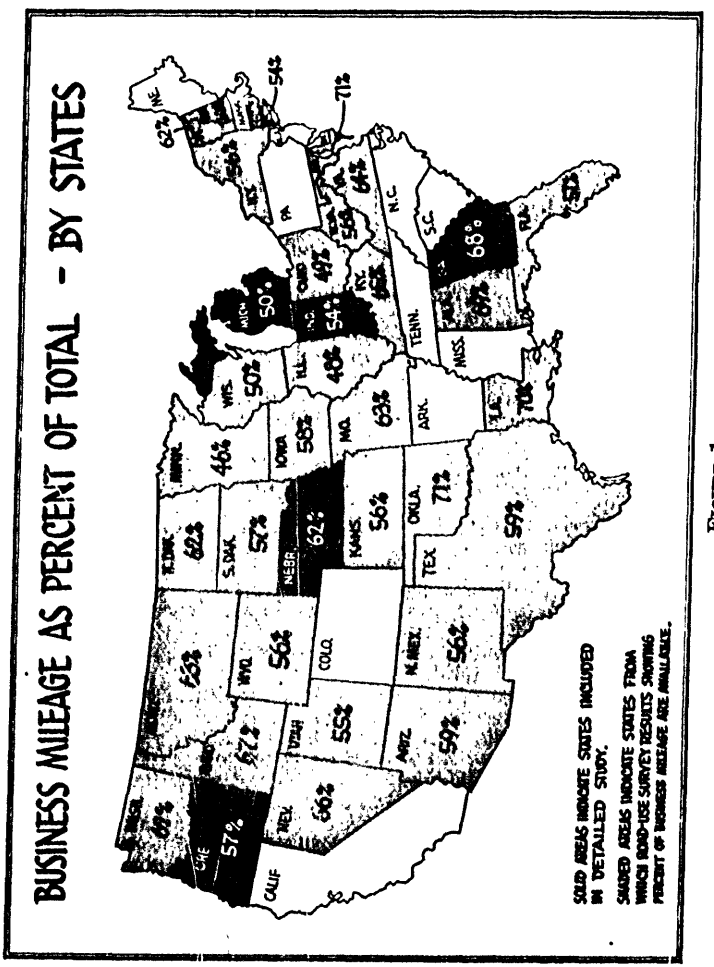


FIGURE 1

Automobile performance records are like fingerprints, in that no two are exactly alike. Each car at the end of a year has its own different speedometer reading of miles traveled, its own individual record of trips made, reflecting the varying distances from each other of home, job, school, church, shopping centers, and other community institutions as selected by each automobile owner.

Examination of large numbers of car-owners' records discloses, however, that despite the individual variations there exist distinct patterns of usage for each car group and each occupational group of owners.

Yet, necessity use was found, in terms of mileage and trips, to predominate among all groups of cars and car owners in the country.

The average annual mileage per car for necessity purposes, for example, was found to range from 46 percent of total mileage in one State up to 71 percent of the total in two States, with the other 32 States scattered in between. (See fig. No. 3.) Of the total reporting, 30 States found the average of business mileage to be 54 percent of the total driving, or more.

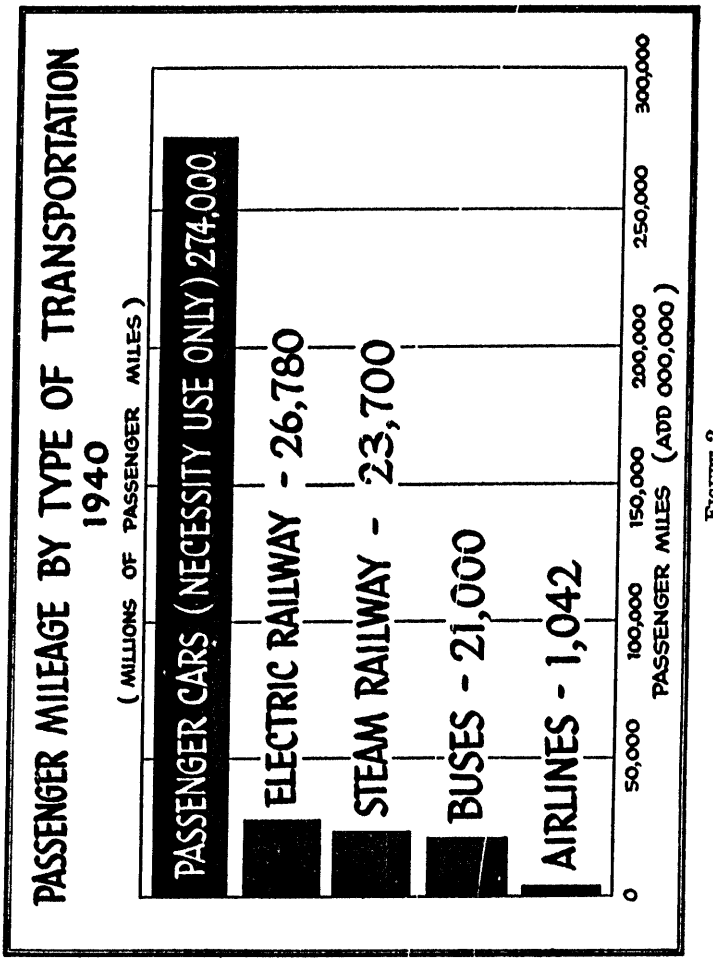


FIGURE 2

•The Opinion Research survey reported an even higher percentage of necessity driving for the test week's mileage, but since the count was made during mid-December, a seasonal decline in recreational travel could have affected the result.

Corroborating the mileage records is evidence that necessity objectives are responsible for three-fourths of all trips taken. In the six representative States, the average numbers of round trips per car in a year were:

State	Average total trips annually	Number of necessity trips annually	Percent of total necessity use
Connecticut	644	487	75.7
Georgia	612	514	83.9
Indiana	557	425	76.3
Michigan	518	383	73.9
Nebraska	541	424	78.4
Oregon	487	394	80.9

These two measures of car use, mileage and number of trips, have separate significance.

The amount of mileage driven is the factor that controls gasoline and oil consumption, and to a great extent the wear of the car, repair and parts replacement, tax revenues yielded to Government, and other major economic considerations.

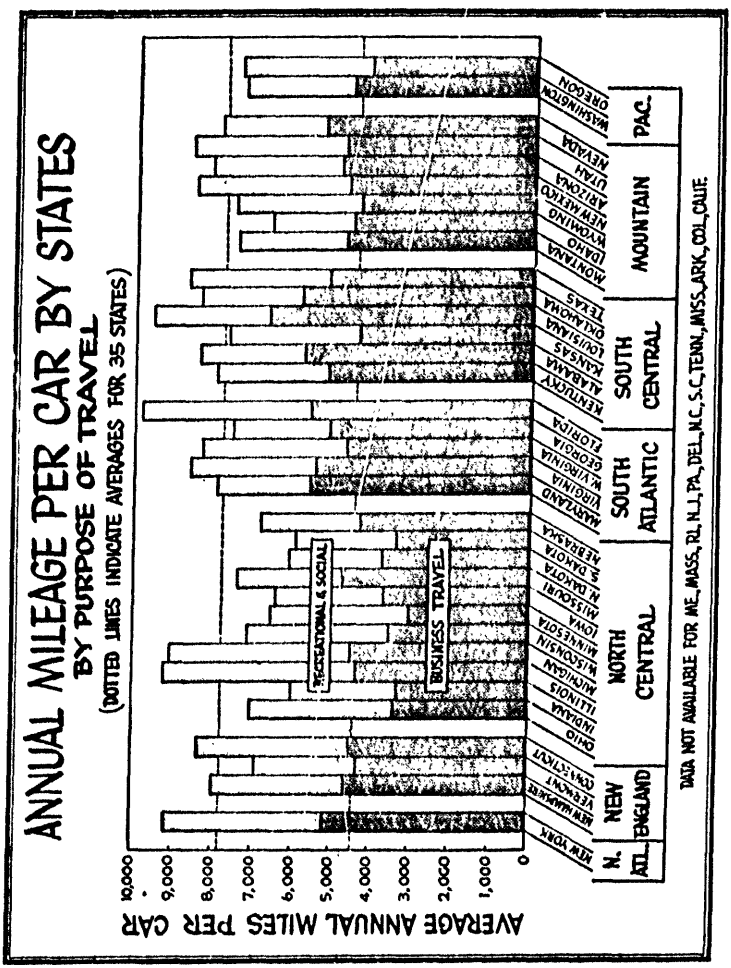


FIGURE 3

But to measure the need for automobile operation in continuing the present organization of family and individual living, or to meet modifications made necessary by the current national effort for defense, the number of times each day or week or year that a car is driven to the factory, the office, the market, or the school, may be found the most substantial yardstick.

II. MOST DRIVING IS LOCAL

The findings that three trips out of every four are for necessity purposes (see fig. No. 4) ties into the conclusion which the Public Roads Administration presented in 1939, in its report, Toll Roads and Free Roads, to the effect that motor trips in this country are predominantly short and local.

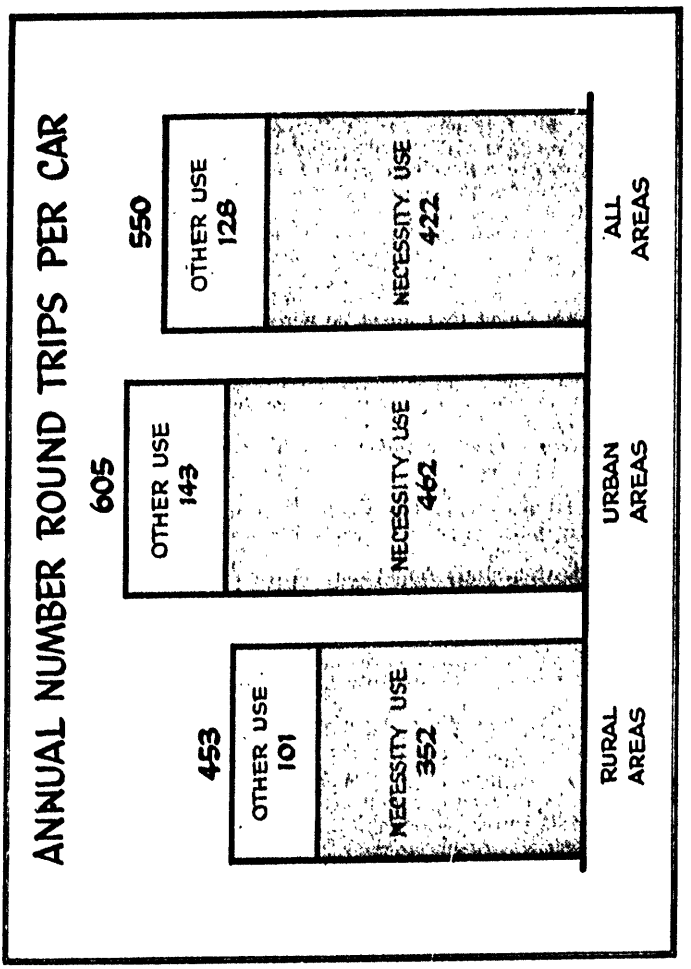


FIGURE 4

Even outside of cities, it was found, trips less than 5 miles in length constitute the major portion of all that are made.

Short trips tend to be the frequent ones, closely integrated with routine movement within the community. Longer journeys, on the other hand, are generally less frequent and usually identified with social and recreational uses of the motorcar, such as vacation trips, week-end tours, Sunday driving.

Evidence produced in the present study eliminates need for assumptions. Driving records by motorists in the six key States (none of which, incidentally, was included among those covered by the 1939 report) confirm the fact that the preponderance of short trips represents also a preponderance of necessity driving.

It is now shown that one-third of all car owners make from 200 to 400 round trips a year for necessity purposes. This 200–400 bracket appears to be dominated by cars making 1 trip per day to and from work, or on business.

Rural and urban areas both show about one-third of their cars in the 200 to 400 trips-a-year class.

Apart from this central third of the cars, one-fourth of all urban-owned cars make more than 600 necessity trips a year. In rural areas only 15 percent come in this high-frequency classification.

In urban districts only 2 cars out of 10 report fewer than 200 trips annually for necessity purposes, but 2 out of 5 rural cars do so.

Six out of 10 cars owned in urban areas are regularly driven to work and back, and of these, 60 percent are so used once a day.

One car out of every seven used in reaching the job makes between 600 and 800 trips annually for this purpose. This places them in the "twice-a-day" class; whether as workers who return to their homes at the noon hour, or those whose wives or other members of the household may take and pick them up, using the car for other purposes during the remainder of the day.

More than one-fourth of the cars used to get to work carry other workers besides the driver, the Opinion Research survey reports. These cars average approximately five persons for every two cars, including the drivers. (For further details on this function of car use, see ch. VII, p. 27.)

The effect of occupation upon frequency and length of trips is pronounced. The highway surveys found that all of 30 percent of the farm-owned cars are in the 200 to 400 annual round-trip category, and 47 percent average under 200.

By contrast, only 1 car-owning physician out of 10 reports fewer than 200 necessity trips a year, and 31 percent—nearly one-third—make more than 1,000. The average length of round trips for necessity driving is 12.5 miles for farm cars, 10 miles for doctors.

Commercial travelers have so much greater trip mileage that, in the five States where occupation of driver was recorded, they average 28.8 miles per trip.

Among commercial travelers 11 percent report more than 1,000 round trips a year for necessity purposes, while nearly half are grouped between 200 and 600 trips.

The Opinion Research study found that 34 percent of all cars had made no journey as long as 200 miles during the year preceding the interviews. For another third the longest trip was between 200 and 600 miles.

Approximately three-fourths of all long trips, this survey found, are for social and recreational purposes, but the sum total of trips of 200 miles or more amounts to only 12 percent of total mileage driven in a year.

III. VARIATIONS BY SIZE OF COMMUNITY

In all groups of communities a fairly regular minimum of "must" service for motorcars is found. While the State reports disclose wide variation between rural and urban-owned cars in total mileage (see table, p. 14), the average necessity mileage was 4,331 per car registered in unincorporated areas, and 4,636 miles a year in the cities.

Total mileage figures show that the bigger a community, the more miles its automobiles tend to run. Cars owned in the unincorporated areas of 31 States reporting to the Public Roads Administration traveled an average of 6,606 miles annually per car. On the other hand, owners living in the cities of 100,000 population or more, showed an average of 8,094 miles.

But the same reports, and also the analyses of the six-State questionnaires, place a major part of the extra city car-miles in the social and recreational column, leaving a considerable uniformity in necessity uses.

The term "unincorporated areas" suggests farm cars. Actually, this population group, as established by United States Census Bureau, includes almost as many nonfarmers—suburban residents, persons living in small villages or open country but not deriving livelihood from the land—as it does farmers.

Preliminary 1940 census figures show the movement of population toward suburban areas outside cities proper has been very great in the past decade. The unincorporated county areas surrounding the 92 largest cities increased in population 14 percent between 1930 and 1940, whereas the cities themselves increased only 3 percent.

This decentralization in itself has resulted in additional millions of persons becoming dependent upon private cars for transportation to jobs, to supply points, and for other essential travel.

The Opinion Research study concludes:

"So far as automobile-owning families are concerned, the picture of workers' homes clustered about mill or factory is obsolete. On the contrary, 70 percent of workers in car-owning families go to work by automobile."

(In 1936 special traffic studies made in the city of Detroit spotted the point of origin of cars parking in various industrial areas of the city. A very pronounced scattering of home sites and relatively small "colonization" close to places of employment was shown by the resulting charts.)

When the drivers covered by the Opinion Research study were asked how they would get to work by bus, streetcar, or train. Only one-third, half of whom live couldn't go at all. On the assumption, individually, that mass transportation agencies would be capable of carrying them all, half the car owners said they would get to work by bus, streetcar, or train. Only one-third, half of whom live within 1 to 5 miles from their jobs, said they would walk.

Necessity mileage among cars owned in the unincorporated areas constituted 65.6 percent of their total mileage, according to the 31 State data. This is higher than in any other population group. Here is the record, on the basis of averages per car:

Population group of place of ownership	Average annual miles per car		Necessity mileage percent of total
	Total	Necessity use	
Unincorporated areas	6,606	4,331	65.6
Incorporated areas with population of—			
Less than 1,000	7,436	4,404	59.2
1,000 to 2,500	7,843	4,399	56.1
2,500 to 5,000	8,236	4,431	53.8
5,000 to 10,000	8,221	4,363	53.0
10,000 to 25,000	8,293	4,267	51.5
25,000 to 100,000	8,360	4,311	51.6
100,000 and over	8,094	4,636	51.5
All areas (31 States)	7,706	4,417	56.7

The mileage records in Connecticut, Georgia, Indiana, Michigan, Nebraska, and Oregon, which are broken down a little more finely to give 11 population classifications ranging from cities over 1,000,000 population (Detroit, Mich., only one in sample) down to the unincorporated areas, tell the same story.

Total mileage per car averaged 9,738 for Detroit owners, contrasted with 6,971 for cars owned in the unincorporated areas of the 6 States, but necessity driving was 4,753 and 4,491 per car, respectively.

Thus, while slightly lower, necessity mileage is a greater part of the total among owners at the rural end of the population scale than in the large communities. (See fig. 5.)

In almost all cities, local transportation has become primarily automotive. A recent summary brought together by the Automobile Manufacturers Association found that in cities up to the 500,000-population class, as many as 70 percent or more of the people entering the business sections of the city on a typical day (excluding pedestrians) do so by private automobile. Another survey disclosed that there now are 2,100 American towns and cities ranging in population from 2,500 up to the 25,000-50,000 class, which have dispensed with, or have grown up without, intraurban mass-transportation systems of their own. Their combined populations of 11,844,000 persons depend, for routine movements other than afoot, upon private cars.

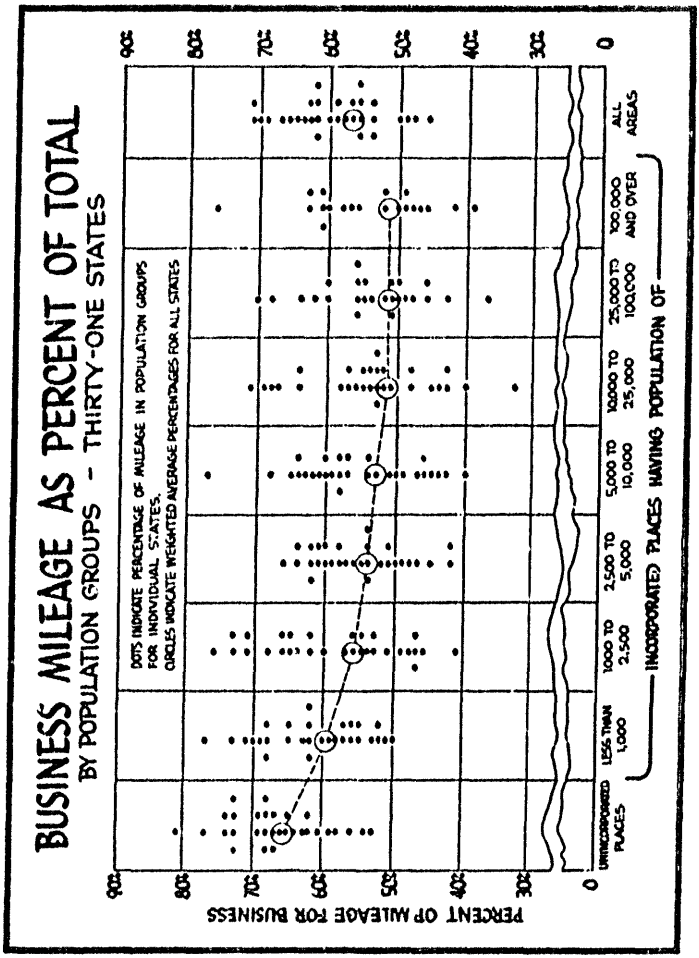


FIGURE 5

All the findings and surveys come together on the fact that, with all of the variations in mileages and trips, automobile travel in communities of all sizes, from farm to village to town to metropolis, is preponderantly for necessity purposes.

IV. EFFECTS OF OCCUPATION ON CAR USE

While mill workers, doctors, salesmen, and farmers all have different objectives in their automobile driving, it would be difficult to single out any one group of owners to say they have more or less need for their cars than the others.

In the analysis of the questionnaires from five of the States (Connecticut did not record occupational data), it was possible to sort out seven broad occupational classifications, which cover more than half of all car owners interviewed. The groups are farmers, industrial and construction workers, commercial travelers, physicians, lawyers, real-estate and insurance salesmen, and other salesmen (unclassified but not including retail clerks).

Since the questionnaires were not originally intended to produce exact occupational classifications, the samples were not balanced to produce a conclusive statistical verdict. However, important general facts stand out. Occupations divide owners into two broad groups, each with distinctive driving characteristics. (See fig. 6.)

The first group, including the owner whose work is on the farm, in the factory, or on some other job which ordinarily does not require him to use his automobile during production hours, has an annual mileage near or below the national average. Car owners in this group use their vehicles to get back and forth to work, to reach stores and schools and churches, but do not regularly drive them during the course of their daily work.

The second group, which has an annual mileage far above the average, covers exactly those occupations which may be logically expected to involve use of a car regularly in the conduct of a business or profession.

The traveling salesman's average annual mileage is shown at 18,791 miles, or more than double the average per car of all drivers. But the average for medical men also is very high, and doctors top all the analyzed occupations in the number of round trips, having an average of 947 trips yearly per car.

The legal, insurance, and real-estate groups and unclassified salesmen also are found in the high-mileage class.

Below is the comparison of total miles driven annually per car, analyzed by occupations:

Occupation:	*Average annual mileage per car*
Commercial travelers	18,791
Physicians	12,932
Legal profession	12,898
Insurance and real-estate salesmen	12,618
Salesmen (unclassified)	12,303
Workers	7,057
Farmers	5,750
All other occupations [1]	8,650
Average mileage, all groups	8,139

[1] A cross-section of car users, whose occupational definition was not susceptible to accurate classification.

