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Hearing held before

SUBCOMMITTEE OF THE COMMITTEE ON FINANCE

Emergency War Time Tax Act

February 18, 1936

Washington, D. C.

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EMERGENCY WAR TIME TAX ACT.

- - -

Tuesday, February 18, 1936.

United States Senate,

Subcommittee of the

Committee on Finance,

Washington, D. C.

The Subcommittee met, pursuant to adjournment, at 10:30 o'clock a.m., in Room 310, Senate Office Building, Senator Joseph F. Guffey, presiding.

Present: Senators Guffey (Chairman) and LaFollete.

Also Present: Ralph W. Brown, Special Assistant to the General Counsel of the Treasury; P. J. Mitchell, of the General's Counsel's Office of the Treasury; Mr. Winsted, of the General Counsel's office of the Treasury; and L. H. Parker, Chief of Staff, Joint Committee on Internal Revenue Taxation.

Senator Guffey: Mr. Brown, you were on the stand when we adjourned. You may proceed.

STATEMENT OF RALPH W. BROWN (Continued),

Special Assistant to the General Counsel of the Treasury.

Mr. Brown: Upon adjournment last week I had nearly completed a summary of the work carried on by the Treasury during the recess. I have only a few additional observations to make before concluding.

There are contained in the bill, as there are in existing law, several provisions dealing with the problem of undistrib-

ted current earnings or surpluses. This problem has had the attention of the Congress ever since the adoption of the first income tax following the taking effect of the 16th Amendment, and grows out of the fact that corporation earnings have been taxed at a low flat rate, whereas those of individuals have been subject to the normal tax and surtaxes.

Section 102 of the Revenue Act of 1934 imposes a surtax at rates of 25 per cent and 35 per cent on corporations accumulating gains or profits beyond the reasonable needs of the business. In Section 102 of the bill these rates are raised to 98 per cent and 100 per cent, respectively. Moreover, so far as appears, this tax is in addition to the taxes imposed by Section 13. In addition Section 102(a)(B) imposes a tax of 75 per cent upon the undistributed surplus of a corporate taxpayer without regard to intention to improperly accumulate surplus. The undistributed surplus of a corporation is defined for the purposes of this subsection as 4.7 per centum of the adjusted declared value, minus certain deductions, which reduce the undistributed surplus to 3.7 per centum of adjusted declared value, or less.

These are very drastic provisions and under certain circumstances may result in a corporation paying taxes substantially in excess of the income upon which they are levied. In the redrafting of the bill we have restored the provisions of Section 102 as they appear in the Revenue Act of 1934 on

the theory that in a revenue act imposing taxes at rates as severe as those found in Section 13, the question of undistributed current earnings is scarcely a problem. Moreover, it was felt that your Committee would wish to consider these provisions in connection with the provisions of those titles of the Act which have to do with the operation and financing of industry in war time. While it is recognized that this action invades the field of policy, it was believed to be justified in the absence of a clearer statement of the necessity for the provisions of Section 102 as found in the bill.

Another section bearing on the problem of undistributed current earnings is found in Subtitle D, Section 351 of which imposes a surtax upon the undistributed net income of personal holding companies at rates of 98 per cent on the amount of such net income not in excess of \$100,000, and 100 per cent on the amount in excess of \$100,000. In computing the undistributed adjusted net income subject to this tax, losses from sales or exchanges of capital assets, which are disallowed as a deduction by Section 117(d), are not allowed. This section is modeled upon Section 351 of Title I-A of the Revenue Act of 1934, except for the higher rates and greatly restricted deductions.

Again in this connection, Section 381 of Subtitle E imposes an excise tax on the issuance of stock dividends at the rate of \$100 a share or fraction thereof. The severity of

this tax, it is feared, raises a question whether an attempt is not being made to regulate the internal affairs of corporations, which regulations is reserved by the Constitution to the States. Probably the drafters made the rate high to take care of stock with a high par value or selling price. It is believed that this difficulty could be met by providing a somewhat higher rate on high-priced stocks than on low. A precedent for this exists in the present tax on the issuance of stock. Subdivision (2) of Schedule A of Title VIII of the Revenue Act of 1926, as amended, particularly section 722 of the Revenue Act of 1932. Probably a fairly high rate of tax could be supported, but it is a question whether the present rate is not too severe.

Apart from the foregoing considerations, it is a question whether the tax imposed by Section 381 of the bill is necessary in view of the fact that stock dividends scarcely present a serious question so far as affects the problem of distribution of current earnings, especially under a tax bill which in the first instance takes so large a share of the corporation taxpayer's income. The declaration of stock dividends presents a problem in the case of surpluses accumulated in the past and not yet distributed, inasmuch as it permits the taxpayer to enjoy such surpluses without immediate tax liability. However, the decision as to the imposition of this tax is clearly a question of policy for the Committee.

