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COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

SEPTEMBER 8, 1969

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STATEMENT OF
PAUL H. DOUGLAS, CHAIRMAN
THE NATIONAL COMMITTEE ON TAX JUSTICE
before the
SENATE COMMITTEE ON FINANCE
September 8, 1969

Mr. Chairman and Members of the Finance Committee:

I should like to thank you for giving me the privilege of appearing before you in behalf of speedy and significant tax reform. We have discussed these matters together in the past as friends around the conference table. They are more important this year than ever, for public interest and indignation seems to be at an all time high. Consequently, this may be the year for a successful conclusion to the long struggle for tax justice or, if not that, for a significant beginning. My former Senate colleagues and friends in the House of Representatives tell me that there is intense public interest in tax reform. Mail protesting the injustices in our tax system is reportedly higher than ever. The debate in the House of Representatives on the Tax Reform Act before you clearly indicated that the vast majority of Congress wants tax reform now; the Administration has promised it. To assure that this opportunity is not passed over, in May and June of this year I asked a number of eminent citizens, prominent in their fields of endeavor, to band together as The National Committee on Tax Justice. All of the committee members share my feeling that tax reform is an

immediate necessity. We have furnished you with a full list of our committee members. Included among these members are experts on the injustices in the present tax system.

The members of The National Committee on Tax Justice endorsed a five-point tax reform package that would provide equity to taxpayers, relieve the tax burden on low and middle income families and provide new funds for the Federal government. To achieve tax justice we have urged Congress to enact the following reforms:

1. Eliminate preferential treatment of all capital gains.
2. Eliminate special deductions for depletion of oil and other minerals beyond the cost of the mineral property and for the expensing of exploration and development costs.
3. Provide federal assistance to state and local bond issues instead of allowing a tax exemption on their interest.
4. Withhold taxes on interest and dividends at the source as is now done for wages and salaries.
5. Provide tax relief for low and middle income families by providing a minimum standard deduction of $1,100 for all families.

It was estimated that this program would provide $7 to $10 billion more in Federal revenues while relieving 38 million low and middle income families of $2.5 billion in tax liabilities.

Congress was also asked to give prompt attention to the ending of other unwarranted tax favors such as accelerated depreciation

on buildings, the multiple surtax exemptions on corporations and the unlimited charitable deduction. The tax laws should also be revised to avoid encouraging the formation of conglomerates.

This reform program is a moderate one and has a broad-based acceptance.

The "Tax Reform Act of 1969" passed by the House of Representatives is an important initial step towards fulfilling the goals of the committee. True reform will require even bolder steps.

Careful scrutiny of the act reveals that the rich continue to receive favored treatment. Tax reform monies are to be used to reimburse persons with large incomes among whom those who presently gain most from tax preferences are found.

A third of the "goodies" providing relief to taxpayers will go to less than 10% of the nation's taxpayers--those with adjusted gross incomes of more than $15,000. The $3.1 billion tax relief package for this small minority of taxpayers is almost 2½ times the $1.3 billion to be recouped by tax reform from them. Over half of the $4.5 billion in general rate reductions goes to this exclusive class. The new lower maximum tax on earned incomes gives $100 million in relief to the less than 1/2 of 1% who have adjusted gross incomes of over $50,000. Although welcome relief is indeed given to low and middle income families, it is obvious that the

wealthy will benefit most from what should be labeled a "readjustment" rather than a reform.

The measure passed by the House adopted The National Committee on Tax Justice goal of a minimum standard deduction of $1,100 for all families. In 1971 this will benefit over 38 million taxpayers and take off the tax rolls almost six million poor people. The raising of the standard deduction to 15% with a $2,000 maximum and the rate decrease in the lowest five tax percentages will help working families earning $7,000 to $13,000 a year. More than half of the tax reduction, however, will eventually go to those persons in higher income brackets who comprise less than 1/4 of the taxpayers. There is no tax justice when money gained from tax reform is used to reduce the rates of those who benefited most from tax inequities. This is especially deplorable when it creates a deficit and would reduce the funds available for much needed federal programs. More money is desperately needed for education, slum clearance and programs to improve our environment. The lost revenue will instead go to individual citizens who are best able and should pay their fair share of these programs. The Senate should closely examine this unfair redistribution of the tax burden. This re-examination should take place in the context of the re-ordering of priorities inherent in the House bill. By 1972 there will be a revenue loss of $4 billion that will fall into the pockets of less than 1/4 of our taxpayers.