In every group listed above, necessity driving claims half or more of both mileage and number of trips. Here is the record:

Occupation	Percent of total	
	Necessity mileage	Necessity trips
Commercial travelers	80.9	86.5
Physicians	66.8	89.0
Legal profession	61.6	77.4
Insurance and real-estate salesmen	71.8	85.8
Other salesmen	66.6	81.5
Workers (industrial and construction)	49.4	72.3
Farmers	66.8	78.3
All others	70.7	76.6

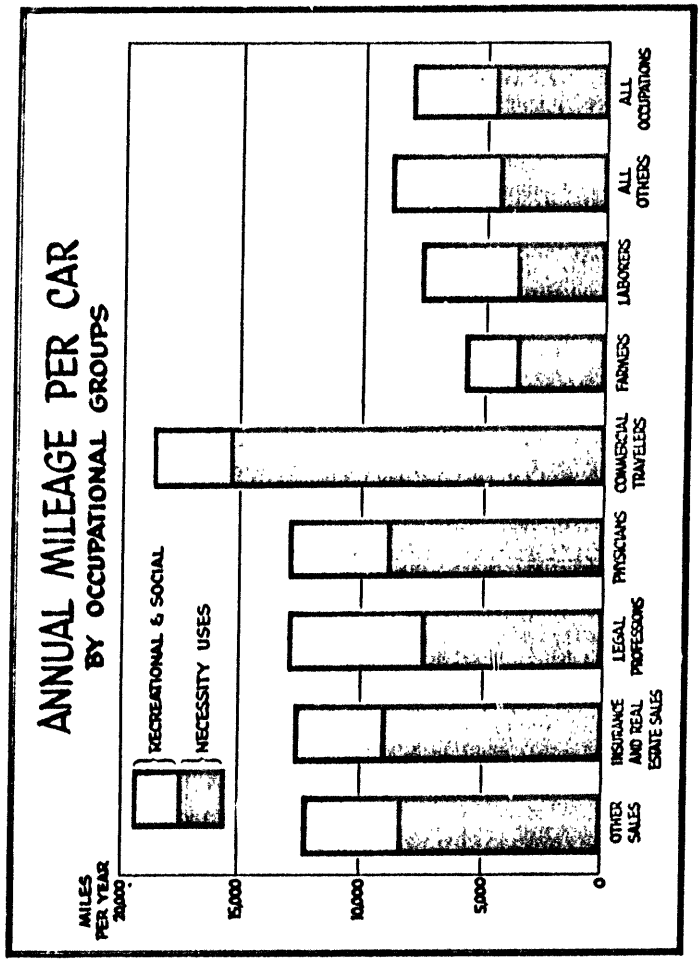


FIGURE 6

A factor of importance is that the information was collected before the pressure of defense production stepped up the use of cars by industrial workers and others who now are employed more days per week and year.

Two of the occupational groups singled out in the State survey, farmers and physicians, although at opposite ends of the driving scale, present an interesting comparison.

While the doctor's annual total of 12,032 miles per car is more than twice as high as the 5,750 miles driven yearly by the farmer-owned car, and the doctors reported 947 round trips a year, which is two and a half times the 392 trips averaged by the farm car, on a percentage basis 66.8 percent of the doctor's mileage, and 66.8 of the farmer's mileage—exactly the same figure for the 5 States surveyed—are for economic purposes.

Part of the reason for differences in total mileage among these groups is undoubtedly economic.

The data in this survey do not directly reflect income distribution. (See fig. 7.) On a trip basis, the physician's necessity use runs up to 89 percent of the total, since a doctor is called upon to go out at all hours of the night and day.

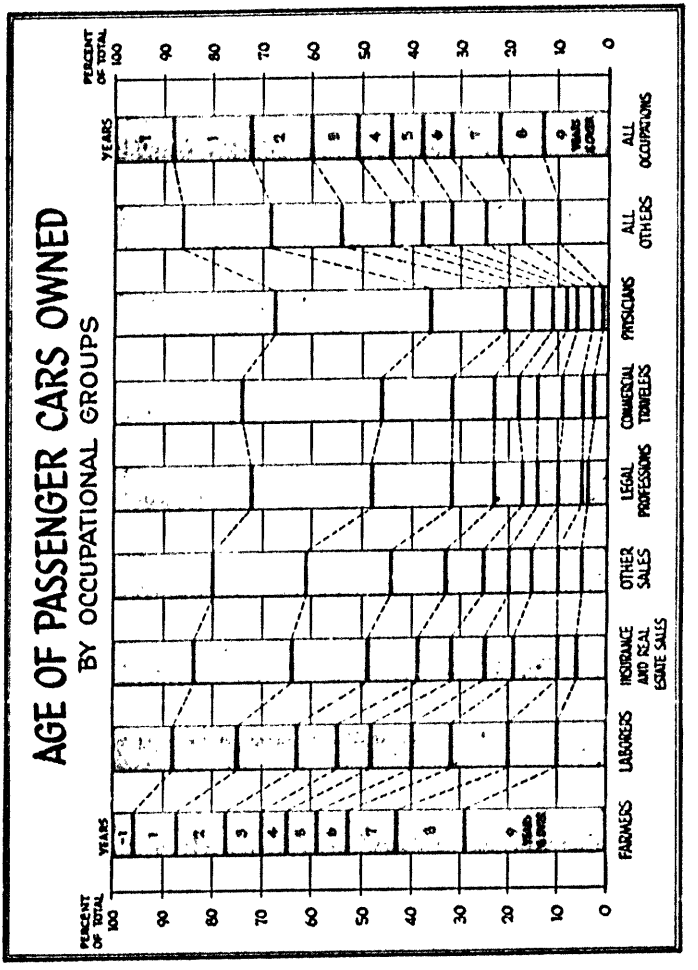


FIGURE 7

But the relative frequency of business trips for the farm car is impressive too—four out of five trips are for necessity purposes.[1]

The Opinion Research Corporation survey yielded a similar picture on a national scale, although the methods of occupational classification were so different that direct comparisons cannot be made. It was found that among farmers the principal necessity usage is for business trips and shopping. Wage earners, in general, travel the longest distances in reaching their job. And the only car-owner groups found driving primarily for recreational and social purposes are retired persons, widows, students, and domestic workers.

[1] The survey found that 98.4 percent of farmer-owned cars are operated in part or entirely for business purposes. A survey conducted in Illinois, Iowa, Nebraska, Kansas, and Missouri by the Corn Belt farm dailies, showed that 98.9 percent of the farmers surveyed purchased their cars either for business use, or for business and pleasure combined.

V. THE DOCTOR'S CAR—AN OCCUPATIONAL CASE STUDY

Group-average figures do not wholly spell out the picture of car operation from an occupational standpoint.

The five-State sample of medical men's cars was found to be sufficiently compact to make possible a more detailed distribution. Here are the results:

Nine out of ten doctors who own automobiles use them in their professional work.

Out of every 100 who so use their private automobiles (see Fig. 8):

Sixteen have more than 1,500 trips annually for necessity driving.

Fifteen make from 1,000 to 1,500 trips per year.

Ten report from 800 to 1,000 round trips.

Twenty-eight range from 400 to 800 trips annually.

Twenty-two list from 200 to 400 round trips (this contains the once-a-day group, where presumably a round of patients is visited in a single trip).

Nine report fewer than 200 round trips a year.

Judged by the frequency of use, the doctor's car is as much a part of his professional equipment as a stethoscope or thermometer.

For all car-owning physicians, the average number of round trips annually was found to be 947, of which 842, or 89 percent, are credited to professional and other necessity purposes. This is the highest occupational group average found in the surveys.

The great bulk of these trips is concerned with transportation to and from the office, and on professional calls. The average was 808, which is equivalent to slightly more than 15 round trips a week.

It was found that in the rural areas, one-half of the necessity trips made by doctors averaged more than 15 miles in length. In the larger cities, 4 out of 10 cars average this distance.

In the small towns, where distances are relatively less, a higher proportion of the doctor's trips are shorter. The following table records the percentage distribution of trip length by size of community:

Average number of miles per round trip	Rural areas	1,000 to 5,000	5,000 to 25,000	25,000 to 100,000	100,000 and over	Average for all areas
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Less than 5	7	17	41	20	6	17
5 to 10	29	20	25	21		24
10 to 15	14	28	13	16		21
15 to 20	12	5	8	9		10
20 to 25	14	8	3	4	13	9
25 or more	24	22	10	[illegible]	15	19

As might be expected from this record, the mileage of doctors' cars ranks high among all groups of car owners. The average distance traveled in a year was shown to be 12,032 miles per car, of which necessity driving accounted for 8,640 miles. Most of this—8,428 miles—was in calling on patients, or in reaching the office or hospital from home.

In towns ranging in population from 5,000 to 25,000, doctors reported lower mileage, following the trend which is typical of all cars in such communities. But the frequency of trips is higher in the smaller towns.

Although the doctor uses his car nine times for necessity transportation for every social and recreational trip, the latter is likely to be three or four times longer. The average length of a pleasure trip for doctors seems to be 40 miles, compared with a general average of 10 miles per trip for all necessity driving. But all of his social and recreational driving combined adds up on the average to only 4,292 miles a year, less than a third of his total.

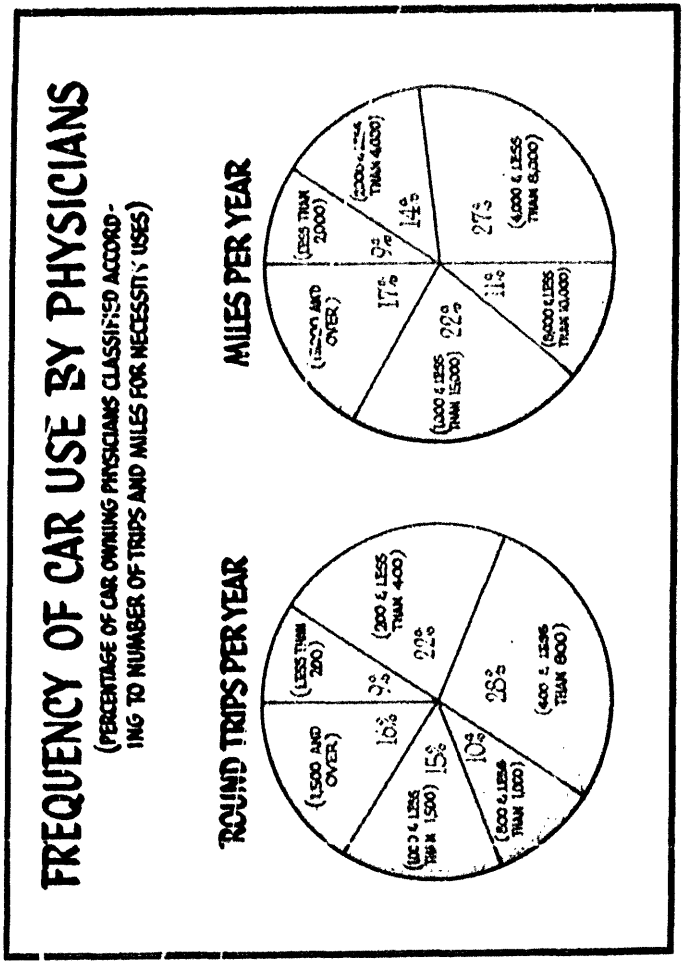


FIGURE 8

VI. EFFECT OF CAR AGE ON USE

In the life cycle of an automobile the number of miles traveled (see fig. 9) and of trips made declines sharply with the advancing age of the car.

During its life span, a typical car changes hands two, three, or more times, often moving from one occupational group to another.

Occupations which require high mileage and constant use tend to have new or "young" cars, trading frequently.

Eighty-nine percent of doctors' cars at the time of survey were found to be less than 5 years of age, and 33 percent were 1 year old or less.

In the six-State surveys, new cars which had been in operation 1 full year were found to be driven on the average of 10,768 miles annually. But vehicles 9 years old or older average only 4,770 miles a year. Intervening ages show a progressive decline.

But, in general, the cars which are nearing the end of their operating life show a much higher ratio of necessity mileage and trips.

Here is the record from the six-State analysis:

Age of car	Average annual mileage	Percent of total necessity miles	Average number round trips	Percent of total necessity trips
1 year	10,768	54.7	619	77.0
2 years	9,628	54.7	620	77.5
3 years	8,592	54.2	593	77.2
4 years	8,106	53.5	604	77.6
5 years	7,624	52.8	545	75.2
6 years	7,053	53.0	524	74.8
7 years	6,718	53.9	496	75.5
8 years	5,804	56.6	468	77.1
9 and over	4,770	61.2	417	78.5

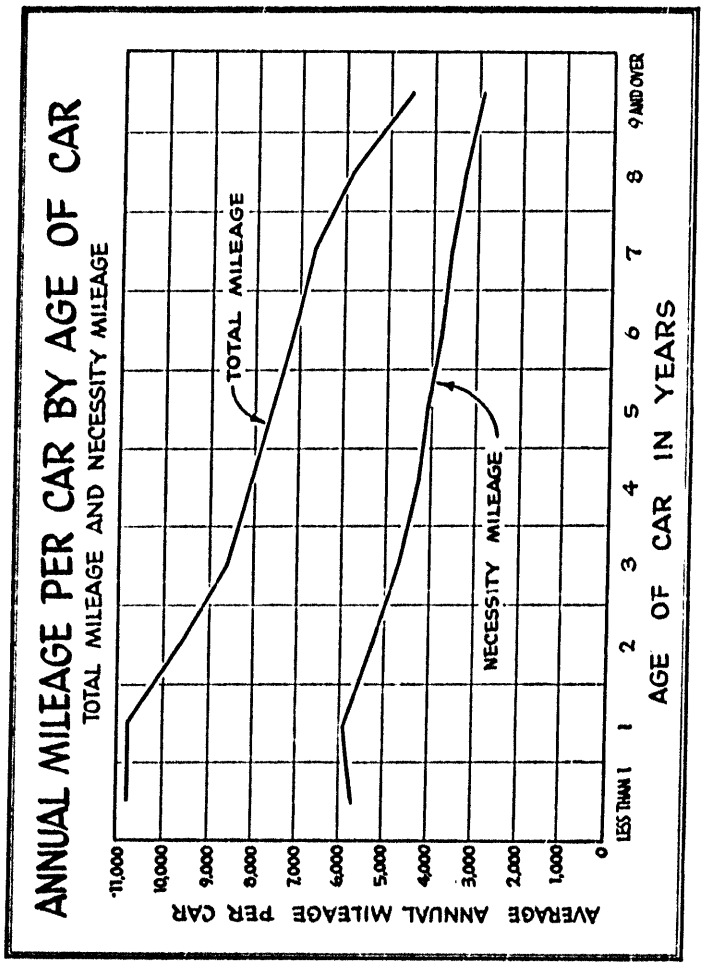


FIGURE 9

The noticeable jump in percentage of necessity usage for cars 9 years old and over suggests that among those of extreme age the ratio may approach 100 percent.

Records for the decade ending with 1939 show that during that time 85 percent of all new cars sold at retail were absorbed as replacements for scrapped vehicles.

During the depression decade, when the combined registration of cars and trucks averaged approximately 27,000,000, the number of new vehicles per

year required to replace scrapped units averaged 2,388,184 (Automobile Facts and Figures, 1940, p. 7). At the present time the automotive transport system is based upon the operation of approximately 26,000,000 passenger cars and 4,000,000 trucks.

Estimates as to the production of new units required to maintain existing rolling stock commonly are based on the assumption that the rate of retirement of worn-out cars is the same today as it was during these previous years. That may be unduly conservative, since the registration figures as of July 1940 showed that one car in four was 9 years old or older.

Eighteen percent of all cars in use were 10 years old or older; 12 percent, 11 years or older; and 6 percent, 12 years or older. More than 4,500,000 passenger cars in service were manufactured prior to 1931.

Following is a tabulation of the ages of cars in use July 1, 1940, and their percentage ratio to the total number of passenger automobiles registered:

Year of manufacture	Number in use [1]	Percent of total cars		Age of car
		Simple	Cumulated	
1940	2,321,239	9.15	100.00	Less than 1 year.
1939	2,422,671	9.55	90.85	1 year.
1938	1,745,888	6.88	81.30	2 years.
1937	3,498,466	13.79	74.42	3 years.
1936	3,243,875	12.75	60.63	4 years.
1935	2,220,362	8.75	47.88	5 years.
1934	1,696,971	6.69	39.13	6 years.
1933	1,250,152	4.93	32.44	7 years.
1932	864,957	3.41	27.51	8 years.
1931	1,438,197	5.67	24.10	9 years.
1930	1,483,787	5.85	18.43	10 years.
1929	1,674,351	6.60	12.58	11 years.
1928	773,170	3.05	5.98	12 years.
1927	302,555	1.19	2.93	13 years
Prior to 1927	441,333	1.74	1.74	14 years and over.
Year not given	188,489			
Total, all cars	25,556,463			

[1] As of July 1, 1940 Data from R. L. Polk & Co. as shown in Automotive Industries, issue of Mar. 1, 1941.

The large proportion of the rolling stock which is near the end of its practicable operating life includes the cars that, as a group, average 6 miles out of every 10, and 8 trips out of 10, on necessity travel—going to work, marketing, etc. Ownership of these cars appears from registration data to be quite largely among farmers.

The armament-production program has added very materially to the number of men going to work; in many cases has increased the distances they have to travel; while defense-plant locations are in many cases not reached by adequate mass transportation. New cars and old, efficient or inefficient, are now harnessed in great numbers to an increased load.

Extent to which cars, regardless of age, are integrated as essential equipment in the daily lives of millions of persons, is reflected in the Opinion Research Corporation answers to inquiries as to what car owners themselves think about their driving.

It was learned that more than half regard their cars as indispensable for going to work or out on business, with a substantial portion concluding: "Oh, I couldn't make out at all without a car."

VII. MAJOR PURPOSE OF DRIVING—MAKING A LIVING

Singled out from the total of necessity uses, driving to work and using the car on the job account for roughly one-half of all automobile usage in the United States. These two objectives consume more mileage than all social and recreational travel combined. (See fig. 10.)

The Opinion Research poll found that 64 percent of all cars are used for travel to and from places of employment to a greater or less extent. Half of all cars are used for this purpose regularly.

The same survey disclosed that 58 percent of all cars are used on business trips; 9 out of 10 of these at least once a week, and 6 out of 10 every working day.

In conducting that poll, the interviewers paid careful attention to the distinction between these two types of driving.

This distinction was not particularly important in the State-road-use questionnaires and, in replying many motorists are believed to have interpreted "business trips" to include driving to places of business. Hence driving on business probably is overstated in the results, at the expense of the "driving to work" classification.

But when the two are combined, the State surveys corroborate the Opinion Research findings to show that the driving in connection with making a living is the major purpose of automobile travel.

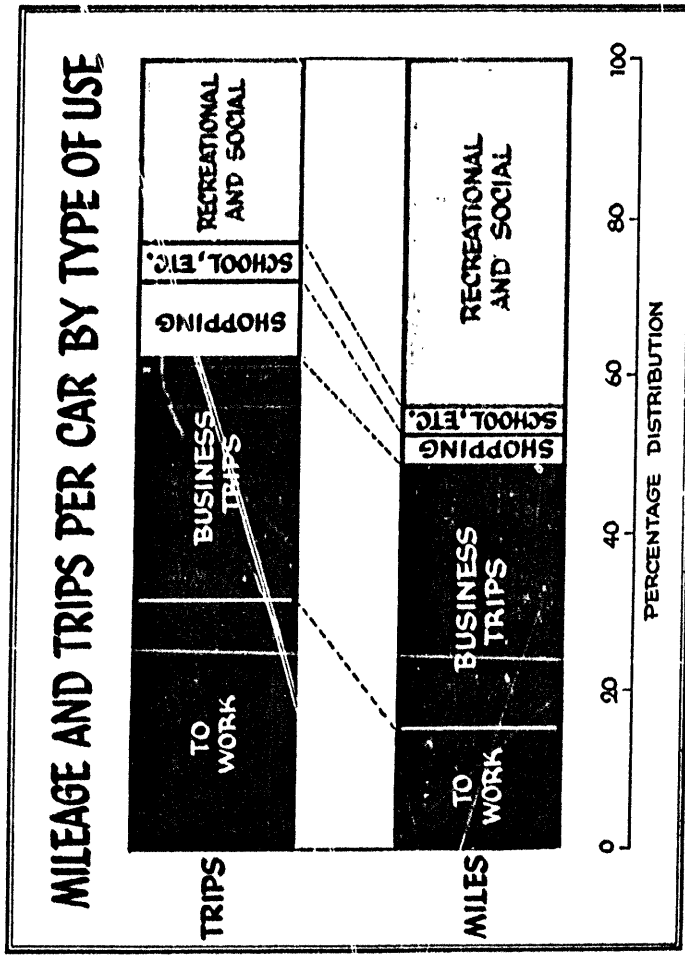


FIGURE 10

The six-State analysis discloses that driving to work and on business together account for approximately three out of every five trips made by all cars (see fig. 10), while only one trip out of five is devoted to social and recreational purposes. The fifth trip is for marketing, going to school or to church, or to a transportation terminal.

In Connecticut, driving to work and on business accounts for 55 percent of total trips. The corresponding percentages are 59 percent in Georgia; 69 in Indiana; 60 in Michigan; 61 in Nebraska; and 65 in Oregon.

The surveys were made during a period of much lower employment than at present, yet the number of round trips per car for driving to work, and on business averaged 352 annually in Connecticut; 361 in Georgia; 385 in Indiana; 311 in Michigan; 386 in Nebraska; and 318 in Oregon.

VII. THE FAMILY SHOPPING BY AUTOMOBILE

Six out of seven automobiles today are used for family shopping. Almost all of these are so employed at least once a week, and two-thirds of them oftener. (See fig. 11.)

The Opinion Research study indicates that a full 14 percent of all the 23,000,000 private-car owners in the country (3,000,000 cars are believed to be owned in multiple-car families, commercially, or by Government) might have to abandon their present principal purchasing locations, or move their homes, if for any reason they should be deprived of automobiles. That means approximately three and a quarter million families.

Distance between home and store is a dominant reason for this. Only 9 percent would abandon shopping centers they now use which are 1 to 2 miles from home, but 22 percent of those who depend on stores 5 to 8 miles from home state they would have to give them up. Thirty-one percent of those who drive more than 8 miles for their shopping say they would not be able to continue using present marketing points without their cars.

Two-thirds of the car owners do their principal marketing 2 or more miles from home. Forty-five out of each hundred travel 3 or more miles, and 30 out of each 100 drive 5 miles or more to shop.

Farmers lead in dependence on the automobile for marketing. Of the 1 in 12 cars that, according to their owners, are used more for marketing than anything else, 61 percent are farm cars. One-third of the surveyed farm-car owners report that without cars they could not get to their present supply points at all. Another 10 percent could do so as long as the farm truck remained in commission.

An important factor in the market picture is that fully a third of all car owners habitually drive to at least 1 secondary shopping point. Of these, 3 out of 10 say the secondary market is from 8 to 18 miles from home; 7 percent, roughly 1 out of every 14 cars in the country, go more than 30 miles.

In part these long shopping distances reflect the movement to suburban zones that has developed during the past decade.

It is a significant fact that the 1940 United States Census of Population finds that the nonurban population of the country is now made up almost equally of farmers and nonfarmers. The latter, whether living in open country, incorporated or unincorporated villages, and satellite towns around big cities, number more than 27,000,000.