This concludes the Treasury's summation of the field covered by its administrative studies.

Senator Guffey: Thank you very much, Mr. Brown.

Senator LaFollete: I now suggest that we have the questions that were worked out by Mr. Parker as pertaining to the policy that must be determined prior to action upon any specific provisions of the bill incorporated in the record at this point.

STATEMENT OF L. H. PARKER (Continued),
Chief of Staff, Joint Committee on Internal Revenue Taxation.

Mr. Parker: I, unfortunately, do not have a copy of the letter here.

Senator LaFollette: The letter is not important.

Senator Guffey: I have the whole thing here for you. It may be incorporated in the record.

The foregoing letter referred to is as follows:

"February 15, 1936.

Honorable Joseph F. Guffey,
United States Senate,
Washington, D. C.

My dear Senator:

"As requested by the subcommittee considering the War Revenue and Industrial Management Bill, I am enclosing a table containing the principal issues which in my judgment should be discussed by the subcommittee.

"I believe that the next meeting of the subcommittee is

tentatively set at 10:00 a.m. on Tuesday, February 18,

Very respectfully,

(Signed) L.H. Parker,

Chief of Staff."

The questions referred to in the above letter are as follows:

PRINCIPAL ISSUES

IN RE

THE WAR REVENUE AND INDUSTRIAL MANAGEMENT BILL - SUBMITTED
FOR THE CONSIDERATION OF THE MEMBERS OF THE SUB-COMMITTEE.

TITLE 1 - INCOME TAXES

- No. 1 - Should the bill be designed so as to take the profit motive away from both corporation and individual?
- No. 2 - If the answer to issue No. 1 is in the negative, what maximum rates can be used without destroying the profit motive?
- No. 3 - Should the bill be designed to produce the maximum revenue possible, or should the social and economic effects of the bill be deemed more important?
- No. 4 - Is it sound to adopt the general principle that the most important thing in connection with war legislation is "To win the war"?
- No. 5 - Should the bill be designed to tax net income, only, or should limitations be imposed on the deduction of necessary business expenses with the result that the tax rates may apply to a figure greater than true net income?
- No. 6 - Should the bill attempt to correct possible defects

and to close possible loopholes in existing law when such defects or loopholes are a present problem not directly connected with war revenue legislation?

No. 7 - Should the rather low taxes proposed in the bill on the individual with a moderate net income be increased so as to secure more revenue?

No. 8 - Is it constitutional to tax gifts as income, as indicated by the bill?

No. 9 - Is it constitutional to require the filing of joint returns by husband and wife as proposed in the bill, - such a provision affecting the present community property system?

No. 10 - The bill taxes all gains from the sale of capital assets, but disallows all losses from such sales, except to the extent of \$3,000 -- that is, if a man has \$50,000 of gain from the sale of capital assets and in the same year has \$80,000 of losses from such sales, the bill proposes to tax the man on \$48,000 regardless of the fact that he had a net loss of \$30,000. Is this a sound policy?

TITLES II to VI - INDUSTRIAL MANAGEMENT

No. 11 - Should the bill be kept in its present form or should it be divided into two separate bills -- one dealing with revenue and the other with industrial management and control?

No. 12 - Title III of the bill gives the President power to fix prices, close exchanges, requisition plant, etc., not only after war has been declared but whenever Congress declares a

grave national emergency exists, or whether there exists a war between two foreign powers. Is it constitutional to grant this power to the President at a time we are not actually at war?

No. 13 - As a practical matter, will the War Department be able to organize quickly enough to handle the exceptional duties placed on it in Titles II and III?

No. 14 - Is the revolving fund of \$500,000,000 provided for in Section 506 sufficient?

No. 15 - Is there any danger, under the terms of this bill, that some future President, personally ambitious of extreme power, would get us into war for the purpose of wielding such power?

Senator Guffey: What else is there that should go in the record today? I agree with you, Senator La Follette, that we should not go ahead when the rest of the Committee are not present.

Mr. Parker: I think there is nothing further to go in the record at this time.

Senator LaFollette: I suggest, Mr. Chairman, that we take a recess then subject to the call of the Chairman of the Committee.

Senator Guffey: With that understanding, we will stand adjourned.

(Whereupon, at 10:40 o'clock p.m., the Committee was adjourned subject to the call of the Chairman.)