This will occur while there is a pressing need for expanding federal and state programs.

The bill is advertised as a tax reform measure but more than half of the revenue gain--$3 billion--comes from a repeal of the investment tax credit. This halfway legislation falls way short of fully plugging all tax loopholes. Elimination of most tax preferences should bring a revenue gain of over $12 billion--a sufficient sum to ease the burden of the low and middle income wage earner and provide some funds for the country's needs.

The House measure ignores unrealized gains transferred by gift or death--a loophole that costs the United States Treasury over $2 billion annually. The National Committee on Tax Justice called for the elimination of the preferential treatment of all capital gains including unrealized gains transferred by gift or death with some provision for averaging over a period of years. The adoption of this proposal would yield an annual revenue gain of $6 to $9 billion. The repeal of the alternative capital gains tax of 25% and the provisions in the minimum tax and allocation of deductions only begin to reduce this unwarranted preference.

The excess oil depletion allowance was reduced from 27½% to 20%. Depletion allowances for other minerals were correspondingly reduced. This action only reduces the unwarranted $1.6 billion subsidy by a quarter and is not a true reform measure. There is no logic to sustain this wasteful practice that produces only

9 cents worth of additional mineral resources for every federal dollar expended. The bill curbs the so-called carved-out and ABC production payments that made it possible for the mineral resources industry to further avoid income taxes. This commendable action will bring an estimated revenue gain of $200 million.

Left untouched were the present tax preferences accorded to the oil industry alone that permit oil operators to deduct in the year paid out most of their costs of exploration for/and development of oil wells--a $300 million subsidy. These costs are comparable to capital outlays which in other industries have to be deducted over a period of years.

The income gained by excess depletion allowances and expensing of exploration and developmental costs are not subject to the minimum tax provisions of the bill, another special concession to the oil industry lobbying effort. The minimum tax itself is an indirect approach to tax preferences. The provision provides that those with considerable means who have escaped taxation pay some tax. The basic inequities of the tax code still remain.

The section on state and local bonds providing for an option of a federal subsidy on taxable issues will confuse the bond market and not dispense with the preference. Tax-exempt interest on state and local bonds should be eliminated. A guaranteed adequate subsidy to the cities would eliminate the need for tax-exempt state and municipal bonds.

The bill does not provide for withholding taxes on interest and dividends at the source, a goal of The National Committee on Tax Justice. This allows nearly $4 billion of dividend and interest income to go untaxed annually.

The bill now before the Senate also falls short in fully plugging the loophole accorded to the real estate industry to deduct depreciation from income faster than the depreciation actually occurs. This preference for real estate operations should be ended. Its need can only be supported in the field of low income housing.

The reform measures in the bill will have to be tightened to cure the present injustices in our tax system that:

-----allow 381 affluent Americans to enjoy incomes of more than $100,000 without paying a penny of income tax;

-----make it possible for one super-rich American to enjoy more than $20 million of income in one year without paying a cent in taxes;

-----allow another super-affluent citizen to enjoy more than $1,500,000 of income without even having to file a tax return;

-----impose the same effective tax rate on those earning over $200,000 as persons earning between $15,000 and $20,000.

The plain fact is that most Americans--those with incomes of less than $15,000 - more than 90% of the taxpayers--shoulder most of the burden of the income tax rates we all see in the tax tables on our tax return. Ironically, though, the higher a person's income and the better able he is to bear tax burdens without sacrificing the necessities of life, the more escape hatches open up to him through which he can avoid paying his fair share of taxes.