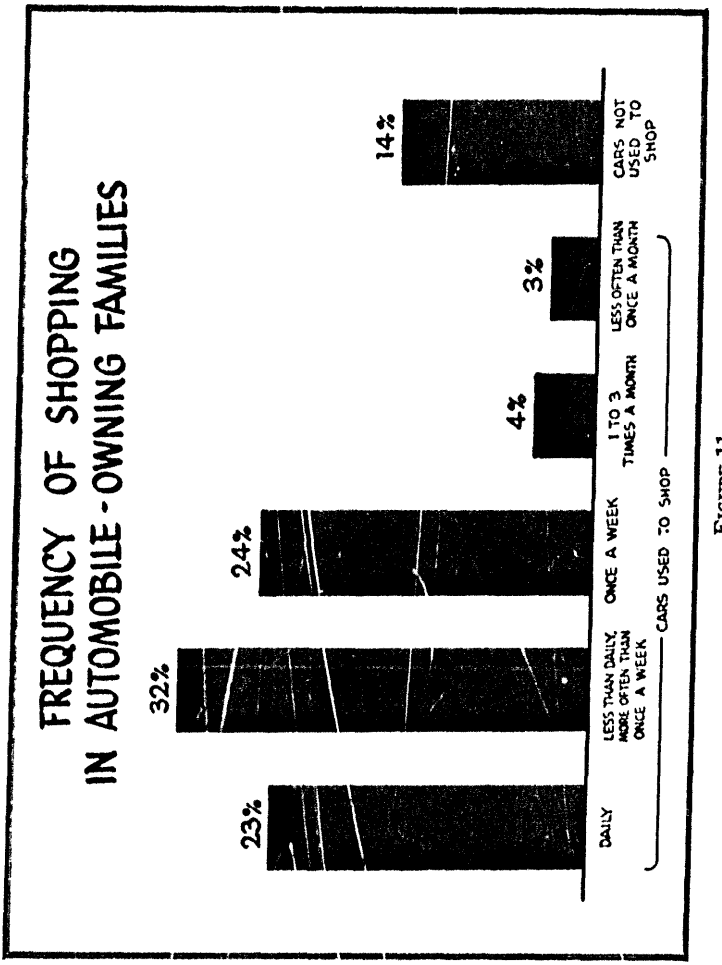


FIGURE 11

Results of the six-State highway surveys tend to support these findings from the Opinion Research poll, but do not present exact records of shopping mileage and trips.

In part this is because much driving has more than one necessity purpose. For instance, the father enroute to work may take the children to school and, on the way home, may stop to pick up the groceries. But in filling out questionnaires for the State surveys, owners in numerous cases recorded only the major purpose of each trip. Hence these surveys produced only "minimum" records of mileage and trips for shopping purposes.

The Opinion Research poll, on the other hand, recorded a test week of driving in mid-December, when the ratio of shopping mileage probably was higher than average. Its findings of 11 percent of all mileage devoted to family shopping may be regarded therefore as a "maximum," and the correct measure probably lies between that figure and the six-State survey average of 4-plus percent.

The latter, by itself, is equivalent to 1 mile of shopping travel for each car in the country each shopping day.

IX. HAULING AND OTHER USES

Related to shopping is a type of automobile use defined in the State questionnaires as "hauling and to market." This is predominantly farm driving.

Nine out of every hundred farm passenger cars are used for this purpose.

One-half of the farm cars so used engage in hauling once a week or oftener; 1 car out of 10 makes more than 300 round trips a year; and 1 in 6 makes between 100 and 200 a year, or 2 to 4 a week.

These trips average 12.6 miles each. Very few of these cars travel more than 2,000 miles annually for this purpose—only 18 out of 100—but another 10 percent average 1,000 to 2,000, and 46 percent pile up distances between 200 and 1,000 miles.

Other groups of owners also use their cars for hauling on an occasional basis.

Two percent of wage-earners' cars, 3 percent of cars owned by the unclassified group of salesmen, 2 percent of commercial travelers' cars, show such driving.

Cars owned by skilled craftsmen of various trades, carrying their tools or materials to the job, and those of salesmen carrying samples, evidence this hauling function performed by many automobiles.

X. TAKING THE CHILDREN TO SCHOOL

One in every five automobiles is used in driving to and from school, according to records of two States (Connecticut and Georgia), which were specially analyzed as to school driving.

The average round trip for this purpose is 5.0 miles. Three out of four cars used to transport children to school report average trips of more than 2 miles in length, and over half of them average 4 miles or more per round trip.

The annual school mileage for automobiles so used is 795, or 10 percent of their total driving for the year.

School driving is found in the cities as well as in rural areas.

The Opinion Research survey found that, on a country-wide basis, one-third of the families having children of school age use their cars frequently for this purpose.

In answering the State questionnaires many motorists appear to have failed to report secondary purposes of their trips. Therefore, in general, figures on school use appear to be on the conservative side since the youngsters often may ride with the father en route to work, or with the make making a shopping trip.

The role of the private family car is auxiliary to the great school-bus systems which carry 3,125,000 children each school day.

It is a substantial auxiliary, however, since all the cars reporting use for this purpose average 135 school trips a year.

XI. DRIVING BY DAYS OF THE WEEK—USE OF THE CAR FOR CHURCH

With one-half of all automobile mileage chargeable to purposes of making a living, the distribution of necessity driving of all sorts over the several days of the week acquires importance.

This phase was inquired into by the Opinion Research study, and the following distribution was found:

Monday through Friday: 65 percent of all passenger car mileage is tied up with earning a living.

Saturday: 45 percent of mileage used going to work or on business, but 22 percent used for shopping, against half as much shopping mileage on other week days.

Sunday: Despite the fact that this is the day when much of the recreational driving is done, 21 percent of the total recorded was devoted to purposes connected with work.

This survey was made before the systematic effort to extend the 40-hour work-week and to eliminate the week-end "blackout," so that an allowance needs to be made for the increasing number of Saturday and Sunday working shifts.

In making the six-State analysis, mileage involved in driving to church was also recorded, with the finding that this use is important, both in mileage and frequency of trip, to one-fourth of the cars surveyed.

Average length of the trip to church for all six States is 5.1 miles.

Of the owners who use their cars to take themselves and families to Sunday worship, exactly one-half were found to average between 50 and 60 round trips a year. This represents a regular use, Sunday after Sunday.

Another 20 percent of the cars driven to church were found to average in excess of 60 trips annually, and 30 percent averaged less than 50. These ratios apply, with minor variations, throughout occupational and population groups studied. However, the automobile is more important for church-going to farmers than to other groups studied; 3 out of 10 farmer-owned cars are used for this purpose, and a quarter of these have more than 500 miles of church driving annually, reflecting the relatively greater rural distances.

Forty-three percent of the farm cars which are driven to church average between 50 and 60 round trips a year.

BRIEF ON ESSENTIAL DEFENSE USES OF MOTOR TRUCKS PRESENTED TO WILLIAM S. KNUDSEN, DIRECTOR GENERAL, OFFICE OF PRODUCTION MANAGEMENT, APRIL 24, 1941

Submitted by MOTOR TRUCK COMMITTEE, AUTOMOBILE MANUFACTURERS ASSOCIATION, in behalf of the MOTOR TRUCK MANUFACTURERS OF THE UNITED STATES

ESSENTIAL DEFENSE USES OF MOTOR TRUCKS

The motor truck members of the Automobile Manufacturers Association and the Ford Motor Co., a nonmember, jointly represent the manufacturers of over 90 percent of the motortrucks produced in the United States in presenting this brief.

The industry recognizes the vital problems involved in the necessary acceleration of production for defense that will demand sacrifices on all industries, and, in that light, the motortruck industry will in good spirit abide by your final decision with respect to curtailment of production.

Is the urgent need for freight-moving capacity going to be met, if the already reduced percentage of truck-producing capacity available for civilian transport, is again cut equally with passenger cars?

The industry feels duty-bound to present facts pertaining to the transportation aspects of the defense program so that they may be weighed in your deliberations leading to a decision on truck-production curtailment.

Production of military equipment

Since the national-defense program started, the industry has been assuming an ever-increasing load in the production of military vehicles and numerous other armaments. From August 1, 1940, to July 31, 1941, the motortruck manufacturers will have produced more than 137,000 military vehicles to meet requirements for the 1,418,000 Army. The industry understands that these are minimum requirements. Information on what additional capacity of the industry will be required for military vehicles is, no doubt, available to the military strategists.

Manufacturers of motortrucks are also engaged in producing tanks, artillery ammunition components, tractors, shells, limbers and adapters, fire engines, ambulances, engines, machinery, pedestal mounts, trailers, and tank transmissions. In addition, they are negotiating with the Army, Navy, and Office of Production Management for production of other armaments.

Will transportation for defense be impaired?

Will curtailment in production in face of increased demand for military vehicles, plus the truck-plant capacity that is already being used for other armaments, divert the industry from the production of civilian vehicles essential to defense?

Will this create a partial break-down in transportation for defense?

Transportation is the lifeline in the defense program. It must be in the picture alternately all along the line from raw materials down through to the military and civilian consumer.

Utility of trucks and railroads on parity in 1918

This factor was recognized by the Priorities Division of the War Industries Board in July 1918, during the World War when, in face of a passenger car curtailment, motortrucks were given a "B-4" rating (not to be confused with the present B-4 on materials priorities), defined as follows:

"Class B comprises orders and work which while not primarily designed for the prosecution of the war, yet are of public interest and essential to the national welfare or otherwise of exceptional importance."

Trucks in 1918 were regarded in the same classification as railroads and other utilities in which there was no distinction made as between the military and essential civilian services performed.

During that time, because of congestion in railroad movement, the Council of National Defense passed the following resolution in March 1918:

"Resolved, That the Council of National Defense approves the widest possible use of the motortruck as a transportation agency, and requests the State councils of defense and other State authorities to take all necessary steps to facilitate such means of transportation, removing any regulations that tend to restrict and discourage such use."

Carrying out the intent of this resolution, so-called Return load bureaus were established in cities throughout the country to facilitate the maximum use of motortruck transport to overcome delays caused by railroad congestion.

Trucks now are a more integral part of our national economy than in 1918. Demands of consumers and shippers on motortruck service have today brought motortruck registrations to 4,650,000 units, or nearly ninefold greater than were in existence in 1918. However, it must be remembered that a comparatively small percentage of these vehicles are in intercity highway transport service, most of them being engaged in the movement of essential commodities from farm to market and in local delivery service to the consumer.

Reports from Europe are to the effect that motortrucks, civilian as well as military, are a principal key to the successes of the German Army.

Other indications are that Britain is woefully lacking in highway transportation facilities due to curtailment of truck production for making of other armaments, and restrictive licensing measures. This transportation shortage in Britain is becoming more acute due to bombings of key railroad points and other acts of war. These considerations, plus the question of sabotage, are mentioned because they seem pertinent to similar transportation problems that might arise in this country in an emergency.

Doubt as to transportation adequacy

There are numerous conflicting statements as to the adequacy of the existing transportation facilities in the United States to stand up under the strain as production for defense accelerates. The divergent views of informed persons indicate the need for a comprehensive analysis of the transportation facilities to determine their ability to do the job.

However, information available shows that the transportation agencies are already running close to capacity, that pinches have been felt in some quarters and that, with intensification of the defense program, this is bound to increase rather than decrease.

Individual railroad executives differ in opinion as to their ability to handle the increased traffic. An "Analytical Study of Railroad Car Equipment" prepared by R. N. Janeway for the National Resources Planning Board, briefly, shows, among other things:

(*a*) Thirty percent decline in railroad-owned freight cars since 1929.

(*b*) No increase in car utilization efficiency beyond the demonstrated maximum level can be relied upon to materialize in an emergency.

(*c*) In a war emergency, would require 360,000 more cars, than are now available (August 1940).

Need for flexible transportation

If, as indicated, the railroads need several hundred thousand cars, will they be able to obtain them from their suppliers in view of the shortages of materials?

Even if the railroads were able to augment their present facilities with several hundred thousand additional cars and were able, in a reasonable time, to have

sufficient equipment, a question arises as to whether the utilization of this equipment can be made flexible enough to have adequate facilities in the right places at the right times.

There are 48,000 communities in the country not served by railroads. In addition, there are numerous functions of the motortruck, such as work on cantonment construction, supplementing rail service and others, that cannot be replaced by any other transportation service.

The Interstate Commerce Commission foresees the flexible job that will be required. In its Fifty-fourth Annual Report to Congress, the Commission states:

"The extraordinary measures which the Government is now taking to prepare for national defense have brought to the forefront the question whether the transportation facilities of the country will be able to do their part adequately and effectively. That the burden upon them will be very heavy is certain, and the difficulties in sustaining it will be enhanced, as they were at the time of the World War, by the fact that the currents of traffic will be shifted from their normal course and that the danger of congestion will arise in unusual and unexpected places and at times, it may be, without warning."

An illustration of this is the shifting of coastwise and canal shipping facilities to ocean service thereby materially increasing the burden on land borne transportation.

Truck transportation is more flexible than railroads and, for that reason, is likely to be called upon to assume a relatively greater share of the defense load than its proportion of normal traffic. Accurate knowledge as to the adequacy of existing trucking facilities to carry the load is much more obscure than information on the railroads.

It has been reported in the press that an inventory of all the trucks in the country is under way through the cooperation of the War Department, the Public Roads Administration and the American Association of Motor Vehicle Administrators. The information developed in that survey should throw further light as to whether there are adequate truck transportation facilities. It is known, however, that trucks now in operation are already close to capacity and that much of the traffic they are moving is raw materials, parts, and finished products into and out of plants producing for defense.

Defense plants use of trucks

In the short time available for filing this brief, it was possible to obtain only samples of the extent of this traffic. Figures based on 36 companies show that 4.3 percent of the incoming traffic and 22.1 percent of the outgoing traffic move by motortruck. The total percent of incoming and outgoing is 12.1 percent.

As typical of unsolicited comment in these replies, one aircraft manufacturer reports 90 percent of its tonnage is handled by truck because the truck permits a lower minimum. These smaller quantities can be accumulated quicker by truck than by rail.

Another aircraft manufacturer reports 50 percent of its tonnage is handled by truck. Claims 100 trucks a day in and out. Both these firms expect decided increases during the next 6 months of shipments handled by truck.

Increasing truck uses for defense

Companies manufacturing for defense have already indicated that they have been confronted with delays caused by lack of transportation facilities. On the basis of 15 companies, there is an indication that the anticipated increase of truck traffic will amount to 10 percent for the next 6 months, as compared with the first quarter of this year.

As another approach to obtaining the picture, an analysis was made by a number of motortruck manufacturers of the break-down of retail sales. This showed that 21.4 percent of the sales for the period from January 1 to April 15, 1941, was of military vehicles. Eighteen percent of the sales to civilians were for defense uses.

It is the opinion of motortruck manufacturers that the sales of trucks to civilians for defense purposes—directly or indirectly—are conservative and that, in a more extensive survey of the situation, the figure would be much higher, particularly from the standpoint of part-time uses of the trucks in defense activity. If it is desirable, a more exhaustive study of this can be made.

Other essential uses of trucks

The vehicles coming under the category of nondefense are, of course, largely going to the farmer, the grocer, the baker, the dairy, and practically every line of business. The question that this poses is whether or not the limitations on the number of vehicles will disrupt the orderly supply of essential commodities to the consumer and, as well, have an adverse effect on the cost of transportation. In other words, even outside of the strictly military and defense vehicles sold to civilians for defense, it might be desirable to weigh the over-all problem to determine whether the consumer should be deprived of sufficient transportation service, or whether, in the early stages of the curtailment program, there are other quarters in which the materials might be conserved without cutting down on transportation which is so vital to the defense program itself, as well as to civilian morale.

In illustration of the vital role of truck transportation, it is pertinent to point out that statistics compiled by the United States Department of Agriculture show that 62 percent of the cattle, 68 percent of the hogs, 61 percent of the calves, 65 percent of poultry, 39 percent of the eggs, 40 percent of the fruits and vegetables, 27 percent of the butter, and nearly 100 percent of the milk shipped to leading markets is hauled by motortrucks. Essential uses of trucks in practically all other civilian lines of business can be cited.

Another consideration that enters into this truck problem is the recognition by the President, by the Public Roads Administration, by the War Department and by the defense authorities of the need for an extensive highway program to improve strategic and access roads and bridges as an essential to the defense program. It would seem just as important as having adequate highway facilities to be certain that there are adequate vehicles to perform the transportation services over those highways.

Truck industry move to conserve materials

The motortruck industry has been keenly aware, over a period of months, of the gigantic task of so many ramifications that confronts the Office of Production Management, and it is the desire of the industry to cooperate in every way possible to lessen the magnitude of this task. Several days prior to the announcement with regard to the 20 percent curtailment, the manufacturers of motortrucks met in Detroit to consider the problems arising out of the shortage of materials and the procuring of essential parts for military, as well as civilian vehicles. At this meeting, it was agreed to survey the possibilities in the industry for conserving on the materials such as aluminum, nickel steel, brass, copper, zinc, and others on which it is understood there are critical shortages.

A questionnaire has been drafted (but has not as yet been released) to determine the minimum amounts of these materials that would be necessary to carry on the production of vehicles. This questionnaire is designed to determine how far critical materials can be conserved in the construction of a motortruck, and to seek engineering opinion as to how far substitutes are feasible from a production standpoint, giving due consideration to avoiding loss of time caused by retooling, even if machine tools were available.

If the industry is right in its thinking that this information will be valuable to the Office of Production Management, we should be glad to carry through with this survey which has been temporarily postponed in view of Office of Production Management's desire to save materials by cutting the number of vehicles produced.

In any event, a committee of engineers, versed in the technical problems arising out of conservation of strategic and critical materials, has been appointed by the Automobile Manufacturers Association motortruck committee and is available for consultation with Office of Production Management staff members, if desired.

Summary

In conclusion, the industry wishes to call particular attention to the following points on the transportation-for-defense aspects of motortrucks:

Existing and ever-increasing production of military vehicles and other armaments in motortruck plants has already been limiting the ability of the truck producers to meet civilian demands.

At the same time, speeding of production for defense is placing added demands on the flexible service that is rendered more efficiently by motortrucks.

Twenty-two percent of outgoing tonnage of plants producing defense matériel is moved by trucks. A 10-percent increase is anticipated within the next 6 months. This indicates that trucks are handling an even greater proportion of the defense traffic than of normal traffic.

Until a more comprehensive and impartial review is made to determine the adequacy of existing transportation facilities to meet the defense requirements, severing of the supply line may have an adverse effect on transportation for defense through lack of enough facilities.

While data show a substantial portion of truck output used for defense purposes, this is not the complete picture of the functions of trucks in facilitating the defense program since the data presented does not include movement of foodstuffs, clothing, and other goods necessary to the life, health, and well being of the millions of Americans engaged in defense activities.

Break down in railroad service during 1918 caused trucks, from a prority standpoint, to be considered in the same category as utilities and essentials.

The industry sees further possibilities for conservation of strategic and critical materials by use of substitutes and this is now under study.

The motortruck manufacturers again desire to emphasize their position that defense requirements must come first.

We only raise the question as transportation men, as to how far curtailment of motortruck production may be carried without impairing total defense output through disruption of transportation service.

Respectfully submitted in behalf of the motortruck manufacturers.

ROBERT F. BLACK,
Chairman, Motortruck Committee,
Automobile Manufacturers Association.

APRIL 24, 1941.

STATEMENT OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION CONCERNING EXCISE TAXES ON AUTOMOTIVE PRODUCTS

By NATIONAL AUTOMOBILE DEALERS ASSOCIATION, Washington, D. C.

National Automobile Dealers Association has upward of 17,000 members, each of whom is enfranchised by a manufacturer of automobiles to sell new automobiles, or automobiles and trucks, replacement parts, and accessories. The members of this association sell about 85 percent of all new automobiles sold in the United States. Through the 17,000 dealers who are direct members and by reason of the cooperation of local and State automobile dealer associations, this association speaks for all automobile dealers who are articulate through organization.

While the revenue act of 1941 was being considered by the Ways and Means Committee of the House of Representatives the Treasury Department recommended to that committee that the excise taxes on new automobiles be increased from 3½ to 7 percent. Other witnesses representing other agencies of the Federal Government recommended to that committee increasing the excise taxes on new automobiles to 20 percent or more. Not, however, for the purpose of raising revenue but for the purpose of dampening consumer demand for new automobiles which would thereby result in a curtailment of production of these articles.

This association by proper action of its members assembled in convention established as the policy of this association the determination to aid and assist in the defense program. Pursuant to this policy and by reason of the extraordinary suggestions made to the Ways and Means Committee, L. Clare Cargile, president of the association, pursuant to instructions of the executive committee, appeared before the House Ways and Means Committee setting forth the basic policy of this association to aid in the defense program, and by reason of the conviction that the maintenance of private automobile transportation is essential to the defense program, opposed the suggestions for high punitive and discriminatory taxes on automobiles, trucks, replacement parts, and accessories.

This association was gratified by the report of the Ways and Means Committee and its subsequent acceptance in the action of the House of Representatives with reference to the matter of excise taxes on automotive products. While this action called for a 100-percent increase in these taxes, which is

drastic, and places a real burden on the industry, nevertheless automobile dealers were willing to assume this burden pursuant to their determination of assisting in and sacrificing for the defense program.

The position of this association and the automobile dealers for whom it speaks in relation to the considerations of these matters by the Senate Finance Committee is unlike that in reference to the Ways and Means Committee hearings in that no specific proposals to further increases these taxes have been made before this committee. If such proposals are made, we must assume that they will be made in executive sessions of this committee, under which circumstances this association will have no opportunity to counsel with the committee on the necessity or propriety of such proposals. We, therefore, are filing this statement to reiterate and reemphasize the basic positions established before the Ways and Means Committee.

We wished to point out to the committee that the considerations recited by the witnesses before the Ways and Means Committee to justify extremely high excise taxes on automotive products, no longer need be considered as essential in the tax program. These considerations were to curtail production of consumer durable goods, to dampen consumer demand thereby creating a backlog of consumer demand for the post-defense period, and to prevent inflation. The curtailment of new automobile production has been provided for through the joint action of Office of Production Management and the Office of Price Administration and Civilian Supply in the order issued on August 21, 1941. This order provided allotments for the months of August, September, October, and November 1941, representing an average 26½-percent reduction and looking toward an average of 50-percent curtailment for the 1942-model year. In order to accomplish the 50-percent average it will be necessary to curtail new automobile production 74 percent during the latter months of the model year. This drastic curtailment removes the necessity of seeking that objective through high excise taxes.

Pursuant to the Executive order issued by the President on August 9, 1941, the Board of Governors of the Federal Reserve System, issued Regulation W on August 22, 1941, to become effective September 1, 1941, restricting the terms on which automobiles can be sold, whereby a minimum of one-third of the purchase price must be made as a down payment and the payment of the deferred balance must be made within a maximum of 18 months. All of the objectives urged by witnesses before the Ways and Means Committee for high excise taxes on automobiles were recited in the Executive order of the President as reasons for regulation of consumer credit and this regulation having been promulgated, there is no longer any necessity to seek to curb inflation or to dampen consumer demand through high excise taxes.

We think it important in levying taxes on the motorcar that its necessity uses be given careful consideration. Contrary to casual opinion, the passenger car nowadays is a luxury vehicle in only a minimum degree. Its necessity uses not only outnumber all others but, owing to new conditions brought about by defense work, they are constantly growing. Here follow official statistics, taken from the United States Census, Opinion Research Corporation, Public Roads Administration, and War and Agriculture Department records, indicating the manifold passenger-car necessity uses:

There are approximately 27,000,000 passenger automobiles in the United States, and practically all of them are devoted, in part at least, to necessity driving.

The necessity driving of the Nation is 274,000,000,000 passenger-miles annually. This is approximately three and one-half times the passenger mileage of all other types of transportation, including steam and electric railways, busses, and airplanes.

The largest percentage of necessity driving occurs in rural sections and small towns. The Bureau of the Census gives the rural population of the country as 57,245,753, and, with the exception of a few horse-and-buggy and bus-line patrons, all of these persons are dependent on the automobile for transportation. An additional 12,678,823 persons who live in 2,320 cities that do not have mass transportation facilities also are dependent on the automobile exclusively.

The farmer is hit especially hard by any increase in the cost of passenger automobiles. Thirty-eight percent of all the passenger automobiles of the Nation are on farms. The average age of these rurally owned cars is 7 years, so replacements during the next 2 years are bound to be large.

Six out of every 10 cars owned in the cities are usually driven to and from work. Twenty-five percent of cars owned by workers are utilized by their owners

for carrying other passengers to work. Many new defense plants are being built in sections which have no public transportation, and hence the workers must depend solely on automobiles for transit.

Believing that motorcar transportation always would be available, thousands of persons have bought homes in recent years away from electric railway and bus lines. The 1940 census shows that in 92 of the largest cities of the country since 1930 the unincorporated surrounding areas increased almost five times as rapidly as the population within the city limits.

The necessity uses of the motorcar are strikingly illustrated by United States Army figures. A year ago the Army possessed 29,867 motor vehicles. Today it has 153,000. The current program calls for 262,950 next year.

Although no specific recommendations have been made by witnesses before this committee but in the chance that the matter may come up during executive sessions, we wish to point out to the committee objections to the imposition of any excise taxes on used cars. A large part of the trading in and selling of used automobiles is done by used car dealers who are not organized, who are constantly shifting their places of operations, and who by the reason of the manner in which they conduct their businesses are difficult to regulate and are difficult to collect taxes from. This fact would make it very difficult for the appropriate authorities to collect such taxes, it would by reason of the evasion by a large number impose an unfair competitive burden on new-car dealers. Furthermore, in order to escape the tax there would be an incentive for individual car owners to attempt to sell their cars directly, which would divert used cars from the normal channels of trade, producing a disruptive effect and would seriously hamper enforcement of State regulations and the collection of State taxes. It is the firm conviction of this association that such a tax would be uncollectible.

In conclusion we wish to point out that we believe that excise taxes on automobiles, automobile parts and accessories, tires, tubes, batteries, and gasoline should not be a permanent part of the Federal tax structure, as all of these are essential to a vital form of transportation. However, recognizing that in this emergency excise taxes on these articles may be necessary for the additional revenue needed, such taxes must be borne. We believe that the rates adopted by the House of Representtives are the highest which in fairness should be imposed on these articles. Any higher taxes would be detrimental to the essential transportation of civilians and civilian goods, to the essential movement of military personnel and equipment, and too great a burden on a vital necessity would impair civilian morale.

We respectfully direct your attention to the statement made before the Ways and Means Committee on behalf of this association, as that statement being available we did not wish to burden this committee with a repetition thereof.

Respectfully submitted.

NATIONAL AUTOMOBILE DEALERS ASSOCIATION,
L. C. CARGILE, *President.*

STATEMENT BY JOHN T. BARNETT, DIRECTOR, INDEPENDENT PETROLEUM ASSOCIATION, DENVER, COLO.

Secretary Morgenthau, in his recent appearance before the Senate Finance Committee, stated:

"For years, the concerns engaged in extracting certain of our national resources, notably oil, have been granted far greater allowance for depletion than can be justified on any reasonable basis of tax equity, if the income tax is to be extended to lower incomes, this privilege of tax escape should simultaneously be removed."

In his statement the Secretary apparently admits that some depletion allowance should be recognized for concerns engaged in producing what he terms our "national resources," notably oil. His criticism goes only to the amount of the allowance. It is a little difficult to understand why the Secretary designates oil as a national resource any more than he would designate our manpower, our farms, or our factories. To me they are all in the same sense national resources. However, there is one difference in these national resources which the Secretary fails to mention; that is, the oil and other mineral resources of the Nation are what has been termed and recognized as exhaustible resources for the reason that all of them, and especially oil, when employed in the uses of industry or national defense, are totally exhausted by such use, whereas the same is not true of the other national resources mentioned above.

Ever since the principle of the income tax was adopted and applied in this country it has been the settled policy of Congress and of the Treasury Department to recognize this difference in the character of our national resources and to compensate for the inevitable exhaustion of them by granting to the owners thereof specified depletion allowances to enable such owners and operators, by the expenditure of the reserves made possible by such depletion allowance, to prospect and search for similar additional resources and thus partially at least to replace those exhausted by use.

That policy having been adopted presumably upon a sound and equitable basis, there is every reason for its continuance. As no one, not even the Secretary, has denied the soundness, or justice, or equity of that underlying basis, I think it may be assumed that some allowance for depletion is justified.

The depletion percentage originally allowed, I believe, was 50 percent, but was reduced and now is, and for a number of years last past has been, 27½ percent, with the limitation that in no event should it exceed 50 percent of the net income from the property.

There has been some talk at different sessions of Congress of limiting the amount of depletion to the basis of actual cost of the particular property producing the oil, and much argument has been made by various persons for the adoption of such a principle. These arguments have always been rejected by Congress, and quite properly so, for the very good reason that the over-all cost to any oil producer of building up a spread of oil properties capable of yielding production for a period of years has very little, if any, relation to the cost of the individual pieces of property which happen to yield oil in any 1 year. The true relationship between depletion and cost must be referred to cost in a broad and general sense—that is, in the sense of what it would cost to replace by new discoveries and development the oil fields as a group being exhausted by use. There is no one who knows anything about that phase of the oil industry who would claim that such replacement can be had for the amount of the tax saved by a 27½-percent depletion allowance.

This subject has been so completely covered heretofore in arguments made before the Ways and Means Committee of the House and the Senate Finance Committee by representatives of the Independent Petroleum Association, individual owners and operators, and others that it would seem not to be necessary to repeat or to reargue the fundamentals of the question.

I desire, however, in connection with the consideration of this problem, to point out to the taxing authorities of the Nation some facts which I fear they have not fully considered:

First. The oil industry, as a whole, has been and is continuing to be a great source of income to the National Treasury, not only through the payment of income taxes by those concerns engaged in the industry, but by the tax that is levied by the Government upon the gasoline and any other residual products derived from the crude oil. The combined sums collected by the Government in the form of taxes on the industry have been of staggering amounts, and this new tax bill will undoubtedly increase the gasoline tax and raise the percentage of tax on corporations and other producers of oil until even greater amounts will be paid.

Second. If for any reason new supplies of oil are not sought out and provided by the industry to take the place of the reserves annually exhausted, not only will the industries of the Nation and national defense suffer, but the Treasury Department itself will suffer a severe decline in the income now being derived by it from the oil industry.

Third. If, as is undoubtedly true, and as the oil industry maintains, the 27½-percent depletion allowance is a tremendously vital and important factor in replacing the supply of oil annually exhausted, that fact should be frankly recognized by the Treasury Department and it should long hesitate and carefully consider the disallowance of depletion. The Treasury itself, in such event, would probably be the greatest income loser.

As the hump on the camel is the reserve that provides the camel with the necessity of food and drink over lean and exhausting periods, so the 27½-percent depletion allowance provides the hump on the oil industry and enables it, as a whole to meet otherwise exhaustive periods of inadequate supply of oil.

ALVORD & ALVORD,
Washington, D. C., August 25, 1941.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

Re radio-broadcasting tax.

DEAR MR. CHAIRMAN: On August 21 there was submitted to your committee, on behalf of Mr. John B. Haggerty (chairman, board of governors, International Allied Printing Trades Association, and president, International Brotherhood of Bookbinders), a statement in support of title VI of the pending bill (H. R. 5417), and recommending a 100-percent increase in the radio-broadcasting tax provided for by that title. While my oral testimony before the committee (hearings, pp. 676-681), together with the written memorandum which I submitted for the record (hearings, pp. 681-689), constitutes an adequate reply to the arguments presented by Mr. Haggerty, his statement contains certain erroneous statements which require correction.

(1) *Need for revenue.*—Mr. Haggerty's first argument is that the revenue needs justify the imposition of a special tax on radio broadcasting, at double the rates proposed by the House. The simple answer to this argument is that the revenue needs can never be great enough to excuse an unjust, discriminatory tax.

(2) *Return on investment.*—Mr. Haggerty next revives the specious argument that the tax is justified because radio broadcasters earn large profits on the investment in, or "value" of, their physical property. He speaks as though the only outlay required were the cost of a moderate amount of technical equipment. He completely neglects the need for operating capital, the certainty of early losses, the constant hazards of the business, and the necessity for plowing back earnings in order to maintain efficient service. In any event, capital is only one of many income-producing factors. As this committee has repeatedly recognized, such factors as individual ability and initiative deserve equal encouragement.

(3) *Entertainment.*—In attempting to justify his position, Mr. Haggerty overemphasizes the entertainment aspects of radio. Radio broadcasting is, as Mr. Haggerty says, the principal source of entertainment in America today. That entertainment, incidentally, comes to the public whether or not it can afford to pay for it, the cost being borne by the advertiser. Of far greater importance, however, is the fact that radio broadcasting is also the principal source of information in America today. In the latter respect, radio performs a unique and vital public service.

(4) *Monopoly.*—Mr. Haggerty once again puts forward the argument that the radio-broadcasting industry's alleged monopoly, based upon a public franchise, justifies the tax. It has already been pointed out to this committee that no broadcaster has a monopoly of the listening public and that radio has no monopoly of advertising media. Furthermore, the necessity for regulation, far from justifying the proposed tax, does not even justify a tax based upon the costs of regulation, unless a similar tax is imposed at the same time upon all businesses regulated by the Federal Government. The imposition of such taxes would require the reversal of a long-standing national policy.

In an effort to demonstrate that the opposition of advertising agencies is founded solely upon a desire to protect a monopolistic source of unconscionable profits. Mr. Haggerty asserts that newspapers and magazines pay a 15-percent commission to advertising agencies for securing advertising, but that radio broadcasters "pay rebates and discounts as well as agency commissions ranging from 36 percent upward." He alleges that these discounts line the pockets of the advertising agencies and cites as his authority, first, a letter from Frank K. White, treasurer of the Columbia Broadcasting System, to Editor and Publisher, and, second, the National Broadcasting Co. red network 1941 published rate card.

Curiously enough, Mr. White's letter, published in the May 3, 1941, issue of Editor and Publisher, specifically states that the standard 15-percent commission is allowed to recognized advertising agencies and carefully explains that discounts, which he states "correspond generally to the frequency and space allowances which are made to advertisers by magazines and newspapers," are passed along "to the advertisers (and not to the agencies)."

Similarly, Mr. Haggerty purports to quote the National Broadcasting Co. published rate card as indicating that large discounts are allowed to advertising agencies. His supposed quotation contains words which would prove his point if they apepared on the rate card, but the fact is that they do not appear there. Wherever the word "advertiser" appears on the rate card, Mr. Haggerty has

inserted, after that word, the phrase "(advertising agency)," so that his purported quotation is not a quotation at all.

As Mr. White's letter indicates, the discounts and rebates allowed by radio broadcasters correspond generally to the frequency and space discounts allowed by other advertising media. They are mere volume discounts, inducing the advertiser to maintain his advertising throughout the year. In the case of radio, they tend to maintain program continuity, an obviously salutary result.

(4) *Wage earners' interest.*—Finally, Mr. Haggerty attempts to belittle the stake the wage earner has in radio. Here again, he disregards the facts. The radio-broadcasting industry has at least 22,000 full-time employees. Its annual pay roll is about $60,000,000, or well over $1,100,000 weekly. The average weekly pay check in the industry is one of the highest in the country, and is becoming higher every year. In addition to full-time employees, about 30,000 more are employed on a part-time basis. Perhaps 250,000 more are employed in the manufacturing and distributing fields. Mr. Haggerty is not specific in his claims of a loss of job opportunities in the printing trades. In view of the increase in recent years in the aggregate circulation of both newspapers and magazines, it is at least doubtful whether he could be specific.

Mr. Haggerty fails to present a single valid argument in favor of the proposed tax. The fact of the matter is that the tax is being urged not because it will produce revenue, not because it is a sound tax measure, but solely in the hope that it will hamper the normal operation of competition between various advertising media. The use of the taxing power for this purpose cannot conceivably be justified. For labor as a whole, and even for the printing trades alone, it would be a short-sighted policy. The stimulation of competition by the development of new industries does not destroy job opportunities, it creates them. In this connection, Mr. W. C. Hushing, chairman of the legislative committee of the American Federation of Labor, had this to say to this committee:

"This is not a new question to us by any means. In the middle 1890's there was another new industry coming into existence and in one of the central labor unions on the west coast, which was located in the largest west coast city, there was an organization which came in with a proposal that no member of the organization, of organized labor, ride in an automobile, even to a funeral, and the motion was adopted. This proposal here is on all-fours with and is made for the same reason that that motion was passed through that central body over 45 years ago; and in the future you will probably look back on this proposal in the same manner that you do on the one which I have just mentioned.

* * * * * * *

"This proposal in this bill could well have been made against electric lights, because they put the manufacturers of oil lamps out of business, or could have been made by the candlemakers with the same force when the oil lamp came into use." (Hearings, August 23.)

I shall appreciate it if this letter can be incorporated in the record of the hearings.

Respectfully,

ELLSWORTH ALVORD,
Attorney for National Association of Broadcasters.

THE NATIONAL CLUB OF AMERICA FOR AMERICANS, INC.,
Washington, D. C., August 21, 1941.

Senator WALTER F. GEORGE,
Chairman, Finance Committee,
Senate Office Building, Washington, D. C.

HONORABLE SIR: As your committee is now holding public hearings on the Revenue Act of 1941, known as H. R. 5417, I desire on behalf of the National Club of America for Americans, Inc., under the laws of California, to submit a few suggestions for consideration of your committee, that will uphold the Federal Constitution, reduce the legal cost of government, and will prepare the way for anticipated saving in conducting the Government, also reduce the labor and worries of the Members of Congress in raising taxes to run the Government.

1. Strike out the unconstitutional provisions of the national social security law that allows the Federal and State Governments to illegally pay out the

public's money in relief to aliens in all the States, and some of the States old-age pensions to aliens.

In a letter addressed to me from the Social Security Board under the date of February 26, 1936, the Board admits that the national Social Security Act grants old-age pensions to aliens. I quote part of that letter:

"The States are to decide whether or not noncitizens are eligible to old-age assistance, and nearly all State laws now make citizenship a condition for eligibility to old-age assistance."

In order that the committee may know the estimated amount of public money which is illegally going to aliens. I suggest you request the Social Security Board to furnish the following information: First column, the name of each State and our possessions; second column, number of aliens drawing old-age pensions; third column, estimated amount of Federal money for 1 year going in pensions to aliens; fourth column, number of aliens drawing relief; fifth column, estimated amount of Federal money for 1 year going to aliens for relief; sixth, grand total for each State and a grand total for all the States and our possessions. Have this data placed in the record.

I contend that the Social Security Board's paying public money for old-age pensions and relief to aliens is unconstitutional as it is contrary to the fourteenth amendment to the Federal Constitution, which reads as follows:

"All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any protection of the laws."

I call your attention to this fact, that when you deny old-age pensions, or deny relief to aliens you do not deprive the alien of equal protection of the laws for they still receive police and fire protection the same as a citizen, nor do you deny the alien life, liberty, or prosperity, for you are not taking the alien's life, nor do you take the alien's liberty away from him, nor do you take any property away from the alien, but, in granting old-age pensions and relief to aliens, you abridge the privileges and the immunities of the American citizens.

I trust Congress will lose no time in amending the national social security law so that the law will free the American citizens from the illegal burden of being taxed to give relief and old-age pensions to aliens.

Further anticipated cut in cost of government can be secured by at once amending our immigration laws in order to guarantee to Congress and the American citizens that an immigrant will not become a public charge or an immigrant violator of our laws be undeportable to his own country by adding the following to our immigration laws.

"And in the event such immigrant does become a public charge, or violates our laws, such immigrant shall be at once returned to the country from whence he came or to such country of which he is a citizen."

Pass such a law and you will not need any deportation treaty with any country.

Further suggestion that will save money to the taxpayers, reduce the cost of crime, give greater protection to United States, also give greater security to the old American citizens, by passing the following legislation:

"Set up the machinery for the registration and fingerprinting of both American citizens and aliens. It would cause alien criminals and aliens illegally in United States to leave the country in a hurry; also would prevent any alien from illegally entering United States, a real defense act. It also would reduce the cost of crime in the United States, would mean more employment for American citizens; and Congress can anticipate a further saving in the cost of government by passing a national old-age pension to American citizens, as all registration data on citizens and aliens would be in Washington. Provide a provision in the Federal pension law that the old American citizens could file their application for an old-age pension in their local post office and then mail their application to Washington. When the pension had been granted a Federal check could be mailed to the old-age citizen wherever he might live. This plan would mean an army of social-service workers and the expense—of their office could be dispensed with in every State. The Federal old-age pension should be the same to all American citizens who reach the required age, regardless of what State they live in or whether they are rich or poor."

For your information I am attaching hereto the full letter from the Social Security Board in reference to matters contained in my letter.

Sincerely yours,

ROYAL C. STEPHENS, *President.*

SOCIAL SECURITY BOARD,
Washington, D. C., February 26, 1936.

Mr. ROYAL C. STEPHENS,
1235 First Avenue, San Diego, Calif.

DEAR MR. STEPHENS: The President has referred to us your letter of December 18, in which you comment on the Social Security Act.

You are not quite correct in your interpretation of title I of the act. The States are to decide whether or not noncitizens are eligible to old-age assistance, and nearly all State laws now make citizenship a condition for eligibility to old-age assistance.

Another point on which we wish to correct your statement is that the selection of the officers to administer the old-age assistance laws is left entirely to the States themselves. The Social Security Board has no power to selection or appointment of administrative officers in the States.

Very truly yours,

(Signed) ROBERT HUSE,
Assistant Director,
Bureau of Informational Service.

NATIONAL DEFENSE,
Arcadia, Calif., August 22, 1941.

Hon. Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: If you will kindly refer to page 1326 of the hearings on the revenue bill before the Ways and Means Committee, you will find there, more fully expressed than I can express in this letter, the views of the retired enlisted men of the Army regarding the proposed tax bill now under consideration by your committee.

I would appreciate it if you would read this letter to the members of your committee and incorporate it in your hearings as a protest against the lowering of the income-tax exemption.

If any lowering or changes in the income-tax laws are approved by your committee, may I call your attention to the following fact, which can be verified from the official records, to wit: Retired enlisted men of the armed forces who receive even less than $50 per month retired pay, in which amount is included their allowances, are required to pay income tax on the $15.75 which they receive for quarters, fuel, food, and clothing, while, at the same time, officers in the active service who receive as much as $156 per month for quarters, fuel, subsistence, etc., pay absolutely no income tax on this $156 per month which they receive.

It is unfair, gentlemen of the committee, to tax an enlisted man for the $15.75 which he receives for these necessities, while officers in the active service who receive virtually 10 times more than do the enlisted men pay no income tax on this $156.

It is accordingly requested that your committee write a provision in the tax law to provide that the amount of money which retired enlisted men of the armed services receive in cash as commutation for quarters, fuel, subsistence, clothing, and so forth, be hereafter tax exempt; or, if this is not done, that a provision be written in the law forcing officers in the active service who receive up to $156 per month for similar benefits, be required to pay income tax.

In all fairness we ask, why should the retired enlisted man who does not receive sufficient to live, be forced to pay an income tax on his allowances; while officers who receive up to $808 per month (pay and allowances) pay absolutely no income tax on $156 per month allowances which they receive?

I inclose herewith a clipping which shows that the State of New York has exempted officers of the Army from paying income tax on their allowances; but no exemption has been made by the State of New York in regard to the allowances received by our aged, disabled, and retired enlisted men.

To recapitulate: Either retired enlisted men should be freed from paying an income tax on the $15.75 which they receive for quarters, clothing, and sub-

sistence, or officers of the Regular Service drawing 10 times more, should be required to pay on parity with that of retired enlisted men.

We reiterate our former statement that it is unfair to lower the income tax exemptions on our citizens, for the Government records prove that less than $2,400 per annum is not a sufficient income for a family of four; therefore, to lower the income tax exemptions for single men to $750 and married persons to $1,500, lowers their living standards and contributes very little to the aggregate tax revenue.

As shown in the hearings before the Ways and Means Committee, the Congress is destroying private initiative and free enterprise when they take from persons in the lower income categories their own right to spend their earnings (through a lowering of income tax exemptions) when the Government takes this same money from the lower income groups and spends it in unnecessary Government activities.

I do not believe that you and the members of your committee desire to stifle and destroy private enterprise, which you will be doing if you lower income tax exemptions.

I enclose herewith a page from our September issue, and would appreciate it if you would consider the proposals we advance here in connection with your tax measure.

Thanking you for your favorable consideration, and with best wishes, I am

Sincerely yours,

J. H. HOEPPEL.

WASHINGTON, D. C., *August 26, 1941.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SIR: May I take the liberty of calling your attention to what seems to us a very misleading impression made by Mr. John B. Haggerty, chairman of the International Allied Printing Trades Association, in a brief he submitted to the Senate Finance Committee, August 21, 1941, advocating a special tax on radio broadcasting commercial revenues, recorded on pages 1140 and 1141 of the report of hearings. In this brief he said:

"Another group that opposes the proposed tax consists of the advertising agencies. These, too, have a reason for complaint that is not hard to understand. The commission paid by newspapers and magazines for securing advertising is 15 percent. Network broadcasters and many of the larger radio stations can and do pay rebates and discounts, as well as agency commissions ranging from 36 percent upward."