Those escape routes, those tax favors, impose a dual hardship on the less well-to-do in America. For not only are they called upon to pay more than their fair share of the tax burden; they are also asked to sit by and do without public programs and services for which they have the greatest need--programs dealing with poverty and the decay of our cities and schools and the pollution of the air and water--supposedly because the government cannot "afford" such programs. For, of course, if the government were collecting the billions of dollars that are currently being siphoned off through gaping tax loopholes, there would be funds for the rebuilding of our slums and schools, for the purifying of the environment and many other programs which are now suffering financial asphyxiation.

The American people know that essential public programs must be paid for; they only ask that their share of that payment be just; that every individual be taxed according to his ability

to bear the burden of taxation; and that no one be asked to bear more than his fair share of that burden because of special tax favors accorded others.

We believe that people with approximately equal net incomes should pay approximately equal taxes. I do not see how this principle of horizontal equity can be opposed by any sensible person. That is what we are trying to obtain. The reforms we advocate would move us much closer to that goal.

The Ways and Means Committee and the House of Representatives have made a beginning in the "Tax Reform Act of 1969." The Senate is in an opportune position to complete the task to provide equity for the taxpayer and recoup funds lost through existing loopholes so that Congress will be able to make some progress on the dire social needs of our country. I know the Senate will take up the challenge and fully meet the growing demand for real tax reform.

SUMMARY OF THE REMARKS OF PHILIP H. WILLKIE

BEFORE THE UNITED STATES SENATE FINANCE COMMITTEE

SEPTEMBER 8, 1969

Philip H. Willkie speaks as Rushville Lawyer-Banker and President, promoter of Rural Small Town-Small City Coalition, Inc.

Willkie believes the Tax Reform Bill would be against the public interests for the following reasons:

It will cripple the creative instincts of man to build for-profit businesses and non-profit, charitable, educational and cooperative organizations; discourage investment in areas essential for national interests; add to the difficulty of middle class people struggling to make ends meet; add to the frustrations of the minorities; further add to the black ghetto crisis, and to the disillusionment of the young people.

That the bill, as passed by the House, will raise real estate taxes, mortgage interest payments and purchase prices of homes; cut down house and apartment starts; slow, if not stop commercial shopping centers and factory building starts; create wide-spread unemployment in the building trades; increase the prices of food; cause the decline of the stock market, possibly precipitating a 1929 type stock market crash; depress the price of older real estate; freeze the real estate and securities market; raise utility rates; hurt the safety of bank deposits in commercial banks, mutual savings banks and savings and loan associations; make it difficult for any man to expand or develop a business; cause capital to flee the country; force much investment banking to be done by the government agencies; curtail the building of local public improvements; and the local control of financing public improvements; cripple independent educational institutions such as schools and colleges and voluntary organizations such as USO, Salvation Army, United Fund; and the other cultural groups; and force individual voluntary, charitable organizations to reduce their functions.

In effect double tax the income of foundations; stop the practice of the great wealth of industry being used for social purposes; force the liquidation of many businesses; hurt the cooperative movement and the development of independent social and fraternal organizations; lead to wide-spread bureaucratic and socialistic control of our entire economic, social and political and cultural life; cripple the use of capital as a tool in a society based on capitalism; freeze markets and reduce incentives; make it difficult go continue profit sharing or bonus type plans of incentive; stymy the development of our national housing goals; and make it difficult to sell farm land.

This bill, if passed in the form passed by the House, will end the American dream------the ability of man in a free society to make their dreams come true.

STATEMENT OF PHILIP H. WILLKIE
BEFORE THE U. S. SENATE FINANCE COMMITTEE
MONDAY, SEPTEMBER 8, 1969

Gentlemen, I appear before you today as a Rushville, Indiana, lawyer, the president and principal shareholder of the Rushville National Bank, and as the organizer and promoter of Rural Small Town-Small City Coalition, Inc., an organization which I incorporated on the 1st day of July, 1969, in association with Max Wright, secretary-treasurer of the Indiana State AFL-CIO, and Grover Hartman, executive secretary of the Indiana Council of Churches, for the purpose of promoting, publicizing and researching the economic, political, and social development of the rural small town-small city areas.

I appear here because I believe the present Tax Reform Bill as passed by the United States House of Representatives is against the public interest. I believe strongly that if the Senate passes this bill in the form that it was passed by the house and should the President sign it, great damage will be done to the country, our society, and the economy. It will do much to curb the creative instincts of man: those creative instincts which have done much to make this country what it is today.