And again:

"Having in mind that the advertising agencies receive some 36 percent from radio broadcasting companies, as admitted by the treasurer of the Columbia (which does not advertise special discounts or rebates), as compared with only 15 percent from printed publications for placement of advertising, it might be well for the committee to look over the National Broadcasting Co. billings of those advertising agencies whose billings exceeded $1,500,000 in 1940."

The impression made is that advertising agencies receive 36 percent as compensation for themselves, including the regular agency commission of 15 percent. This is quite untrue. And the inference is also drawn by Mr. Haggerty that—

"Little wonder the advertising agencies are concerned about a tax on radio broadcasters."

This is entirely out of keeping with the facts. The agency receives no other compensation from radio broadcasters than the same standard rate of 15 percent on the net which is allowed by magazines and newspapers.

There is no financial incentive whatever to prefer radio to publications. They are both used impartially by the agency as and when needed to reach a given market or solve a given advertising problem for the client.

The 15 percent is not allowed to agencies for "securing advertising," but for making it productive of sales results to clients, and out of this 15 percent the agency earns a net profit averaging 1.7 percent, according to our figures for the year 1940.

The other discounts and rebates referred to do not belong to the agency. They belong to the client, whom the agency merely represents. There is nothing "generous" about them. They are simply an inducement to the advertiser to make

a steady weekly use of broadcasting and to continue it for at least a year. Newspapers use the same device, more or less, for the same reason.

Will you be good enough to include this letter in the record?

Respectfully,

AMERICAN ASSOCIATION ADVERTISING AGENCIES,
JOHN BENSON, *President.*

BRIEF ON BEHALF OF THE BEAUTY AND BARBER SUPPLY INSTITUTE, INC., OF NEW YORK, N. Y., WITH RELATION TO PASSAGE IN ITS PRESENT FORM OF SECTION 2402 OF THE PROPOSED REVENUE BILL OF 1941

To the honorable the Chairman and Gentlemen of the Senate Finance Committee of the United States:

In the matter of H. R. 5417, revenue bill of 1941.

A. PRELIMINARY

I. The petition

This brief is submitted respectfully to induce the Senate Finance Committee to adopt and the Senate to pass section 2402 of H. R. 5417, the revenue bill of 1941, in the same form as that section was passed by the House of Representatives.

II. Section 2402

As passed by the House of Representatives, section 2402 (a) of H. R. 5417 levies a retail excise tax of 10 percent on all toilet preparations and section 2402 (b), which is the immediate concern of this brief, provides that the tax imposed by the previous subsection shall be based upon the total amount of toilet preparations used during any month by the beauty shop, barber shop, or similar establishment, and the total amount so used shall be considered as sold at retail, the tax to be based upon the fair retail price of the amount of toilet preparations so sold, as such price shall be determined by the Commissioner of Internal Revenue. Section 2402 (b) as passed by the House reads as follows:

"SEC. 2402. (b) For the purposes of subsection (a), if any person operating a barber shop, beauty shop, or similar establishment, uses any article described in subsection (a) in the treatment of any customer or patron, the total amount so used during any month shall be considered as sold at retail by such person during such month, and the fair retail price of such amount, as determined by the Commissioner, shall be considered to be the price at which so sold."

III. The purpose of this brief

The undersigned believes that the tax as imposed by section 2402 of H. R. 5417 creates an equitable tax which will present no enormous difficulties in collection and will so far increase the revenues to be obtained by the Federal Government as to make any additional difficulties involved in its collection minimal. This brief is further dedicated to the proposition that to change this tax into a manufacturer's excise tax or to require that the manufacturer or distributor be made the agency for the collection of this tax would create great inequalities, would impose upon the manufacturers a burden which should properly belong to the barber shop and the beauty shop and would reduce the revenues most necessary at this period of national defense to an amount far below that which would be yielded by the passage of the bill as it now stands.

B. ARGUMENT

IV. The beauty and barber shops which would be required to pay the tax in section 2402 of the proposed bill would not suffer as a result of such taxation

1. It is, of course, a matter of common knowledge that the many thousands of beauty and barber shops throughout the country are more or less one- or two-man establishments operated in the main as unincorporated businesses, or at the most as partnerships. These business establishments, it is commonly realized, do not and have not for many years maintained a strict system of account-

ing. As a matter of fact, it is true that such organizations are extremely haphazard in keeping books and in maintaining records.

The effect of this haphazard nature of doing business is to deprive the Federal and State Governments of a large source of revenue which they might otherwise realize. Moreover, this indifferent way of keeping books and record creates an inequality which results to the favor of the beauty and barber shops and to the detriment of such other retail organizations as chain groceries, clothing stores, and the like. The imposition of the present tax upon the beauty and barber shops and the requirement that they make the necessary monthly returns would as a matter of course require a stricter method of accounting and a strict attention to the keeping of books and records which would redound to the benefit of the State and Federal Governments not only in the matter of this excise tax here under consideration, but also to the general question of income taxes which could not be evaded if a strict system of bookkeeping were maintained.

2. In addition to the fact that the imposition of the presently proposed tax would in a financial way be beneficial to the various taxing units involved, it should be pointed out that the present state of national emergency creates a patriotic duty to which the beauty and barber shop must respond as have all other units of the national economy. The mere fact that the beauty shop and the barber shop is a small unit of the total national economy, when taken singly, is no measure of the real importance of the beauty and the barber shop when regarded as a whole and as part of the Nation's business. It is a matter of common knowledge again that many hundreds of millions of dollars are yearly spent in these shops throughout the Nation and thus far these organizations have escaped the direct taxation which has been imposed on other types of businesses lacking the over-all gross income of this line of business.

V. Revenue

Two other methods of imposing this tax are feasible apart from that proposed by section 2402 as it presently stands.

A manufacturer's excise tax on toilet preparations might be imposed which would be similar to the tax now existing under the Internal Revenue Code. Such a tax would then be payable by the manufacturer and based upon his selling price. This tax at 10 percent would yield no more than is presently being yielded by the tax now on the statute books and consequently reenactment of such a tax would not only defeat the purpose of Congress in revising the revenue bill, but would in addition lighten the burden of the manufacturer when compared with the new burdens being imposed on other manufacturers in other lines of business.

The second alternative for section 2402 in the proposed bill is to make the manufacturer the agent for the collection of the retailer's excise tax and require the manufacturer to pay the tax and collect from the retailer. Such an alternative errs on the other extreme. It imposes burdens upon the manufacturer which he should not be asked to assume. It makes the manufacturer bear a proportion of tax far beyond that which other manufacturers in other lines of businesses are being asked to pay. It requires the manufacturer to make a cash outlay month by month which would go far in many instances toward making it impossible for the manufacturer adequately to function.

To illustrate the unfair and inequitable burdens which such a substitute for the present section 2402 would create, the following example may be used.

Suppose that the manufacturer makes a bottle of tonic which the beauty or barber shop would sell or use and which the Commissioner of Internal Revenue might decide had a fair retail price of $1. The cost to the manufacturer of this item is 35 cents, and his selling price to the wholesaler is 45 cents. If the manufacturer were to be required to collect and pay the 10-percent retailers' excise tax based on the fair retail price as established by the Commissioner, the manufacturer would have to pay to the Federal Government on this item which costs him 35 cents a tax of 10 cents which would be an approximate increase of 33⅓ percent over the manufacturer's own manufacturing cost. This increase of 33⅓ percent would have to be paid monthly by the manufacturer to the Government and in many instances such payment would have to be made prior to the actual collection by the manufacturers of this amount. The manufacturer would thereby have perforce to make an additional investment in his produce of 33⅓ percent which would in many instances prove uncollectible and in all instances prove a great burden since

the manufacturer in the industry has not and has never had to any great extent direct contact with the retailer.

It should also be pointed out that the imposition of the tax on the manufacturer directly or as agent of the retailer would in every instance result in a greater burden upon the public because, in the natural process of distribution, were the manufacturer to pay the tax, the wholesaler and the retailer would pass the tax on to the public and not in the exact amount by which it has been imposed upon the manufacturer but in larger sums. On the other hand, if the retail beauty and barber shops were to be required to pay the tax as they will be so required under the terms of section 2402 as it now stands, the retailer will pass this tax on to the public in the exact amount which the retailer is required to pay.

VI. Collection

1. The argument has been advanced from many quarters that to impose a tax upon the beauty and barber shops such as that proposed in section 2402 would be to create a problem of collection which would be burdensome to the Internal Revenue Department and excessive in cost. This argument ignores the remarks made in IV above, and it further ignores the fact that the increase of revenue to be expected from such a tax would more than offset any increased cost to the Internal Revenue Department in the collection of such a tax. Furthermore, it should be remembered that the tax as proposed in section 2402 will be administered by the Commissioner of Internal Revenue and that it is perfectly feasible for the Commissioner to issue regulations which will so facilitate the collection of this tax by standardizing the methods of making returns and simplifynig the forms upon which returns are to be made, that it is extremely doubtful that the collection of the tax from the beauty and barber shops will be more expensive in any way than the collection of the tax from the manufacturers.

2. Another argument which has been employed by those who advocate a revision of proposed section 2402 is that the tax as there imposed will provide many opportunities and possibilities for evasion. The mere statement of this argument is its own refutation. Our own Internal Revenue laws have since 1916 afforded many opportunities of evasion, but the sound administration of these laws by the Internal Revenue Department and Congress' vigilance have closed up the gaps where such opportunities lie with the result that the opportunities which now exist for evasion are small, if they actually exist at all.

C. CONCLUSION

VII. Revenue bill of 1941 (H. R. 5417) section 2402 should be recommended to the Senate by the Senate Finance Committee and should be passed by the Senate as it presently stands

Because of the arguments advanced above, the honorable chairman and gentlemen of the Senate Finance Committee, Senate of the United States, are respectfully urged to direct their attention to the admirable provisions of section 2402 of the revenue bill of 1941 (H. R. 5417) and to recommend to the full body of the Senate that this section of the new revenue bill be passed as it presently stands, since such a tax would be fair and equitable, would call into play the legal and patriotic duties of a large segment of this Nation's business, would not prove unduly difficult in its administration, would create no striking possibilities of evasion, and would, most importantly, yield far larger revenues than any alternative which has been suggested without at the same time unfairly burdening any other group in the industry.

Respectfully submitted.

BEAUTY AND BARBER SUPPLY INSTITUTE, INC.,
By JOSEPH BYRNE, *Secretary.*
WALTER C. B. SCHLESINGER, *Counsel.*

(Thereupon, at 1:15 p. m., the hearing concluded.)

(The following statement and memoranda were subsequently submitted by Senator Connally:)

STATEMENT OF HON. TOM CONNALLY, UNITED STATES SENATOR FROM THE STATE OF TEXAS

Mr. Chairman, I would like to present a memorandum regarding the Finance Committee's action proposing to disregard the community-property system of legal and beneficial ownership of income and property.

The hasty action of the Senate Finance Committee in adopting an amendment directed at the community-property system of marital property is unfair, unwise, and illegal.

1. It is unfair, because the community-property States, while perfectly willing to rely on the presentation made on the House floor with respect to the universal mandatory joint return, had no notice whatever of any prospect that the Finance Committee would abandon that proposal and in effect single out the community-property States for discriminatory taxation.

Indeed the Assistant Secretary of the Treasury, Mr. Sullivan, specifically testified before the Ways and Means Committee as follows:

Mr. REED. I was just wondering how much consideration you have given to this complexing problem that has faced the committee for a long time, known as community-property taxes.

Mr. SULLIVAN. I think that later in the year there will be a bill in here containing many revisions to the code. I thought that that might be a more appropriate place to consider that question than in this bill.

Mr. REED. I say, have you been considering that question of the amount of revenue that it will produce?

Mr. SULLIVAN. Yes, sir.

Mr. REED. About how much revenue do you figure that you might gain?

Mr. SULLIVAN. I will get that figure for you.

Mr. REED. Will you put that in the record?

Mr. SULLIVAN. Yes; I will.

(The estimate referred to follows:)

Estimated increase in individual income taxes under the suggested Treasury surtax schedule if taxpayers in community-property States are required to allocate community-property income to its actual recipient

	Millions of dollars
Income tax	13.8
Defense tax	1.2
Total	15.0

Certainly this statement amounts to an admission that the bill expected later this session is "a more appropriate" place for consideration of the community-property question. Certainly community-property States Representatives were led to believe that the question would be considered on its own merits in this later bill and that they would then have opportunity for full hearing. Certainly the present last-minute action of the Finance Committee has taken unfair advantage of them, and the committee should reverse its action and permit the question to come up for hearing in connection with the later bill.

2. The action is unwise because it means that for revenues which amount to less than $15,000,000 on the high Treasury surtaxes, the passage of the revenue bill including the excise taxes will be indefinitely delayed.

The intense feeling in the community-property States regarding their system of marital property may be difficult for common-law States to understand, but it is there nevertheless; and the citizens of those States are as intent upon its preservation, and the recognition of its consequences, as they are upon the rights of free speech and liberty. The attempt to impose a different system or to ignore an actual constitutional and statutory scheme of marital property ownership in those States arouses the utmost resentment; and Senators and Representatives from those States have no alternative but to fight it to the last ditch. Long and arduous debate will plainly be involved, particularly in view of the lack of any public hearing by the committee on the subject. It is not unlikely that the Treasury will lose four or five times as much from the resulting delay in enacting the excise taxes as they will gain from this provision even if finally adopted.

3. The proposal to single out the citizens of community-property States to compel them to pay tax on income belonging to their spouses is certainly violative of due process under the fifth amendment to the Constitution.

The Supreme Court of the United States in a series of carefully prepared and presented cases held that one-half of the community income belonged to the husband and one-half to the wife, that it was actually owned by them in these proportions, and therefore taxable to them in such proportions (*Poe* v. *Seaborn*, 282 U. S. 101; *Hopkins* v. *Bacon*, 282 U. S. 122; *Bender* v. *Pfaff*, 282 U. S. 127; *Goodell* v. *Koch*, 282 U. S. 118). The sixteenth amendment gives Congress authority to tax income, but it does not give it authority to tax the income belonging to one person to another. Those incidents of ownership, legal and beneficial, established by State law have always been recognized as governing by the Federal courts and by Congress. The very incidents, legal and beneficial, of ownership by husband and wife in community income which the Supreme Court held made one-half of it taxable to the husband and one-half to the wife are also governing as to the power of Congress to tax one spouse with the income of the other.

None of the "grantor" cases, "trust" cases, or "income gift" cases has any bearing on this question. Indeed, it is to be noted that in interpreting exactly the same language of the revenue act under which the Supreme Court has held that the income of various trusts and transferred items were included in the grantor's and transferor's income the Supreme Court expressly decided that community income belonged and was taxable one-half to the husband and one-half to the wife.

In other words, the Supreme Court has drawn the line directly between unreal technical transfers attempting to avoid taxation of income to its real owner in these cases and the real incidents of ownership, legal and beneficial, to community-property spouses. The line thus drawn is valid constitutionally as well as for purposes of statutory construction.

These "grantor" "transferor" cases therefore give no support to the power of Congress to tax the husband or the wife with the income belonging to the spouse. Such action by a State was held unconstitutional in *Hoeper* v. *Tax Commission* (284 U. S. 206) as violative of the due-process clause of the fourteenth amendment. The same due-process clause is equally applicable to such action by Congress under

the due-process clause of the fifth amendment (*Heiner* v. *Donnan*, 285 U. S. 312).

The present action is more directly contrary to the holding in the *Hoeper case* than the joint-return proposal, for there can be no question of creating a family classification in eight States of the Union, nor is there a question of measuring the tax by a combined income. The proposal is to tax one person on income which the Supreme Court has held legally and beneficially belonged to another. This proposed action falls under the direct condemnation of the *Hoeper case* even as the joint committee counsel interprets it.

Of particular interest on the problem of community income are the comments by the ninth circuit court of appeals in *Graham* v. *Commissioner* (95 Fed. (2d) 174), decided March 4, 1938. The income involved was net community income of $82,577.64, derived from the professional architectural services of the petitioner's husband. The court said:

> Even though "earned income" were defined as income received as compensation for personal services actually rendered by the taxpayer, still petitioner's half of the above-mentioned community income would be within the definition. The Board found that said community income was received as compensation for professional services rendered by petitioner's husband. Respondent assumes, erroneously, that these services were rendered by petitioner's husband individually, on his own account and for himself alone, thus assuming as a fact that which, in Washington, is a legal impossibility. When a married man residing in Washington practices a profession or engages in any gainful occupation or activity, he does so as the agent of a marital community consisting of himself and his wife (*Poe* v. *Seaborn*, *supra*). He cannot do so in any other way or in any other capacity. Services rendered by him are actually rendered by the community; that is to say, by him and his wife, equally. So, in this case petitioner was, no less than her husband, the actual renderer of the services for which they received as compensation the community income above referred to.
>
> That petitioner did not personally participate in the professional labors of her husband is immaterial. One may actually render a personal service without personally performing the acts constituting the service. Otherwise, a partnership acting through one of its members, or a principal acting through an agent, could not actually render a personal service, the truth being, of course, that such services can be and, in countless instances are, actually so rendered.
>
> Respondent cites *Burnet* v. *Harmel* (287 U. S. 103, 110, 53 S. Ct. 74, 77; 77 L. Ed. 199), and *Thomas* v. *Perkins* (301 U. S. 655, 659; 57 S. Ct. 911, 912; 81 L. Ed. 1324), to the effect that, in the absence of language evidencing a different purpose, a Federal income-tax act "is to be interpreted so as to give a uniform application to a Nation-wide scheme of taxation," and that "State law may control only when the Federal taxing act, by express language or necessary implication makes its own operation dependent upon State law," all of which is true but not here applicable. There is here no conflict between the State law and the Federal taxing act, no attempt by the former to control the operation of the latter. The Federal act defines "earned income" as including compensation for personal services "actually rendered," but it does not define the term "actually rendered." Whether the personal services here involved were actually rendered by petitioner's husband alone, as claimed by respondent, or were actually rendered by the marital community, as claimed by petitioner, is a question to which the Federal act provides no answer. The question must, therefore, be determined by the State law. By that law, these services are deemed to have been actually rendered by the community; that is to say, by petitioner and her husband, equally.
>
> As to uniformity of application, respondent's construction of section 31 would tend to defeat rather than promote such uniformity. It is conceded that, if an ordinary business partnership, acting through one of its members, had rendered the services here involved, such services would be deemed to have been actually rendered by the partnership, and each partner's share of the compensation received therefor would be regarded as "earned income," within the meaning of section 31. A uniform application of this section requires that the same treat-

ment be accorded to a member of that species of partnership known as a marital community.

Furthermore, as was said in *Poe* v. *Seaborn* (282 U. S. 101, at 51 S. Ct. 58, 61; 75 L. Ed. 239, p. 117), "the constitutional requirement of uniformity is not intrinsic but geographic. * * * And differences of State law, which may bring a person within or without the category designated by Congress as taxable, may not be read into the revenue act to spell out a lack of uniformity."

(Senator Connally submitted the following memoranda for the record:)

COMMUNITY PROPERTY INCOMES AND THEIR TAXATION, AN ADDRESS BY GEORGE DONWORTH, SEATTLE, WASH.

[Read at the joint conference of the Pacific Coast Institute of Law and Administration of Justice and Washington State Bar Association, July 27, 1935]

Mr. Chairman, Ladies, and Gentlemen:

In view of the provisions of the Federal Constitution relating to taxation of incomes, the authoritative decisions of the Supreme Court and the historical development, the basis upon which the Federal Government may impose an income tax can hardly be said to be open to question. That the basis upon which such a tax is levied against any individual is the ownership of the income by that individual is an established constitutional doctrine. In the case of a community income the husband owns one-half of the income and the wife owns one-half.

In 1895, in *Pollock* v. *Farmers Loan & Trust Co.* (157 U. S. 429, 158 U. S. 601), the Supreme Court clearly enunciated the proposition that under the Constitution an income tax is a direct tax and that a tax on the income of real or personal property is a direct tax on the property producing such income. It necessarily resulted, as that Court declared, that under the then existing provisions of the Constitution, such a tax could not be imposed unless apportioned among the several States in proportion to population.

The impracticability of levying an income tax in proportion to population led to the adoption of the sixteenth amendment, taking effect February 25, 1913. Under that amendment Congress has 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."

As the Supreme Court has since pointed out (*Eisner* v. *Macomber*, 252 U. S. 189; *Bromley* v. *McCaughn*, 280 U. S. 124), the sixteenth amendment did not extend the taxing power to new subjects, but merely removed the necessity which otherwise existed for an apportionment among the States of taxes laid on income. The Supreme Court said in *Eisner* v. *Macomber* (which I call the *Macomber case* to distinguish it from the earlier case of *Towne* v. *Eisner*, 245 U. S. 418):

"A proper regard for its genesis as well as its very clear language requires also that this amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts."

The word "incomes" being now in the Constitution, the definition of that word and its implications is a function of the Supreme Court. In exercising that function the Court has spoken in no uncertain language. In the *Macomber case* the Court said, in defining the meaning of the term:

"Here we have the essential matter: * * * a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital, however invested or employed and coming in, being 'derived,' that is received or drawn by the 'recipient' (the taxpayer) for his separate use, benefit, and disposal; that is income derived from property. Nothing else answers the description."

Let it be noted that the parenthetical phrase "the taxpayer" is not my interpolation. It is the language of the Court. Income is something derived by the taxpayer.

The dissenting opinions in the *Macomber case* picture in clear relief the substantial holding of the Court. The dissenting opinion of Mr. Justice Holmes takes the ground that the word "incomes" in the sixteenth amendment was

used, not in the sense announced in the majority opinion of the Court, but in a broader sense conforming to a supposed common understanding among the public. Nevertheless, the above-quoted declaration as to the meaning and effect of the amendment has been expressly reaffirmed by the same Court and is the established law. In *Bromley* v. *McCaughn* (280 U. S. 124), the Court, in upholding the gift tax as an excise and referring to other cases where excise taxes of various kinds with reference to property had been upheld, said:

"It is true that in each of these cases the tax was imposed upon the assertion of one of the numerous rights of property, but each is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property."

In *Taft* v. *Bowers* (278 U. S. 470), the Court upheld the validity of the provisions in the Revenue Act of 1921 which requires the donee of a gift to pay an income tax on the capital gain based on the cost of the gift to the donor. In the unanimous opinion, the Court said:

"Under former decisions here the settled doctrine is that the sixteenth amendment confers no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income."

So in *Home Savings Bank* v. *Des Moines* (205 U. S. 503) (not an income-tax case), the Court said:

"Taxes are assessed against persons upon the property which they own, not upon the property which others own. We should be reluctant to suppose that there has been any departure from this principle in this law."

It being established that an income tax can be assessed only against the owner of the income, the next point for consideration is: By what law is the ownership of income determined? It is determined by the same law as the ownership of any other class of property, namely, by the statutes and decisions of the State in which the property originates or has its situs.

There are 48 States in the Federal Union. In no two of the States are the statutes concerning property rights alike. In no 2 of the States are the laws concerning marriage and the property rights of married persons of identical tenor. There are 48 different systems by which property rights in general and the property rights resulting from the marriage relation are determined. The legislature in each of the 48 States is supreme in determining all such matters entirely without restraint so far as concerns the sixteenth amendment, which merely authorizes the imposition of Federal income taxes without apportionment. In fact, the States are subject to no restraint whatever in determining the property rights of their citizens not originating under a Federal law or treaty except that imposed by the fourteenth amendment which prohibits the deprivation of the property of any person without due process of law. Aside from the fourteenth amendment (which certainly gives no added Federal power in connection with the imposition of income taxes), each of the 48 States is as free to determine for itself the results of the marriage relation as if it were an independent nation and the Federal Union had never been formed. There is no dissent on this point in the decisions of the Supreme Court.

In *Smith* v. *Alabama* (124 U. S. 465), the Court said:

"It has never been doubted but that this entire body and system of law, regulating in general the relative rights and duties of persons within the territorial jurisdiction of the State, without regard to their pursuits, is subject to change at the will of the legislature of each State, except as that will may be restrained by the Constitution of the United States. Is it to this law that persons within the scope of its operation look for the definition of their rights and for the redress of wrongs committed upon them. It is the source of all those relative obligations and duties enforceable by law, the observance of which the State undertakes to enforce as its public policy. And it was in contemplation of the continued existence of this separate system of law in each State that the Constitution of the United States was framed and ordained with such legislative powers as are therein granted expressly or by reasonable implication."

This principle was well expressed by the supreme court of Washington in *Curry* v. *Wilson* (57 Wash. 509), where the court said:

"The right of the State to fix the character of property acquired by its citizens and the terms under which it shall be holden, is a right of sovereignty and a matter in which the Congress of the United States can have no concern."

In speaking of the power of the State to control and regulate property rights

of married persons, the Supreme Court of the United States said, in *Neilson* v. *Kilgore* (145 U. S. 487):

"Marriage is a civil institution, a status, in reference to which Mr. Bishop has well said 'public interests overshadow private' * * * one which public policy holds specially in the hands of the law for the public good, and over which the law presides in a manner not known in the other departments."

In *Ohio* v. *Agler* (280 U. S. 379), the Court said:

"It has been understood that the whole subject of the domestic relations of husband and wife, parent and child, belongs to the laws of the States and not to the laws of the United States. * * * In the absence of any prohibition in the Constitution or laws of the United States, it is for the State to decide how far it will go."

Similar declarations are made in *U. S.* v. *Hudson* (7 Cranch 32).

The case of *Kansas* v. *Colorado* (206 U. S. 46), contains clear and excellent language pointing out how restricted are the powers of the Government of the United States when the attempt is made to trench upon local subjects of legislation.

It is well to bear in mind this observation made by the Court in the last-cited case:

"One cardinal rule underlying all the relations of the States to each other is that of equality of right. Each State stands on the same level with all the rest. It can impose its own legislation on no one of the others, and is bound to yield its own views to none."

In 8 States of the Union, including Washington, the property rights of married persons are governed by a statutory relation generally known as the community system. The form of the community system differs in each of the 8 States, but in all of them the marriage relation results in a species of partnership between husband and wife. In the other 40 States there is no community system. Nevertheless it would be distinctly erroneous to refer to these 40 States as "common-law States."

The rules of the common law relating to the property rights of husband and wife were barbarous rules. Every one of the 40 States that inherited those rules has materially changed them, and further statutory changes are constantly taking place. Uninformed persons not familiar with the community-property system and its underlying reasons gratuitously assume that that system was devised and put in force by 8 States for the purpose of reducing the Federal income taxes payable by their citizens. Nothing could be farther from the truth. With the exception of California, which in 1927 amended its community-property statute (this amendment being more in the nature of the filling of a hiatus in the law than the adoption of a new system), all the community property States have retained their system without amendment since sometime in the last century. All of these 8 States chose that method of regulating the property rights of married persons because they considered it the most just system. They adopted it long before the sixteenth amendment was proposed or thought of.

Not only for many years before 1913, but during the period since that date, the amendments to the community-property laws of those States have been few and minor. It is a safe assumption that the 40 noncommunity-property States have in the past 50 years more often and more materially changed the laws relating to the property rights of married persons than have the community-property States. They are progressing away in varying degrees from the barbarity of the common-law rules governing this subject. While they are to be congratulated on this progressive approach to marital justice, we may express the hope that they will not be led into any "holier than thou" or "more in the fashion than thou" attitude toward the well-tried and steadier system of community property. The community system is not aware of any inferiority complex. Those who, living elsewhere, read about it and register their disapproval without having experienced its workings, seem to regard it (quoting, I believe, Christopher Morley) "like a thoroughbred bulldog, ugly enough to be attractive."

It is sometimes said by those who would attempt to change the present method of taxing community incomes that the application of the income-tax law to citizens living under community-property laws results in inequality. The fact is that the application of the Federal income-tax law to the property systems of all the States results in some inequality. As no two States have the same local laws of property, a Federal law uniform in its terms throughout the country necessarily produces different results in operating upon different

local systems. This has frequently been recognized as one of the necessary results of our Federal Union.

As the Supreme Court pointed out in *Florida* v. *Mellon* (273 U. S. 12, differences of State law which may bring a person within or without the category designated by Congress as taxable may not be read into the revenue acts to spell out a lack of uniformity.

The product of a constant and a variable is of course a variable. The only way to produce a uniform result in the application of a Federal income-tax law is to enact a constitutional amendment which would transfer to the Federal Government the power to fix and regulate the property rights of married persons. No one, I hope, is suggesting that course. Such inequality as results from the application of the Federal law to the diverse property systems of the 48 States is a part of the price we pay for our Federal Union. The results of this inequality have been much exaggerated by the opponents of the community property system. In every one of the 40 noncommunity States, husbands transfer income-producing property to their wives and thus divide an income which otherwise would belong solely to the husband. They make use of many other methods, lawful under their respective State laws, for effecting transfers of income. They voluntarily do what the citizens of the State of Washington are compelled to do and cannot avoid doing, namely, they vest in their wives the ownership of a part of their accumulations received after marriage.

The sun shining from the heavens shines uniformly upon all things. Where it shines upon 48 different objects, there cannot be 48 shadows of the same length and form unless the objects are of the same height and size. Though the sun shines with uniformity, men know that diversity in their created structures is inevitable.

Such inequality as results from the application of a Federal law to situations arising from the varying laws in the 48 States was bargained for and agreed upon at Philadelphia in 1787, where a division of powers between Federal and State sovereignties and jurisdictions was made a basic principle of the Constitution. The same freedom of State legislation was bargained for again and agreed upon again when the sixteenth amendment was adopted. By that amendment the people of the United States constitutionally decreed that Congress may lay and collect taxes on incomes from whatever source derived, but they conferred no power upon Congress to regulate property rights or the results of the marital status in the several States. It is obvious that in 1913 and prior years when the sixteenth amendment was under consideration and was adopted, everyone knew what is known now, namely, that questions concerning the general ownership of property producing income in each of the several States must be determined by the laws of that State. Then as now the community-property system was in force in 8 States. It was a time-honored system. Its basic principles were well known. From the beginning of statehood each of these States had established and maintained the system because its citizens believed it to be the most just method of defining the property rights of husband and wife.

When the power was thus conferred upon Congress to tax incomes without apportionment, the community-property system was taken into consideration fully as much as was any other of the numerous and varying statutory systems for regulating the rights of married persons existing in any of the States. There was no uniformity anywhere. The whole matter of ownership was left to the local determination of the States as it had been in 1787 and has been ever since.

The suggestion has been made from time to time that Congress should amend the income tax statutes so as to "hit" in some way the community-property system. Various devices have been suggested for this "hitting." One device suggested has been that Congress should by statute declare that management and control by the husband are considered equivalent to ownership. This reminds me of a conundrum that made the rounds among school boys years ago: "How many legs could a dog have if you considered his tail one?" The answer was: "He would have four, because considering it one would not make it one."

It does not require much consideration to discern the invalidity, and if not the absurdity, of this suggested device. Time and again it has been decided by the courts, State and Federal, that the husband's power of management and control is no more than a statutory power of attorney, the equivalent of an irrevocable power of attorney which a wife may give to her husband, or vice

versa, in any of the States. Washington decisions embodying this conclusion are numerous. Some of them are:

Schramm v. *Steele* (97 Wash. 309); *Olive Co.* v. *Meek* (103 Wash. 467); *Marston* v. *Rue* (92 Wash. 129); *Stewart* v. *Bank of Endicott* (82 Wash. 106); *Bortle* v. *Osborne* (155 Wash. 585); *Huyvaerts* v. *Roedtz* (105 Wash. 657).

To quote at length from these decisions would unduly extend this paper. Time and again the Supreme Court of Washington has decided that the community property, real and personal, is actually owned by two persons, namely, by the husband and by the wife, and that this ownership is an actual legal title vested equally in each spouse.

Schramm v. *Steele* (97 Wash. 309), may be taken as typical. In that case the court said:

"The same circumstances, all of them and no others, which make real estate community property make personalty community property. The two kinds of property are impressed with the community character by the same facts and by force of the same words in the same defining statute. All property, whether real or personal, property and pecuniary rights without exception, acquired after marriage by either husband or wife, or both, otherwise than by gift, bequest, devise or descent, is community property. * * * The provision of the statute entrusting the husband with the management and control of community personal property * * * except he shall not devise by will more than one-half thereof (Rem. Code, sec. 5917), must be construed in the light of this dominant fact of ownership. The property referred to is community property, that is, property belonging to the community. The husband is made, by the statute, the manager, not the owner. * * * To hold that the whole substance of the term community property as applied to personalty consists in a mere contingent expectancy of the wife, would make of the term 'community personal property' a palpable misnomer. It would take away every community element except that the wife's labors and sacrifices had helped to earn it. It would destroy that equality which it is the obvious purpose of our community property law to conserve. * * * The words of the statute are generally no broader than those often employed in general powers of attorney for the management and disposition of personal property; but we have yet to learn of a case in which such a power, however broad, was held to destroy the estate of the donor of the power and subject the property to the personal debts of the attorney in fact."

Many other Washington decisions are equally clear and emphatic in upholding the equal title and ownership of the two spouses in the community property, real and personal, neither having a superior title or interest to the other.

In *Marston* v. *Rue* (92 Wash. 129), the court used language to the effect that under the Washington statute the community property, real and personal, is just as much the wife's as the husband's.

Kaufmann v. *Perkins* (114 Wash. 40), and numerous other cases hold that, as to real estate, conveyances, and agreements for conveyances and leases made by the husband alone are void, even as against the husband.

A voluntary conveyance of a half interest made to a wife by a husband in New York can have no greater effect. Yet no attempt is made to tax the New York husband for the entire income after making such a conveyance. Even the gift tax gives him liberal exemptions, especially if made by annual gifts of $5,000 each.

The Supreme Court of the United States has considered and sustained the provisions of State community-property statutes in a variety of cases, among which are *Arnett* v. *Read* (220 U. S. 311); *Warburton* v. *White* (176 U. S. 484); *Buchser* v. *Buchser* (231 U. S. 157). I discuss later two of these cases which decisively bear on our present subject.

Those who advocate the insertion in the Federal income-tax statute of a declaration that management and control by the husband with respect to community property shall be the basis of the Federal income tax are not really content to declare management and control the equivalent of ownership; they really propose to make management and control superior to ownership and to predominate over ownership as the basis of the Federal tax. There is no doubt where the ownership lies; hence they wish to depart from ownership and base the tax solely on management and control. But they propose this only in the case of community property. That means in effect that they propose this rule for eight States only. They do not suggest that management and control by the husband be given a like effect in the non-community-property States.

We may note, in passing, the injustice of following a State community-property statute only to the point of joining the earnings of a husband and wife in a common fund and then departing from that statute insofar as it fixes the ownership in the two spouses equally of the fund thus created. This injustice and the constitutional difficulties involved are frankly recognized by some writers on the subject. They suggest, therefore, with more justice a uniform system of taxing "family incomes" throughout the United States, disregarding practically in their entirety all State statutory provisions defining the property rights of married persons.

The Supreme Court of the United States has decided in *Arnett* v. *Read* (220 U. S. 311), and *Warburton* v. *White* (176 U. S. 484), that the wife's vested interest in community assets in States having the community system in property in the constitutional sense, and that it cannot be taken away from her without compensation, by reason of the fourteenth amendment. That Court has equally decided in *Warburton* v. *White* that the management and control given by statute to the husband can be taken away without compensation despite the fourteenth amendment, because it is not a property right vested in the husband but a mere statutory agency subject to change whenever the legislature so wishes. The proponents, therefore, of the management-and-control device seriously propose to base an income tax upon something which the Supreme Court has held is not property and is not protected by the fourteenth amendment, namely, the right of management and control. And they equally propose to disregard something which the Supreme Court has said is property and cannot be taken away without compensation, namely, the wife's statutory ownership of her one-half interest. What chance there is of the upholding of such a device as a constitutional Federal enactment may be readily conjectured. It seems not too much to say that any proposition of departing from the trail well blazed by the Supreme Court, the trail of ownership, leads into a hopeless morass of tangled substitutes. Let it be noted that in this paper when I speak of the Supreme Court, without other designation, I mean the Supreme Court of the United States.

We hear it said that the Supreme Court has upheld the imposition of an income tax on one who is not the owner. An analysis of the cases cited as sustaining that proposition will show, I think, that they do not in fact support it. In all those cases it will be found that the person, not the owner, against whom the Supreme Court has held that a Federal income tax may lawfully be imposed was one who had been the owner and had not entirely divested himself of that ownership. Of course, there are numerous cases in the books holding that a status once established for taxing purposes retains its efficacy until completely changed. A partial change does not prevent the exercise of the taxing power against one originally taxable.

I am reminded that I once lived in the town of Machias, in Maine. There was a citizen of our town who was going to change his residence to Cherryfield. He said: "I will beat the town of Machias and the other towns out of 1 year's taxes." The towns in Maine have jurisdiction to do the assessing and the taxing, and by statute they assess and tax property to the owner in the town where he resides on the first day of April.

So on March 31 John Doe, of Machias, arranging to remove from that town, packed up his household goods, having already sold out everything he did not want to take, and, with his family, drove 15 miles on the way of Cherryfield. He arrived at the town of Jonesport in the afternoon of March 31.

He spent the night of March 31 and the day and night of April 1 in Jonesport. He left Jonesport about 10 o'clock on the 2d of April, arriving a few hours later at the town of Cherryfield, where he took up his permanent abode.

He said: "I cannot be taxed in Machias because I left there for good on March 31; they won't think of taxing me in Jonesport, because I was only passing through there on April 1. As far as Cherryfield is concerned, I was not living there until the 2d of April."

His plan failed. They taxed him in Machias, and the tax was upheld. The Court said that for taxation purposes a status once acquired continued until it was completely changed. A partial change was not recognized. His status on April 1 was that of a resident of Machias, because he had not yet acquired any other status. That is the substantial principle that I find applied in the cases where a person no longer the complete owner is held to be subject to an income tax.

Why is it that in all of these cases the decision upholding the tax pursues the point of an interest retained by the grantor, the former owner? It is because the income tax is assessed against the owner and the courts refuse to recognize an incomplete change of ownership. The cases cited under this head are *Reinecke*

v. *Smith*, 289 U. S. 172; *Burnet* v. *Wells*, 289 U. S. 670; *Burnet* v. *Leininger*, 285 U. S. 136; a partnership case where *Hoeper* v. *Tax Commission of Wisconsin*, cited below, is distinguished but left unquestioned. All of these are grantor cases, where a tax was upheld against a grantor who had not completely parted with the title. There is an excellent comment on *Burnet* v. *Leininger* in *Lowery* v. *Helvering* (70 Fed. (2d) 713).

It has been suggested that *Burnet* v. *Wells* (289 U. S. 670), cited above, has a broader implication than I have indicated. I do not think so. In that case, by a 5-to-4 decision, the Court sustained an income tax against a grantor who in creating a trust directed that a part of the income should be applied to the payment of premiums thereafter accruing on life-insurance policies taken out by the grantor before the creation of the trust on his own life for the benefit of two women considered by the court to be members of his family, an expenditure which the majority opinion speaks of as being "a common item in the family budget." All nine of the Justices recognized that a remaining interest in the grantor was necessary in order to uphold the assessment of an income tax against him, and that he could be taxed only for so much of the income as represented that interest. It was tacitly assumed by all that the validity, construction, and effect of the instrument creating the trust were to be judged by State laws. State laws also controlled as to the construction of the life-insurance policies. Congress had enacted a special provision in the revenue act directing that—

"Where any part of the income of a trust is or may be applied to the payment of premiums upon policies on the life of the grantor * * * such part of the income of the trust shall be included in computing the net income of the grantor."

Five justices held the statute to be constitutional because the grantor had a continuing interest in the policies. They were at much pains to point out that it was a grantor who was taxed and that his continuing interest was substantial.

Mr. Justice Cardozo, speaking for the majority, said:

"If the insurer without cause were to repudiate the policies, the insured [the grantor] would have such an interest in the preservation of the contracts that he might maintain a suit in equity to declare them still in being (citing authorities). The contracts remain his, or his at least in part, though the fruits when they are gathered are to go to someone else."

The outstanding fact is that the Court in the majority opinion upholds the constitutionality of the assessment of the tax only because of the continued interest of the grantor who first took out the policies and later created the trust.

In effect all the grantor cases are distinguished from the community property cases by the court itself in the *Seaborn case* (282 U. S. 101), cited below. There (as shown in the passage of the opinion hereinafter quoted) the court pointed out the difference between the situation of a grantor technically parting with the title while, in fact, retaining ownership with its incidents in whole or in part, and the situation of the husband under the community property system where "the husband never has ownership."

The leading case of *Poe* v. *Seaborn* (282 U. S. 101), and the companion cases (the income-tax cases dealing with community property), decided in 1930, make it clear that ownership of the income is the basis of the assessment of income taxes under the sixteenth amendment and that that ownership is determined by the local State laws. That case involved the community-property law of Washington and held the husband, not liable for a Federal income tax assessed against him by the Commissioner on the entire community income. The decision is rested definitely on the ground that only one-half of the community income belonged to Seaborn, the other half being his wife's. In decisions rendered the same day a like ruling was made as to community incomes in Texas, Louisiana, and Arizona (*Hopkins* v. *Bacon*, 282 U. S. 122; *Bender* v. *Pfaff*, 282 U. S. 127; *Goodell* v. *Koch*, 282 U. S. 118).

The three cases last cited and *Poe* v. *Seaborn* were test cases. The Government there strongly asserted the theory that the husband's management and control of community property is the equivalent of ownership and that to hold the contrary would involve an unfair discrimination against the taxpayers in the 40 States having other systems. These contentions were fully considered by the Court and were overruled. The question must therefore be regarded as set at rest by these four cases, especially when they are read in connection with the later cases of *Hoeper* v. *Tax Commissioner of Wisconsin* (284 U. S. 206) and *Heiner* v. *Donnan* (285 U. S. 312), hereinafter discussed.

For 15 years the practice of the Department has been in accordance with this principle. In April 1920, United States Internal Revenue Commissioner's office decision No. 426 (2 C. B. 198) gave specific recognition to the community-property laws of Texas and Washington, and upheld the propriety of returns dividing the community income equally between the husband and wife. Later in the same year, by opinion of Attorney General Palmer, the ruling was extended to all of the community-property States except California, where the local State courts had held that under the then existing statutes the wife had no vested interest in the community property or income. In February 1921 the second opinion of Attorney General Palmer (32 Ops. Atty's. Gen. 435) considered the subject exhaustively and adhered to the ruling already announced. There has since been no departure from it. Various attempts have been made to persuade Congress to amend the income-tax law by the insertion of language by which the advocates of a change hoped that this established practice might be overborne. Both Houses of Congress have turned deaf ears to these proposals.

The holdings of the Supreme Court may be synopsized, I think, by stating that in no case has that Court held any person liable for a Federal income tax unless he was the owner or had been the owner of the income or the property producing it, and had parted with an interest less than the entire interest, thus retaining a substantial interest in himself. In the *Seaborn case* (282 U. S. 101) the Court, speaking of *Corliss* v. *Bowers* (281 U. S. 276) (a case cited to the Court as having a contrary import), expressed itself as follows:

"We held that where a donor retains the power at any time to revest himself with the principal of the gift, Congress may declare that he still owns the income. While he has technically parted with title, yet he in fact retains ownership with all of its incidents. But here (in the *Seaborn case* construing the community-property law of the State of Washington) the husband never has ownership. That is in the community at the moment of acquisition."

The case of *Hoeper* v. *Tax Commission of Wisconsin* (284 U. S. 206) establishes the proposition that an income tax assessed against a husband cannot be increased by reason of the fact that his wife receives an income which she owns. That case, like others decided by the Supreme Court, denies the asserted power to add together two incomes owned by the husband and wife and to tax them as one income to the husband. It holds that the Constitution is violated as to the fourteenth amendment when a State attempts to tax a husband for property or income which under the State law belongs to his wife.

In *Heiner* v. *Donnan* (285 U. S. 312) the Court states that a course of action prohibited to the States by the fourteenth amendment is prohibited to the Federal Government by the fifth amendment. It is held, applying this principle, that a Federal statute is unconstitutional which creates a conclusive presumption that gifts made within 2 years prior to the donor's death were made in contemplation of death. The court says that the conditions stated in the opinion "show that to impose liability for the tax as a gift tax upon the estate, as they in terms require, is, in effect, to exact tribute from the gains or property of one measured by the gains or property of another." This holding and this language are pertinent when it is proposed to add together and tax to the husband in the higher bracket two incomes which under State law belong to two persons, namely, one to the husband and one to the wife. The proposal becomes obviously more unwarranted and unjust when the husband has also a separate income, since in that case it is proposed to add the two community incomes to the separate income of the husband and to subject the husband to a higher rate of tax and surtax as a consequence.

Nor can the supporters of the proposed innovation find consolation in the opinion of the dissenting judges in the *Hoeper case*. That being the case of a Wisconsin State tax, the tax was imposed by the same legislative authority which had established the property relations of husbands and wives and had changed the common law of the State of Wisconsin in that respect. The dissenting judges pointed out that Wisconsin, if it so desired, could have restored the common law and in that way could have vested the entire ownership of the wife's property in the husband. In their view it followed that the Wisconsin statute there in question could be treated as a reenactment of the common-law property rights of husband and wife, insofar as the State income tax was concerned. That is the only ground that the dissenters appear to have found for questioning the validity of the majority decision.