In the effort to eliminate many so-called "loopholes" in the present tax structure, many valuable incentives to investment in areas essential to the national interest will be eliminated. In many cases, the most effective means of problem solving are through tax credits extended to the private sector. The proposed law threatens this concept in several areas.

I believe that the bill if enacted into law will stymy men and stop them from building and improving both for-profit businesses and not-for-profit organizations and institutions which have contributed so much to the common welfare. I believe this bill is the most socialistic ever seriously considered by the Congress of the United States.

This bill, if enacted in its present form will make it more difficult for the middle class, struggling now to make ends meet. It will add to the frustrations of the minorities, and it will indirectly contribute to the disillusionment of many of our young people.

I think the "reform" would raise real estate taxes, raise mortgages and interest payments, raise the purchase price of homes, cut-down housing and apartment projects, substantially slow if not stop the construction of all commercial shopping centers, office and factory buildings, and create widespread unemployment in the building trades, which will of necessity spread to other industries. Once a rise in unemployment begins, where does it stop? So called "reform" will increase the price of food, cause a further decline of the stock market, precipitating possibly a 1929 type crash, depress the price of older real estate, freeze both the real estate and securities market, cripple the municipal bond market, substantially end the local control of public improvement financing, raise all utility rates, electric, gas, water and telephone, hurt the safety of all deposits in commercial and mutual savings banks and savings and loan associations, making it practically impossible (or very difficult) for any man to expand or develop a business. It will further aggravate the dollar drain problem by causing capital to flee the country, creating a situation where most investment banking functions of necessity are done by government banking such as our SBA or RFC type arrangements.

The Tax Reform Bill if it becomes law in the form in which it was passed by the House will curtail the building of local public improvements such as schools, university dormitories, sewerage systems and fire stations, forcing them to borrow from federal agencies. Local control of the financing of public improvements will be ended. It will seriously hurt if not cripple all independent educational institutions such as schools and colleges, voluntary organizations like USO, the Salvation Army, United Fund, the Heart Fund and the Cancer Fund, hinder the cultural development of the country by hurting museums, symphony orchestras and theater groups, force all independent voluntary, educational, charitable and service organizations to either drastically reduce their functions or become wards of the Department of Health, Education and Welfare.

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The bill places an unprecedented tax on the income of foundations. Most money that goes into foundations has been previously earned and taxes paid on it at the time it was earned so that for the first time in history charitable contributions to educational institutions and to churches and others will be taxed the second time. This is not only unfair but it will obviously reduce contributions by at least the amount of the tax. Also the stipulation in the new tax bill relating to foundations specifies that a foundation may not own more than 20% of the voting stock of a corporation. There are other stipulations which will make it necessary for a great many foundations to se'l stock in companies that are small. Larger companies will probably have to put their stock on a public market in spite of the fact that the owners of the stock believe this is undesirable for the business. We would like to see both the tax and these new stipulations relating to foundations removed when the tax bill is finally passed.

In my opinion, the house version of the "reform" bill will seriously damage the cooperative and hurt the development of independent organizations. It will either lead to wide-spread bureaucratic and socialistic control of our economical, social, political and cultural life, or mean the drastic curtailment of many social services now provided by independent institutions. This bill has been highly publicized as a bill to soak the rich and help the poor and middle classes. I believe, the bill should it become the law, without major revision, will be a tax measure by which the wealthy wiggle out and the poor and middle classes get soaked.

Why do I believe that this bill will do all these drastic things? Because this bill as it 's presently is an anti-capital bill. In its basic concept it breaks down the distinction between capital and income. It will make it difficult for any individual or group of individuals operating on either a for-profit or not-for-profit basis. This goes not only for individuals and corporations but also for colleges, charitable organizations anc cooperatives to accumulate and use capital. Capital is the basic tool in the functioning of a free economic system. I do not believe, its effectiveness can be crippled as it is crippled in this bill without crippling the system. Specifically, the bill increases the capital gains tax at the top end of the spectrum from 25% to 32½% ~~and in some instances up to 50%,~~ and extends the holding period from six months to a year on the sale of all properties and securities. This can only have the effect of slowing and freezing markets and reducing incentives to build and develop businesses and real estate projects.

This substantial increase in taking long-term capital gains is not benefitted by the new 50% maximum rate to be applied to earned income. This is one of the extremely rare instances in which a law is made retroactive to cover gains made prior to the year in which the law was passed. An individual who has spent much of his lifetime as an executive of a company, having invested not only his efforts and know-how but a great deal of his personal funds in that company's stock, undoubtedly planned his future based upon the expected after-tax monies to be received upon the retirement of this stock. It appears to be against all previous IRS policy and certainly is not morally justifiable, to suddenly reduce the funds (in some cases a 15% reduction) that an individual needs upon retirement in order to fulfill his future plans. It would certainly seem to be more equitable to eliminate the alternative tax computation on any securities acquired after July 25, 1969.

If this would be unacceptable to Congress, perhaps it would be willing to allow the alternative tax computation to be used for that portion of any gain on the sale of securities represented by the appreciation in the securities up to July 25, 1969. As the proposed law now stands, Congress is, in effect, proposing to increase the tax rate on long-term capital gains, most of which occurred in prior years.

It should be noted that the bill contains a provision which would ban capital gain treatment for the taxable portion of a distribution from a qualified pension, profit-sharing or stock bonus plan made by the employer during plans years beginning after 1969. Thus, employer contributions made on behalf of an employee prior to 1970 will still get full capital gain treatment on lump sum distributions. This prospective approach to new tax legislation exists throughout not only this law but all prior tax law changes. The retroactive feature of the elimination of the 25% maximum alternative tax would not seem to be in keeping with prior policy of both the IRS and Congress.

Both the increase in capital gains tax and the provisions in the new tax bill which will make it impossible to continue profit-sharing, bonus plans of one kind or another, are definite restrictions on incentive. In the U. S. we do have a capitalist system. It is a system based on private ownership of property, a system based on competitive rewards to those who compete best for serving the customer in a free market, and yet a system which has been freely open to ability, talent and creativeness wherever it has appeared. And what has been the result? A system which has brought greater benefits to more people than any other system in all history. The Russians have found it desirable even in their system to introduce more and more incentives for a better result for everyone. It seems strange that the United States is now enacting laws that will reduce or eliminate incentives.

The changes on the depreciation rules on real estate coupled with the increase in the capital gains tax, coupled with the interest limitation to $25,000 for each individual plus the income received from any project has to slow if not stop all kinds of real estate development and cause unemployment in the building trades. This will prevent the fulfillment of our national housing goals. A reliable source in the accounting field reports that one real estate investor "has halted a deal for the construction of 25,000 apartments because he does not choose to pay the proposed 32½% capital gains tax for the privilege of transferring his investment from (i.e., selling) land he has owned for 15 years."

At this time, Mr. Chairman and members of the committee, I would like to call your attention to the present housing condition in the United States, and invite you to consider the serious crisis we face in the home building field. One of the best examples I can refer to you exists in Greater Indianapolis; not far from my home. In that area, according to the National Association of Home Builders, housing starts took a tremendous dip in July, while the House considered this bill. July is traditionally considered the height of the building season. As a result, good housing for either purchase or rent is scarce and becoming more scarce. Interest rates which undoubtedly would be raised by the adoption of this bill, are already at record levels. This production of low and moderate income housing is reaching the vanishing point.

If, indeed, any further evidence is required, I would point out that sales prices on housing have risen from 13% to 16% in just the last 12 months due to inflation, land costs, labor costs, and the higher cost of money. Obviously, the passage of the tax reform bill as it presently stands would only exacerbate this situation.

If the situation is not so serious, gentlemen, why is it that craftsmen and subcontractors are working less than a forty hour week, and thus are being forced to seek other employment? Indeed, unless the situation improves, it is predicted that many of these men will be lost to an already critically short skilled housing labor force.