In the case of a Federal income tax on incomes owned by husbands and wives, no such considerations exist. United States statutes cannot change the relations or the property rights of husbands and wives in any State. The United States cannot reenact the common law as to property rights between husbands and wives

in any State. The *Hoeper case* is emphatic and is in line with the other cases cited which declare that there is a constitutional barrier to the enactment of a Federal law which would join together and tax as a unit incomes which, under State law, are owned by the husband and by the wife.

INHERITANCE AND ESTATE TAXES

So far as concerns inheritance and estate taxes, little need be added. It necessarily follows from the provisions of the Washington statutes and decisions that the wife's interest in community property is a continuing interest existing during marriage and thereafter, and that in case of the husband's death the wife in no sense inherits her one-half interest in the community property from the deceased spouse. In the converse case, equally, the husband is not an inheritor of his one-half, but is a continuing owner both before and after the wife's death. The long-established practice of the inheritance tax department of the State of Washington in this regard is too well known to justify further comment.

The Federal Government has uniformly adhered to the same method in valuing and taxing the estates of deceased married persons. The rule was made clear by Internal Revenue General Counsel's Memorandum No. 7773 (August 1930) in which reference is made to the decisions of the United States District Court for the Northern District of Texas in the *Vincent* and *Underwood cases*. In those cases the decisions of the Court were oral and consequently unreported. In the General Counsel's memorandum No. 7773 it is said:

"In view of the court's decision in the *Vincent* and *Underwood cases* which are applicable to the instant case, it is the opinion of this office that the value of B's interest in the community property is not a part of A's gross estate within the purview of section 302 (a) of the Revenue Act of 1926, notwithstanding the fact that she elected to take under the will."

The general principle stated in the cited memorandum had been enunciated in department rulings long previously. The only question raised in 1930 and on which the General Counsel's opinion was sought was whether a different rule applied where, by reason of testamentary provisions, an election by the wife was required.

In referring to the two decisions just mentioned, the memorandum says:

"In each of those cases the Court held without written opinion that the interest of the wife in the community estate was not a part of her deceased husband's gross estate. The Government did not appeal from those decisions."

I believe no question has been suggested as to the propriety of this long-established practice in the application of the laws governing the Federal and State estate and inheritance taxes.

GEORGE DONWORTH.

NOTE.—In *Blair* v. *Commissioner of Internal Revenue* (— U. S. —), decided February 1, 1937, the unanimous opinion of the Court cites twice with approval *Poe* v. *Seaborn* (282 U. S. 101) in support of the proposition that the decisions of the State courts are final as to property rights and that Federal income-tax liability attaches to ownership of the income as defined by State laws.

NOTE 2.—While for obvious reasons the State statutes and decisions cited in the foregoing paper are those of the State of Washington, it follows under the decisions of the Supreme Court of the United States therein discussed that the conclusion reached is equally applicable to community incomes received by residents of the other seven States where the community-property system is in force.

MEMORANDUM BRIEF

(*a*) Explanation of substantial character of wife's ownership of half of the community partnership income and property in Louisiana.

(*b*) Summary of the practical and substantial differences between the community property or marital partnership law and the common law.

(*c*) Illustrations of the practical and serious burdens on husbands in relation to their property rights in community property States, as distinguished from common law States, which entitle such community property States to the benefit of separate returns for income-tax purposes.

(*d*) Discrimination and unfairness to community property States resulting from the attempt by the Government to ignore local State laws regulating and fixing ownership and property rights by the passage of the proposed bill. (H. R. 8396.)

CHARLES E. DUNBAR, Jr.,
SPENCER, GIDIERE, PHELPS & DUNBAR,
New Orleans, La., Attorneys for
Louisiana Community Property Taxpayers Committee.

FOREWORD

Following an earlier opinion applicable to Texas rendered in 1920, the Attorney General of the United States, on February 26, 1921, rendered an opinion which was promulgated by the Commissioner of Internal Revenue as Treasury Decision 3138 on March 3, 1921, based on exhaustive study of the laws of all the community property States. In these opinions, the Treasury Department announced that in Louisiana, Texas, Arizona, New Mexico, Idaho, Nevada, and Washington, all of which are community property States, the wife, as a partner in community, was the vested and real owner of one-half of all of the community property and income of the community partnership, and that all community partnership income, for the reason that it belonged equally to husband and wife, might be returned separately for income-tax purposes. (California was excepted from the ruling in 1921. Subsequent changes in the community property law of California have resulted in the Government recognizing the same right of husbands and wives in California since 1930.)

In 1921 and 1924, attempts were made in Congress to amend the revenue act, which amendments were designed to compel the husband in community partnership States to include in his individual income-tax return the half of the community income which belonged to his wife under the local State law. These amendments were similar to H. R. 8396, which is now pending in Congress. Arguments were made and briefs were filed in behalf of the community partnership States in 1921 and 1924 showing that the proposed amendments were grossly discriminatory and unjust, and, as a result, the amendments were rejected by Congress (appendix 1). When the sponsors of the legislation in 1921 and again in 1924 failed to persuade Congress to ignore the laws of the community partnership States and to compel by legislative fiat the husband to pay taxes on his wife's half of the community partnership income, efforts were then made to change the rulings of the Treasury Department and of the Attorney General which had been in effect for many years. Following the decision of the Supreme Court in *U. S.* v. *Robbins* (269 U. S. 315), dealing with the law of California, the Treasury Department finally decided to institute test suits in some of the other community partnership States, so that the Supreme Court of the United States might decide the matter. The Supreme Court of the United States in 1930 unanimously decided that the prior rulings of the Attorney General and Treasury Department were correct and that accordingly in the States of Louisiana, Washington, Texas, New Mexico, and California the wife had a legal and real ownership in half of the community partnership property and community partnership income, and the right of husbands and wives in community property States to make separate returns of the community income was again recognized (appendix 2). The Treasury Department accepted the decisions of the United States Supreme Court dealing with the local laws of Louisiana, Texas, Washington, Arizona, and California, as applicable to the remaining community property States of New Mexico, Idaho, and Nevada without the necessity of further test cases. Another attempt is now being made by legislative act to take away from husbands and wives in community partnership States the rights, which, after a careful study of the local laws, have been recognized by three Attorneys General, the Treasury Department, and the Supreme Court of the United States (appendix 3). The pending bill which has been introduced for this purpose is H. R. 8396, which reads as follows:

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That for the purpose of determining the income-tax liability of any individual during any taxable year beginning after December 31, 1933, property of a marital community shall be considered as the property of, and income of a marital community shall be considered as the income of, the spouse who has the management and control thereof under the law of the jurisdiction in which the marital community exists, and such spouse shall alone be entitled to the deductions and credits allowed under the internal revenue laws which are properly allocable to such property or income."

The purpose of the above-quoted bill, which is now pending, is to ignore and nullify the effect of the local community partnership laws of Louisiana, Washington, Texas, California, New Mexico, Arizona, Idaho, and Nevada, and force the husband in these States to include in his individual tax return property and income, which, under the law of his State, does not belong to him, but which belongs to his wife. The present proposed legislation is not only grossly discriminatory and unfair to the community property States, but it violates the Constitution of the United States.

The sixteenth amendment to the Constitution permits Congress to tax a person's income. The Federal Government under this amendment has adopted on the whole a policy of taxing the real or equitable owner of income as determined by local State law. If ownership as created by the local statutes of the various States is not recognized by Congress and is to be disregarded by Congress endless complications, hardships, and gross injustice and discrimination will result and uniformity in matters of Federal taxation will be destroyed.

To the average layman and lawyer unfamiliar with the community-property or marital-partnership law there is a general impression that the only difference between the laws of community-property States and common-law States is a difference of theory, and that the community-property law is only a fiction which gives community-property States benefits in relation to income-tax returns at the expense of common-law States that have a different system of law.

It is respectfully submitted that such an impression is erroneous and contrary to the law and facts as announced by three Attorneys General, the Treasury Department, and the Supreme Court of the United States (appendix 4).

The purpose of this memorandum is to explain simply and briefly, with as little use of technical language and the citation of authorities as posible, the general principles of the community law and by practical illustrations to demonstrate that the community-partnership law is not only theoretically different from the common law, but as a practical and substantial fact creates a marital partnership in which the wife is the real and substantial owner of one-half of the community property and income, with resulting burdens and practical limitations on the property rights of husbands, unknown to the common law, which entitle such husbands in community-property States to the corresponding benefits that they now enjoy in the way of separate income-tax returns.

BRIEF EXPLANATION OF THE EFFECT OF THE COMMUNITY-PARTNERSHIP LAW

The most important effect of the law of Louisiana and other community-property States is to create a partnership between the husband and wife, and, as a result, one half of the income and property acquired during marriage by this partnership immediately vests in the wife and the other half in the husband. The community system of law as it exists in Louisiana and other States is more analogous as a matter of legal principle and substantial fact to a partnership than any other common-law legal status. The right of the husband to administer and manage the community partnership property that is acquired after marriage as a result of the joint or individual efforts of the two spouses is in substance analogous to that of a managing partner at common law or a trustee at common law with very broad power of administration (appendix 5). Under the community or partnership theory, the husband and wife, with certain exceptions, become absolute and equal owners of all property and income acquired by them during the marriage, share and share alike (appendix 6). The courts of the various States have repeatedly held that there is no distinction to be made between husband and wife as to the degree, quantity, nature, or extent of the interest each has in the community property (appendix 7). The husband, as managing partner or trustee, or, as he is called in some of the community States, "the master of the community," is given the administration of the community property by law, and this right to administer is terminated by divorce, or by his death or the death of his wife. This right of administration may also be terminated, without the necessity of a divorce, by a separation of the community property and a liquidation of the partnership, which may be claimed and obtained by the wife on the ground that the husband is a gambler, or if he is guilty of mismanagement or otherwise incompetent or incapable of properly administering the community partnership property.

The pending bill proposes, although the husband is admittedly not the owner, to tax him on his wife's half of the community-partnership property, because he is the manager and administrator of the community partnership under the local

State law. It is probably unnecessary to state, that in common-law States, a managing partner of a partnership is not required by the Federal revenue act to include in his individual income-tax return, the share of the partnership income belonging to his other partner or partners. The proposed bill, however, would require the husband, who is analogous to a managing partner at common law, to include in his individual income-tax return not only his share of the community-partnership income, but the share which belongs to his wife as a partner in the community partnership. In short, it is proposed that for taxation purposes the community partnership in eight States is to be treated differently from ordinary partnerships in every State of the Union.

PRACTICAL ILLUSTRATIONS OF THE WIFE'S ONE-HALF OWNERSHIP OF THE COMMUNITY-PARTNERSHIP PROPERTY AND INCOME AND THE SUBSTANTIAL RESTRICTIONS AND LIMITATIONS PLACED ON THE HUSBAND'S ADMINISTRATION OF THE COMMUNITY-PARTNERSHIP PROPERTY

(*a*) The husband in Louisiana, in addition to being restricted by law as to gifts of community-partnership property (appendix 8), is expressly denied, by statute, the right to dispose of or deal with the community-partnership property or income in fraud of his wife's property rights in half of the community-partnership property and community income. The liberal equitable power of our courts in relation to fraud are an ever-present potential protection to the wife against an unfaithful or dishonest husband, who deals with the community-partnership property in violation of his trust or fiduciary obligation as master and managing partner of the community (appendix 9). The husband is merely the managing partner of the marital partnership, with full discretion and power of administration, but, as an agent and fiduciary, he must act in good faith in the handling of the wife's interest in the community partnership. If the husband wastes the community-partnership property in dissipation and debauchery for his own pleasure, it has been held in several community-property States which have no express statute on the subject similar to the Louisiana statute, that such conduct on his part is a disposition of the community property in fraud of his wife's rights. The husband, in common-law States, since he is the owner of all property acquired by him during marriage, can give it away to anyone he pleases and whenever he sees fit. Moreover, he can use it for gambling, waste it in dissipation, or dispose of it in any other way he chooses, and it is no fraud against the wife, and the wife has no right to complain, because, in common-law States, the husband is the exclusive owner of all of the property and the wife has no interest in it (appendix 10).

(*b*) Unlike the common law, and because of the community-partnership law, if the husband in Louisiana, even in the absence of fraud on his part, is wasteful, reckless, incapable or incompetent, or if he is a careless administrator and is mismanaging the community-partnership property, or if his affairs are in such disorder as to jeopardize the wife's property rights, or, a fortiori, if he is fraudulently disposing of community property, the wife can immediately demand and obtain a separation of property, which carries with it the dissolution and liquidation of the community partnership. The wife, under such circumstances, receives immediate possession and control of her half of the community property existing at the date of the separation of property, and takes over the immediate control and administration of her half of the community property and removes the husband thereafter as managing partner of the community property. Each spouse thereafter manages his or her property, and all property thereafter acquired belongs, as separate property, to the spouse acquiring it. While the wife sues for separation of property, she may, as a matter of protection, immediately obtain an injunction restraining the husband from further activity as manager of the community property (appendix 11). This right of the wife in Louisiana is similar to the right of a partner in an ordinary commercial partnership to provoke a liquidation or dissolution of the partnership in case of mismanagement or fraud. Furthermore, this right of the wife in Louisiana has nothing to do with and is distinct from her right to a divorce, and can be asserted by her while she and her husband are living together as man and wife. This right of the wife to force a dissolution and liquidation of the community, in case the husband is incompetent or guilty of mismanagement, or fraud, or if his affairs are in disorder, is a serious limitation and check on the husband's authority as manager of the marital partnership, and is a substantial safeguard established for the benefit and protection of her property right.

This very practical remedy given by the Louisiana law to the wife is consistent only with the theory that the husband is only an administrator or managing partner, and that the wife has a real and substantial ownership in half of the community property administered by the husband, which the Louisiana courts will protect. In common-law States the wife, of course, has no such right, because there is no community partnership between husbands and wives created and established by State law. The husband, in common-law States, is the owner of all property acquired by him during marriage, and it is immaterial whether he is incompetent or incapable, and he can spend it in dissipation or debauchery, gamble with it, or mismanage it, as he chooses, and the wife, because she has no ownership or interest in her husband's property, has no legal right to complain (appendix 11).

(*c*) That the husband is only the managing partner of the community partnership and cannot enjoy or use the property for himself is further demonstrated by his inability to use community partnership income or property without accountability to his wife. Thus, if he uses any part of the community partnership income for the benefit of his separate estate, he becomes a debtor to the community partnership to the extent to which his separate estate has been enhanced in value. If he pays his separate debts out of the community funds, his separate funds must reimburse the community for the amount so paid. In common-law States, where there is no community partnership between husbands and wives all property and income acquired by the husband during marriage belongs exclusively to him, and all property and income acquired by the wife during marriage belongs to her, and the husband can use and spend his property and income to pay his personal and separate debts, or in any other way he pleases, and his wife has no legal right to complain because she has no interest or ownership in the property and income acquired by her husband during marriage (Appendix 12).

(*d*) The wife, in the event that she does go into business for herself, is still a partner in the community estate and if she acts unwisely and contracts debts, these debts operate against the entire community estate and against the husband individually, since he is the head and master of the community. This situation is true even though the husband has nothing whatever to do with the business which the wife has undertaken and even though he objects to the debts being contracted. (See appendix 13.)

(*e*) The husband in Louisiana can, by his will, dispose only of his half of the community property, and is powerless to affect the wife's half. The converse of the husband's lack of testamentary power over the wife's half of the community income is illustrated by the completeness of the wife's power of disposition of her half. The wife can will her half of the community property to anyone she chooses, even to a lover, and when she dies, the husband must, by agreement or judicial partition, sell the community property, and liquidate any and all business ventures in order to deliver the value of half of the marital partnership property to the legatee or legatees of the wife. It is only because one-half of the community partnership property belongs to the wife that the law gives her the right of testamentary disposition of half of the community partnership property and income. At common law, because the husband owns all property and income acquired by him after marriage, he has the free and unrestricted power of testamentary disposition of the whole of this property, and his wife cannot dispose of any of his property by will. Likewise, since the wife is the exclusive owner of all property acquired by her during marriage, she can dispose of all of it by will, and the husband cannot dispose of any part thereof. This is because there is no community partnership in common-law States and the wife has not a half interest in any part of the husband's property acquired during marriage, and the husband has not a half interest in any part of the wife's property acquired during marriage (appendix 14).

(*f*) If the wife in Louisiana dies without having made a will, her half of the community partnership property and income descends to her heirs, and her husband is powerless to prevent it. It has been held in Louisiana, that even the illegitimate children of the wife, born before her marriage and not the children of her husband, were entitled, on her death, to inherit her share of the community estate, to the exclusion of the surviving husband (appendix 15). If the wife in Louisiana dies, her heirs or legatees pay both State and Federal inheritance taxes on her half of the community partnership property and income, and if the husband happens to be the legatee or heir of his wife, he is required

to pay both a State and Federal inheritance tax. Thus, under the law of Louisiana, if a man has the misfortune to lose his wife, he must pay to the United States and the State of Louisiana a heavy inheritance tax for the privilege of inheriting from her one-half of the property which in a common-law State would be considered entirely his. In this connection, it should be noted that the Treasury Department recognizes the community partnership and the wife's half ownership in the community property and income for the purpose of levying an inheritance tax on the husband or the heirs of the wife, or the theory that they receive the wife's property and income, and yet, if the present bill is adopted, the Government will compel the husband to pay an income tax on the same property and income, evidently on the theory that it should be treated as his property. We submit that this is in effect "blowing hot and cold" at the same time (appendix 16).

The rules we have stated are unknown to the common law. At common law, all of the property acquired by the husband during marriage belongs to him alone, and, accordingly, upon his death, descends to his heirs, and his heirs must pay both State and Federal inheritance taxes; and, conversely, all the property acquired by the wife during marriage belongs to her alone, and, upon her death, descends to her heirs, and her heirs must pay both State and Federal inheritance taxes.

(*g*) The community partnership in Louisiana is dissolved and the husband is automatically removed as managing partner in case a divorce is obtained by either husband or wife, and as a result the community partnership property is immediately liquidated and the community property and accrued income divided equally between the husband and wife. This is true irrespective of the merits of the marital disagreement, and even though the wife alone is guilty and wholly to blame for the situation bringing about the divorce and the resulting dissolution and liquidation of the community partnership (appendix 17). The right of the wife in this connection is independent of any question of alimony, which is governed and regulated by separate statutes. The wife's right, in the event of divorce, to remove the husband as manager of the community partnership and immediately receive one-half of the community partnership property and income results from the fact that in Louisiana she is the owner of one-half of the community partnership property and income. As a consequence, therefore, if a wife in Louisiana is guilty of adultery and runs away with her lover, she can leave instructions with her attorney, in connection with the divorce proceedings, to require an immediate dissolution and liquidation of the community partnership, and she can force the husband to account for and deliver to her immediately one-half of the community partnership property and income, which she can then spend, if she pleases, in luxury with her lover. In a common-law State, a wife leaving her husband under such guilty circumstances could be divorced by her husband, and would not even be entitled to alimony, much less to an equal division of property. The simple reason for this result, as we have said before, is because in common-law States the husband is the exclusive owner of all the property acquired by him during marriage, and the wife has not the slightest interest or ownership in his property.

SUMMARY

In the light of the many illustrations of the practical and substantial nature of the wife's ownership and the restrictions on the husband as agent or managing partner of the community partnership we have briefly outlined, we submit that the proposed bill is grossly unjust and discriminatory. The pending community property bill, in substance, proposes to tax the husband on income which belongs to his wife, by treating the income as if it were his, when, as a matter of fact, he cannot give it away if he chooses; when he cannot dispose of it in fraud of his wife's property rights, if he pleases; when, if he is reckless, careless, or a bad manager, he loses the administration of it; when, if he is of a speculative disposition, or the disorder of his affairs is such as to jeopardize his wife's property rights, he loses the administration of it; when he loses the administration of it in case of a divorce and even without any fault on his part, if his wife is unfaithful to her marital obligations; when he cannot spend it to improve his separate property, if he wants to; when he cannot use it to pay his separate debts, if he pleases; when he has no right or power to have it descend to his heirs; when, if his wife dies, he loses the administration of it and must deliver it to his wife's heirs;

and when, if it is willed to him by his wife, he takes it not as owner, but by inheritance, and is compelled to pay both a State inheritance tax and a Federal estate tax for the privilege of receiving it.

None of these restrictions and limitations on the power of the husband with regard to property and income acquired during marriage exists in common law States, where the husband is the owner of all of the property and income acquired during marriage; and, conversely, the restrictions and limitations we have outlined exist in Louisiana, because the wife is the owner of one-half of the property and income acquired during marriage by the marital partnership composed of both husband and wife.

We have emphasized the fundamental and practical features of the Louisiana community-partnership law, in order to show clearly that the community partnership between husband and wife in Louisiana and other community-property States is not a fiction, but is, in substance, a partnership imposed by law, which creates burdens and limitations as well as privileges in relation to the property rights of husbands and wives. These burdens and limitations on property rights are unknown in the common-law States, and, we submit, if it were true that any benefits flowed from the community-partnership law, they are more than counterbalanced by the multitude of burdens and restrictions placed upon the property rights of husbands and wives in Louisiana, which do not exist in any common-law State. The proposed bill is unjust and discriminatory in its practical effect, and violates sound principles of uniformity in Federal taxation.

PRACTICAL INSTANCES OF DISCRIMINATION AND UNFAIRNESS, WHICH WILL RESULT FROM THE PASSAGE OF THE PROPOSED BILL

The Supreme Court of Louisiana has held that under the Louisiana community-partnership law, the earnings of the wife from a business, trade, occupation, or industry carried on separate from her husband, as well as the earnings of the husband, become community-partnership property under the management and control of the husband, and each spouse has an undivided and equal half ownership in the combined earnings (appendix 18). Since a wife's earnings, as pointed out above, are community-partnership property under the Louisiana law, if the proposed Treadway bill is adopted by Congress a husband in Louisiana would be compelled to pay a Federal income tax not only on his own earnings and income, but also on the combined earnings of his wife, which, under the Louisiana law, constitute community-partnership property and which neither in law nor fact belong as a whole to the husband. The effect of the adoption of the proposed Treadway bill would be to tax one person (the husband) on the property partly owned and entirely earned by another (the wife) which would not only be unjust and grossly discriminatory but unconstitutional.

Moreover an attempt to force the husband and wife in Louisiana, who, under our local law, are in substance partners, to report all of the community-partnership income in the name of the husband alone, when, as a matter of law and fact the husband owns only one-half of the community income, and is merely the managing partner of his wife's other half, will not produce uniformity, but, on the contrary, will unfairly discriminate against Louisiana and other community-property States, and will ignore the fundamental law of our State by treating what in Louisiana is in substance a partnership created by law, differently from voluntary partnerships in every common-law State.