Another critical point to examine in the bill, gentlemen, is the change in the rules of depreciation on utility companies which will be used as an excuse by utility companies all over the country to raise their rates. If this bill is enacted in the next congressional campaign, candidates will be running against incumbent congressmen on the issue that they raised utility rates.

Addressing your attention now to the agricultural area, I wish to point out that the proposed bill heavily penalizes the farmer if he should choose to sell his farm, and to further clarify this, permit me to list a few examples of why I believe this.

1. If he needs to sell for cash, especially, he is subjected to the proposed 32½% capital gains tax even after 20 years of ownership.

2. If the farmer tries to sell his land on installments, he is limited in his ability to contract with the buyer because of the new restrictions on installment sales.

3. The farmer depends upon the economic function of the land investor to provide a ready market for the farmer's land, should he wish to sell before his land is ripe for its next higher use. The investor pays taxes and interest on

his investment and takes the risk of a profitable resale in the unknown future. The farmer receives an intermediate price, higher than warranted for farm use, but lower than for the anticipated ultimate use.

Under the proposed law, the farmer's land becomes less marketable on the installment plan because the land investor cannot surely deduct all the interest on the purchase money mortgage he gives the farmer (Limitation on Interest Deduction).

Even if an investor at the time of proposed purchase should be within the interest limitation (as for example because of a large down payment), an investor will hesitate to commit large sums to a non-income producing, non-liquid investment when he knows he cannot later borrow on it in an emergency except at the risk of losing his interest deduction. Thus, the market for the farmer's land is deprived of a large segment of would-be investors, such as physicians and business executives, who have high incomes but not high investment income against which interest is deductible.

The interest limitation is a fearful specter to a potential land investor because a miscalculation can make the interest offset and completely wipe out any concurrent capital gains.

All the above provisions can only restrict the free sale of farm land, and for that matter, all land.

The placing of the curtailment of capital gains of breeding stock will necessitate cutting down the numbers of breeding stock and definitely will bring about an increase in the price of food.

Placing a tax on municipal bonds even though minimal, is already having the effect of crippling those markets and causing great loss to any individuals who bought the bonds with the belief that those bonds were tax exempt. Such an effect would make it far more difficult for states and communities to finance their public institutions. They would be forced to rely on federal assistance, adding greatly to our national budget and further undermining the federal system of government by shifting more responsibility toward Washington.

Commercial banks, mutual savings and loan associations have all been fighting each other as to the amount of our Bad Debt Reserves. The Ways & Means Committee under the Chairmanship of Mr. Mills clobbered all of us in the financial institutions field by curtailing all bad debt reserves. The net effect on all financial institutions is to weaken the capital accounts which serve as a protection for bank depositors fund. If we have any economic trouble in this country, it will mean that there is less money to pay the depositors.

Many of our young people are disillusioned by society as it is and want to bring about its reform through various social service institutions. The provisions of this so-called "reform" measure which will substantially discourage the giving of appreciative assets not only hurts all types of existing groups and organizations, but dangerously weakens the giving of similar type organizations in the future. Such an effect would of course greatly limit the opportunities which many young people have taken advantage of to express their social commitment. This would substantially increase the alienation of many of these people.

NO TAX REFORM WITHOUT TAX RELIEF

Testimony of

Honorable ABNER J. MIKVA

of Illinois

Before the SENATE FINANCE COMMITTEE

on the Tax Reform Act of 1969

September 8, 1969

Senator Long, distinguished members of the Committee: I am most grateful to the Committee for allowing me this time to present my views on the bill which so recently passed the House, H.R. 13270, the Tax Reform Act of 1969.

When I looked at the list of witnesses scheduled to appear before this committee, I must admit that frankly I was surprised to be one of the few members of the House who is testifying. 394 members of the House voted for the Tax Reform Act. But, Mr. Chairman, less than two months before, 205 of us had voted against the extension of the income tax surtax. The fact that 394 members voted for tax reform should not obscure the fact that many, many of us were unhappy not to have the opportunity to vote against continuation of the surtax. Thus I feel that I have a special responsibility today to tell this committee why many members of the House would be grateful for an opportunity to vote again for tax reform that includes real tax relief -- an elimination of the surtax.