Furthermore, in addition to the discrimination resulting from voluntary partnerships, it is important to note that as a matter of fact there are a number of common-law States that permit husbands and wives to form partnerships voluntarily and, in these States, husbands and wives may make voluntary partnership agreements which may accomplish the same result, by contract, that the law accomplishes in Louisiana. Where such a partnership agreement has been entered into between husband and wife in these common-law States, the Commissioner of Internal Revenue has recognized that each spouse may return his or her distributive share of the partnership income, and is liable only for the tax upon such share. Numerous cases, both in the Federal court and before the Board of Tax Appeals, recognize that under the common-law system separate returns by husband and wife, effecting a division of income, may easily be arranged by any one of a number of legal transactions which have been sanctioned by the law. For example, an informal joint venture or partnership for

the purpose of trading on the stock exchange has been recognized as legally authorizing husband and wife to return one-half of the profits each (appendix 19). Likewise an oral agreement that a partnership should exist in a lumber business between husband and wife, although the wife takes no active part in the business, will authorize separate returns and, in the same case, a donation of a farm by the husband, which the husband subsequently rented from the wife, was authorized and the wife was permitted to return the profits from the farm (appendix 20). A simple declaration by the husband that he is purchasing certain property and that the ownership is to be divided equally between him and his wife authorizes the wife to return one-half of the profit resulting from a subsequent sale on her separate income tax (appendix 21). There are numerous other cases illustrating the same principle and rulings (appendix 22). As shown by the rulings set out in the Income Tax Service of the Commerce Clearing House, section 1169, the Government has recognized and permitted separate returns as a result of a partnership entered into between husband and wife in 22 common-law States and in the District of Columbia.

It is to be noted that none of the transactions above referred to, which have been held legal in common-law States, is permissible under the Louisiana law. The husband and wife in Louisiana cannot make contracts with each other or enter into partnership agreements (appendix 23). It is thus apparent that while the common-law States, by a variety of legal transactions between husband and wife which have already been approved by the Government, permit the making of separate returns by husbands and wives and the shifting of property in various ways to authorize a rearrangement of income between husband and wife, none of these accepted legal methods in common-law States is possible under Louisiana law.

Moreover, the voluntary partnership arrangements between husbands and wives in the common-law States, permitting and authorizing husbands and wives to make separate income-tax returns referred to above, will not be affected or changed by the proposed Treadway bill because the Treadway bill only applies to so-called community-property States and is, therefore, intended to and actually does affect only eight community States. The adoption of the proposed Treadway bill, therefore, would result in permitting husbands and wives who are voluntary partners in other States to divide income, and would, in eight States of the Union, where a partnership between husband and wife is created by law and called a community partnership, prevent the division of income between the partners, and the making of separate returns by the partners.

On the other hand, if the husband in community-property States is analogized to a trustee at common law insofar as he manages one-half of the community-partnership property and income for his wife, surely it cannot be contended that one in the position of a trustee for another person can or should be forced to add the income derived from property administered for the benefit of the beneficiary to his individual property and income for Federal income-tax purposes. Yet, this is in substance what the pending community-property bill proposes to do, by forcing a Louisiana community husband to add the community partnership income to his personal income for taxation purposes.

It is respectfully submitted that if the inhabitants of common-law States should be of the opinion that it is to their interest to place the burdens and limitations on the husband's earningsc and accumulations during marriage and confer upon the wife a substantial property right in the earnings and accumulations of the husband during marriage, which the law of Louisiana confers upon her, there is nothing to prevent them from changing their laws accordingly, and from accepting this advanced view of women's rights by adopting the community-partnership system. By establishing a community-partnership system which has prevailed in eight States long before the income-tax amendment was adopted, common-law States may obtain any advantages, if such there are, that flow from the law and facts in community-partnership States. It is evident that the community-partnership system is so substantial in its nature with reference to property rights that common-law States, up to this time, have considered it objectionable in this regard and not desirable to adopt on any theory of Federal income-tax benefit.

With reference to the argument as to the necessity for bringing about harmony in the Federal taxation law, this is impossible on account of the fact that the Federal tax must be based on the person's income, and what is property and income of an individual, corporation, or partnership is necessarily a matter depending on the constitutions and laws of the various States of the Union. We

have already pointed out that in many common-law States husbands and wives may make voluntary partnership agreements and obtain the same benefits which result from a community-property partnership established by law. More than this, in all common-law States a husband may make a gift of half of his property to his wife, and thereafter the income from the property thus donated may be returned as the separate property of the wife (appendix 24). This is done as a matter of practice and has never been questioned. The laws of Louisiana and other community States make the wife the owner of one-half of the income and property acquired during marriage and yet the Federal Government, by the proposed amendment, is attempting to ignore this fundamental law of the State for taxation purposes. The result will be, in case the proposed bill is adopted, that simply because the property becomes joint property as a result of the positive law of Louisiana and other community-property States, a different rule will be applied in community States than is applied in other States where the same situation is brought about voluntarily.

In Louisiana a gift by a husband to his wife during marriage is as a matter of law revocable during the marriage, and in view of the provisions of the Revenue Act taxing income from revocable trusts to the grantor, the Treasury Department may contend that the income from property donated by a husband to his wife should remain taxable to the husband. In common-law States no such contention can be made and the income from donated property is clearly taxable to the wife only. Thus the Louisiana law may prevent the husband from making an effective division with his wife by donation to her. This is not important so long as the present Treasury regulations stand, recognizing the right of the husband and wife in Louisiana each to return his or her half of the community-partnership income, but it affords another reason why, so long as spouses in noncommunity States can make an effective division of property by donation from one spouse to another with a resulting division of income for income-tax purposes which spouses in Louisiana may not be able to accomplish, Congress should not undertake by passage of the pending bill to ignore the division which the fundamental law of Louisiana automatically accomplishes between the spouses (appendix 25).

It is important to note, in connection with an explanation and statement of the practical effect of the wife's half-interest in community-partnership property in Louisiana and other community-property States, that a common-law State will recognize the ownership and legal title of the wife in one-half of the community-partnership property acquired while the spouses are domiciled in Louisiana, when the spouses leave Louisiana and community-partnership property is removed by the spouses from Louisiana to other States. It is a generally recognized proposition of conflict of laws that the title and status of property is to be determined by the law of the jurisdiction under which the property was acquired, and in case of the removal of the property to another State, the State to which the property is removed will assume and recognize the law of the jurisdiction from which the property was removed, in order to determine the ownership of the property. Thus, if a husband and wife domiciled in Louisiana accumulate $1,000,000, this is community property, and under the amendment disregarding the Louisiana law for Federal tax purposes, the husband is compelled to report as his income the wife's one-half of the income of this property. If the husband and wife, however, sell their Louisiana property and move to New York or some other common-law State and invest the proceeds of the property in the latter State, the common-law States, under the law and decisions of the courts, recognize the vested interest of the wife created by the law of Louisiana, where the property was acquired, and the $1,000,000 invested in New York is, therefore, recognized by the courts of New York as belonging one-half to the husband and one-half to the wife. This is true, even though the property technically may stand in the name of the husband in the common-law State, for under such circumstances the husband is considered trustee for $500,000 of the property for the benefit of the wife. In New York, therefore, or in any common-law State, when the property taken from the community State is reinvested, one-half immediately becomes the property of the husband and the other half the separate property of the wife, and the husband and wife may make separate returns for Federal income-tax purposes (appendix 26).

It is clear, in the light of these facts, that if the proposed bill is passed, the result of the situation will be that a husband and wife who sell their community property in Louisiana and reinvest it in common-law States where the same property will be considered separate property, will be able to make separate

returns in the common-law States, whereas if they had remained in Louisiana they could not make separate returns. The proposed bill, in attempting to emasculate the law of Louisiana and other community-property States, and applying, as it does, only to community-property States, would result in discrimination against community-property States, and would not be legally applicable when the husband and wife removed their property to another State.

We have the amusing and illogical situation of Congress attempting to fix property rights in eight States for taxation purposes in the very teeth of the law of the eight States involved, when, if the same property is removed to the other States of the Union, these latter States recognize the law of Louisiana and the property rights of the spouses, and Congress following the law of the common-law States, taxes the former community husband and wife on the very basis that they should have been taxed on if the pending community-property bill had not been adopted. In short, Congress would recognize for income-tax purposes the law of common-law States which recognize the law of Louisiana, but when dealing directly with Louisiana citizens the Louisiana property law would be disregarded.

Another gross discrimination against and injustice to citizens of community-property States that would result from the passage of the pending bill is illustrated by the fact that earnings and profits of both the wife and husband become community-partnership income and property in community-property States. In Louisiana, for example, the salary or wages of the wife, if she is employed, and the earnings of the wife if she is engaged in a business, occupation, or industry separate from her husband, become community-partnership income and property if she is living with her husband at the time they are acquired. Moreover, money and profits made by a wife in speculation wth money or property belonging to her separate estate become the income of and belong to the community partnership (appendix, 27). On the contrary, in a common-law State, the wife's earnings and profits during marriage would be her separate income and property. The husband in common-law States has no interest or ownereship whatever in her earnings or profits and she can make them the subject of a separate return upon which she pays a tax based only upon their amount, and the common-law husband in his tax return can omit all such earnings and profits of his wife. If the present bill is adopted, the husband in Louisiana and other community-property States would have to pay on all the wife's earnings and profits as well as on all his own, and in addition upon dividends, rents, and interest upon his wife's separate property under his administration. The accumulation of all of this income in a single return as required by the present bill would, of course, greatly increase the tax rates and the resulting tax in community-property States would be much greater than in a common-law State where the wife could make a separate return of her own earnings. In short, husbands and wives in community-property States would be required to pay much larger taxes than husbands and wives in common-law States on the same character of income. This is only another illustration of the inequity and unfairness resulting from any attempt on the part of the Government to disregard the local State laws with reference to the ownership of income and property. Unless the Government is prepared to go to the full extent of requiring husbands and wives in every State, common law as well as community, to combine all their income in one return, there can be no justification for requiring such a result in community States alone.

We might give numerous illustrations, showing that by contract the ownership of property may be and is frequently changed in the various common-law States, resulting in a different application of the Federal income-tax law. This condition of affairs is inherent and fundamental under our State and Federal Constitutions, and ownership and property rights, as fixed by the various State laws must, in the nature of things, be followed by the Federal Government in applying its laws. It is submitted that the principles we have outlined are elementary under our constitutional system. In Louisiana, the community-partnership law is imposed by statute, and does not result from contract, and, of course, was not adopted to bring about any income-tax benefits, because the community-partnership law was in existence many years before the adoption of the first income-tax law. In fact, the community-partnership law has been a part of the civil law of Louisiana ever since colonial days. Louisiana inherited the community-partnership law from France, which in turn borrowed it from Spain, where it had prevailed since the seventh century (appendix, 2, 3, 5, 6, and 7).

UNIFORMITY AMONG ALL STATES COULD FAIRLY BE OBTAINED BY FEDERAL LEGISLATION ONLY BY REQUIRING INCOME OF HUSBAND AND WIFE IN EVERY STATE TO BE COMBINED IN FEDERAL INCOME TAX RETURNS

It is apparent, since the law of each State must determine questions of ownership, that it is not possible to obtain identical practical results from the operation of the Federal revenue laws in each of the 48 States of the Union, unless Congress wishes to do violence to the dual character of our Government and the historic and settled principle that the Federal Government will recognize property and the ownership of property as defined and created by local State laws in the various States. It has been suggested that uniformity is desirable. It is obvious that uniformity cannot be obtained by having Congress, in the form of a discriminatory legislative act, disregard the fundamental laws of 8 States of the Union, and, at the same time, recognize the local law of all of the other States of the Union as a guide and basis for the application of the Federal income-tax law. If the Government desires to tax the separate income of both husband and wife as a whole and as a unit in one return, it is not fair to attempt to bring about this result by legislative fiat in only 8 States of the Union. If identical uniformity is desired, Congress should tax husbands and wives as a unit in all the States of the Union, and compel a single return in which must be included the income of both husband and wife in all States. Insofar as husbands and wives are concerned, such a law would be perfectly uniform in its application in every State of the Union. In fact, we understand that this is the method of solving the problem suggested and recommended by Secretary Morgenthau of the Treasury Department. (See statement of Secretary Morgenthau, issued December 15, 1933; appendix 28.) In referring to this method of solving the problem of uniformity, we do not intend to suggest that husbands and wives of common-law States would approve such a law even if it could be sustained under the Constitution. In fact, it might be contended with considerable force that by the adoption of such a bill husbands and wives would be discriminated against in favor of single persons.

The foregoing brief summary of the community partnership law and its practical operation make clear how futile and impossible it is for Congress to ignore property rights in an attempt to produce uniformity, and that instead of securing uniformity, the proposed bill, even if it could be adopted under the Constitution, will produce endless confusion and inequities. Moreover, we feel that we have demonstrated that the proposed bill (H. R. 8396) is discriminatory and if passed will result in gross unfairness to the taxpayers of eight States of the Union.

Respectfully submitted.

CHARLES E. DUNBAR, JR.,
SPENCER, GIDIERE, PHELPS & DUNBAR,
Attorneys for Louisiana Community Property Taxpayers Committee.

APPENDIX

The following decisions, statutes, and authorities are submitted in support of the statements of law contained in the foregoing brief:

(1) Vol. 61, Congressional Record, No. 146, for November 3, 1921; pp. 8037, 8038; Report of hearings before Committee on Ways and Means, House Reports, Revenue Division, 1924, pp. 104, 348, 375 to 482, inclusive.

(2) *Poe* v. *Seaborn* (Wash.), 75 Law Ed. 239–247, 282 U. S. 101–118; *Fred O. Goodell* v. *I. B. Koch* (Ariz.), 75 Law Ed. 247, 282 U. S. 118–122; *Jacob O. Bender* v. *Wm. Pfaff* (La.), 75 Law Ed. 252, 282 U. S. 127–132; *Geo. C. Hopkins* v. *G. W. Bacon* (Texas), 75 Law Ed. 249, 282 U. S. 122–127; *United States* v. *Malcolm* (Cal.), 75 Law Ed. 714, 282 U. S. 792; see also *Warburton* v. *White*, 176 U. S. 484; *Arnett* v. *Reade*, 220 U. S. 311.

(3) Opinions of Acting Attorney General Mitchel in 1927, and Opinions of Attorney General Daugherty in 1924; Attorney General Stone in 1924, and Attorney General Sargeant in 1926; see 32 Op. Att. Gen. 208, 435; 34 Ibid 376, 395; 35 Ibid. 89, 205. General Counsel Memorandum, 6351; 32 Op. Att. Gen. 435. T. D. 2090, 2137, Of. Dec. No. 426, reported at 2 C. B. 198. T. D. 3071, reported at 3 C. B. 221; and T. D. 3138. See also appendix (1), *supra*.

(4) See Appendix (1), (2), and (3), *supra*.

(5) Louisiana Revised Civil Code, Arts. 2404, 2399, 2402, 2334. *Childers* v. *Johnson*, 6 La. Ann. 634, at p. 641

(6 Louisiana Revised Civil Code, Arts 2334, 2399, 2402, 2404, 2386, 2385, and 2106.

(7) See State decisions cited and quoted in Supreme Court decisions referred to in appendix (2), *supra*, and decisions quoted in opinion of Attorney General Palmer, of February 26, 1921 (32 Op. Att. Gen. 435), which was published and promulgated by the Treasury Department on March 3, 1921, in connection with T. D. 3138. See also authorities and statutes quoted in brief for respondent in the Supreme Court of the United States, in the case of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930, filed in behalf of respondent and

Louisiana taxpayers by Charles E. Dunbar, Jr., and Monte M. Lemann, attorneys, of New Orleans, Louisiana.

(8) Louisiana Revised Civil Code, Art. 2404; *Melady* v. *Succ. of Bonnegent*, 142 La. 534; *Bister* v. *Menge*, 21 La. Ann. 216; *Radovich* v. *Jenkins*, 123 La. 355; *Snowden* v. *Cruse*, 152 La. 144; *Ramsey* v. *Beck*, 151 La. 100; *Succ. of Moore*, 42 La. Ann. 331, at p. 341. See authorities contained in brief of respondent in Supreme Court of the United States in the matter of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, pp. 23–26, inclusive.

(9) Louisiana Revised Civil Code, Art. 2404; *Smallwood* v. *Pratt*, 3 Rob. 132; *Dixon* v. *Dixon's Executors*, 4 La. 188; *Phillips* v. *Phillips*, 160 La. 813. See authorities contained in brief filed in Supreme Court of the United States in behalf of respondent in the matter of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930, pp. 26–28, inclusive.

(10) See authorities referred to in Appendix (9), *supra*.

(11) Louisiana Revised Civil Code, Arts. 140 to 161, inclusive, and Arts. 2425 to 2437, inclusive, and Art. 155. *Davock* v. *Darcy*, 6 Rob. 342; *Jones* v. *Morgan*, 6 La. Ann. 630; *Wolfe & Clark* v. *Lowry*, 10 La. Ann. 272; *Mock* v. *Kennedy*, 11 La. Ann. 525; *Webb* v. *Bell*, 24 La. Ann. 75; *Vickers* v. *Block*, 31 La. Ann. 672; *Chaffe* v. *Watts*, 37 La. Ann. 324; *Brown* v. *Smyth*, 40 La. Ann. 325; *Walmsley* v. *Theus*, 170 La. 417, *Gasteur* v. *Gasteur*, 131 La. 1; C. F. opinion of District Court in this case, R. 21. *Carite* v. *Trotot*, 105 U. S. 751; *Jones* v. *Jones*, 110 La. 677; *Larose* v. *Maquin*, 150 La. 353, at 358; La. Code of Practice, Art. 298; *Hill* v. *Hill*, 115 La. 459; *White* v. *White*, 159 La. 1065; see authorities referred to, pp. 28 to 30, inclusive, in brief for respondent, filed in the Supreme Court of the United States in the case of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930.

(12) Louisiana Revised Civil Code, Arts. 2403, 2408; *Glenn* v. *Glan*, 3 La. Ann. 611; *Dillon* v. *Treville*, 129 La. 1005; *Succ. of Casey*, 130 La. 743; *Succ. of Goll*, 150 La. Ann. 910. (Compare *Childers* v. *Johnson*, 6 La. Ann. 034). See authorities referred to, pp. 35 to 38, inclusive, in brief for respondent, filed in the Supreme Court of the United States in the case of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930.

(13) See *Lob's Sons* v. *Karnofsky*, 177 La. 229, 148 So. 34.

(14) See Louisiana Revised Civil Code, Arts. 915 and 916; *Theall* v. *Theall*, 7 La. 226; *Ramsey* v. *Beck*, 151 La. 100; *Succ. of Hayes*, 33 La. Ann. 1143; *Succ. of Moore*, 40 La. Ann. 531.

(15) Louisiana Revised Civil Code, Art. 915; *Bossier* v. *Herwig*, 112 La. 539; *Brooks* v. *House*, 108 La. 542. See authorities referred to in appendix (14), supra.

(16) *Burton* v. *Brugier*, 30 La. Ann. 478; *Webre* v. *Lorio*, 42 La. Ann. 178; *Succ. of Marshal*, 118 La. 212; *Corell's Estate*, 137 La. 702; *Liebman* v. *Fontenot*, 275 Fed. 088; *Succ. of May*, 120 La. 692; see appendix (14) and (15), supra. See authorities referred to, pp. 38 to 43, inclusive, in brief for respondent, filed in the Supreme Court of the United States in the case of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930.

(17) Louisiana Revised Civil Code, Arts. 123, 136, 138, 140, 150, 155, 159, and 2406. Louisiana Code of Practice, Art. 298. *Dillon* v. *Dillon*, 35 La. Ann. 92; *Succ. of Lebesque*, 137 La. 507; *Crochet* v. *Dugas*, 126 La. 285; *Williams* v. *Goss*, 43 La. Ann. 868; *McClelland* v. *Gasquet*, 122 La. 241; *Hill* v. *Hill*, 115 La. 490; *White* v. *White*, 153 La. 313, 159 La. 1065; *Lockhart* v. *Dicey*, 161 La. 282; *Nichols* v. *Her Husband*, 7 La. Ann. 263; *Ford* v. *Kittredge*, 26 La. Ann. 100; Act 21 of 1928, amending Art. 160 of the Revised Civil Code. See authorities referred to, pp. 31 to 35, inclusive, in brief for respondent, filed in the Supreme Court of the United States in the case of *Jacob O. Bender* v. *William Pfaff*, Docket No. 86, October Term, 1930.

(18) See *Houghton* v. *Hall*, 177 La. 237, 148 So. 37; *Succ. of Howell*, 177 La. 270, 148 So. 48.

(19) *Tracy* v. *Commissioner* (C. C. A. 6th Cir.), 70 F. (2d) 93.

(20) *Virden* v. *Commissioner*, 6 B. T. A. 1123.

(21) *Wright* v. *Commissioner*, 20 B. T. A. 21.

(22) See, for example, *Dunham* v. *Commissioner*, 27 B. T. A. 1068, *Gillette* v. *Commissioner*, 18 B. T. A. 434; *In re Bellingrath*, 8 B. T. A. 11; *First National Bank* v. *Commissioner*, 13 B. T. A. 1096.

(23) Louisiana Revised Civil Code, Articles 2440, 2329, and 1790.

(24) See, for example, *Appeal of Robinson's Estate*, 4 B. T. A. 47; *Garden* v. *Commissioner*, 10 B. T. A. 592; *Henningsen* v. *Commissioner*, 30 B. T. A. 301; *Johnson* v. *Commissioner*, 5 B. T. A. 253; *Bailey* v. *Commissioner*, 3 B. T. A. 362; *Appeal of Hoffman*, 3 B. T. A. 964; see also *Bingham* v. *White*, 31 Fed. (2) 574.

(25) Louisiana Revised Civil Code, Art. 1749.

(26) *Depas* v. *Mayo*, 11 Mo. 314; *T. O. Phillips, Petitioner*, v. *Commissioner*, 9 B. T. A. 153 (1927); *Succ. of Popp*, 146 La. 404. The Treasury Department has also recognized this rule in the application of the Income Tax Law in Solicitor's Opinion 121, reported in Internal Revenue Cumulative Bulletin for December 1921, at page 197.

(27) *Houghton* v. *Hall*, 177 La. 237, 148 So. 37 (1933); *Hellberg* v. *Hyland*, 168 La. 493 (1929); Louisiana Revised Civil Code, Articles 2402, 2334, as amended by Act No. 170 of 1912 and Act No. 186 of 1920; see authorities referred to in appendix (5) and (6), supra.

(28) Revenue Revision 1934, hearings before the Ways and Means Committee, December 16 to 21, 1933, and January 9 to 11, 1934, pp. 112–113.

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