The need for substantial reform of the federal income tax laws is real and urgent. It has been a necessity for years. It has probably remained unaccomplished simply because of the sheer complexity of the Internal Revenue Code. Most citizens simply are not trained and do not have the time to labor through the enormously complex code provisions and appreciate their significance. Thus the case for tax reform has been made largely in terms of symbolic issues: the oil depletion allowance, tax free municipal bonds, and high income citizens who pay little or no tax.

But I would remind this committee that it was not the long-standing and long-recognized need for reform of the tax system which brought this whole issue before us.

It was the agonized screams of the American middle-income taxpayer that he simply would not stand for anymore. Mr. Chairman, I am not telling this committee anything it doesn't already know when I say that to the average American taxpayer, tax reform means tax relief. This is the urgent, crying need. This is what Congress must provide if we are to avert that taxpayers' revolt which former Treasury Secretary Barr described wo well.

The surtax has been touted by the Administration as an absolute necessity to stop inflation. But there is no evidence that the surtax has had even a minimal anti-inflationary effect. To the contrary, it is as easy to contend that the surtax actually produces inflation; we have had a worsening of the spiral since the surtax was enacted.

The most ironic thing about all this is that the middle-income taxpayer is footing the bill for inflation, even though he is victim rather than cause. The government goes along its merry way pouring billions into a war we said we were going to end and this money finds its way into the market place. Corporate profits rose almost four billion dollars last year after taxes. The middle-income taxpayer has nowhere to pass on the cost of the surtax; the tax comes out of his salary. No matter how hard he works, he cannot keep pace with inflation and taxes. This is the man I want to speak for today. This is the man who may not understand exactly what tax reform means, but he knows that what he needs is tax relief. For him there will be no meaningful reform if there is no relief.

Mr. Chairman, I have just returned from my home in Illinois. Most of us have just returned from talking to our constituents during the recess. There is one thing on their minds. They have been squeezed, and milked, and rolled and drained until they are not going to stand for it any longer. We have a tax system which has always been the envy of other countries because of the high level of voluntary compliance. But I fear that our record in this respect may be in danger unless we show our citizens that we are willing to give them a break. The moderate-income, salaried taxpayer is now paying more for his goods and services, he is now borrowing money at higher rates than ever (with

no one to pass those rates on to), and in addition we are asking him to pay a surtax on top of already high state and local taxes and a federal income tax. This is too much to ask.

I urge this committee to take either one of two actions in connection with the present Tax Reform Act. First, rethink the decision which was made earlior this year to extend the surtax for six months at 10%. End it on October 31, which would give the American citizen a tax dividend for the last two months of this year. If the committee does not feel that such action is possible on the 10% surtax, then I urge you at least to delete the provisions in H.R. 13270 which would extend the surtax for still another six months at 5%. The extra six months are not necessary for federal revenues. If we keep our word and begin to withdraw some of our men, material and money from South Vietnam, the justification for the surtax will have ended. Much has been demanded from the American citizen and taxpayer, and much has been given. But I fear to think what will follow if our tax reform does not include substantial tax relief. I hope the Administration can be discouraged from trying to make up the fiscal deficit the bill produces by cutting the tax relief to the middle-income families of America. I hope, finally, this committee will come to the conclusion, as I have, that for the great majority of Americans, there will be no tax reform if there is nc meaningful tax relief.

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SUMMARY OF PRINCIPAL POINTS

Statement of Joel Barlow

Before The

Senate Finance Committee

on H.R. 13270

September 8, 1969

The machine tool industry and the tool, die and precision machining industry and their more than 2,000 member companies[1/] are concerned to find that this major tax reform bill (H.R. 13270) fails to include any part of the long promised and overdue reform of the depreciation tax structure.

* * *

The Treasury in recommending no overall depreciation reform seems to be quite unmindful of the fact (and the public and the Congress are obviously quite unaware of it) that the United States has the highest percentage of overage obsolescent production facilities of any of the leading industrial nations, and that the United States also has the most restrictive and outdated capital recovery tax structure of any of these industrial nations.

* * *

In compliance with the Committee's rule excluding testimony relating to the investment credit, no presentation

1/ The national organizations of these industries are the National Machine Tool Builders Association (NMTBA), American Machine Tool Distributors Association (AMTDA) and National Tool, Die & Precision Machining Association (NTDPMA).

is being made on the importance of continuing the 7% credit until reforms in the depreciation structure can be adopted.

* * *

This statement deals only with the four specific reforms that are required to correct the deficiencies in the depreciation tax structure, particularly if the investment credit is repealed:

(1) The amendment of Section 167 to make possible the elimination of the restrictive reserve ratio test from the Depreciation Guidelines because of (a) its complexity, (b) the difficulties taxpayers face in meeting the test, and (c) the importance of following the simpler and more effective patterns of other nations so as to get rid of all the headaches and controversies involved in individualization of tax depreciation lives and service-life auditing.

(2) The inclusion of the depreciable lives of the Depreciation Guidelines by amendment in Section 167 of the Code to deter the Treasury from unilaterally (and even arbitrarily) extending depreciation lives to increase the revenues as it did in the 1930's.

(3) The amendment of Section 167 to eliminate the requirement for establishing salvage or residual value for productive equipment so as to preclude adjustments by and controversies with the IRS, which are wholly unnecessary now with the advent of additional recapture provisions in Section 1245.

(4) The amendment of Section 179 to eliminate the $10,000 ceiling with a possible reduction in the rate of the additional first-year depreciation allowance from 20% to 15%. This would make U.S. capital recovery allowances more comparable to those of other nations, and it would make up in part at least for the reform bill's tremendous loss of cash flow for U.S. industry that could be

so disruptive for the economy in the next few years. Unlike the investment credit, this allowance would not exceed cost and presumably would be less vulnerable to change.

* * *

If as a condition to this depreciation reform the Treasury should insist that tax depreciation be booked for financial reporting purposes, the industries making these proposals believe that all industry should accept the condition.

* * *

There must be immediate depreciation reform not only to tax the capital intensive industries more equitably and realistically, but also to make the United States tax structure as vital and as effective as the tax structures of the other industrial nations of the world with which we must compete.

* * *

These other industrial nations are deadly serious about facility modernization and replacement in their effort to capture America's traditional markets. Their more liberal tax allowances not only give their industries a great competitive advantage but in addition encourage American industry to expand abroad instead of in the United States.

* * *

Most industrial nations make their more liberal depreciation or capital recovery allowances available as a matter of right under a simple, easily administered tax structure.

* * *

In contrast, depreciation allowances in the United States are determined under a very complicated tax structure, and usually only after protracted negotiation and controversy with a revenue agent.

* * *

Instead of having tax allowances available based on the most enlightened and acceptable practices as in other nations, the United States taxpayer may be left for years in the straitjacket of his own unenlightened depreciation practices.

* * *

Smaller companies particularly have difficulty sustaining the burden of proof imposed by the tax depreciation structure and in coping with revenue agents in depreciation controversies.

* * *

The special 7-year amortization provision in Section 705 limited to railroad rolling stock other than locomotives and the special 5-year amortization provision in

Section 704 for pollution control facilities are in themselves a clear recognition of the inadequacy of our present depreciation tax structure to keep United States industrial facilities modern and adequate.

* * *

These are clearly necessary provisions and an equally cogent case for amortization can be made for many of the metalworking industries, including machine tools, aircraft and steel.

* * *

Both the Kennedy and Eisenhower administrations recognized the need for depreciation reform and moved ahead in initiating important improvements. The present Administration has turned back the clock by eliminating the investment credit and proposing no depreciation reforms at all, only another Treasury study.

* * *

The very least the Administration could have done when it decided it could not honor the Treasury's earlier assurance that the credit was to be a permanent part of the tax structure was to make certain that the repeal would recognize the hardships of those who had made formidable commitments in reliance on the credit. It could have done this in two ways: (1) By recommending more liberal transitional

rules for those taxpayers who had committed themselves to long-range plans or programs even though they had not made purchase commitments, and (2) by repealing or at least modifying the reserve ratio test because of the difficulty or even impossibility taxpayers now face in trying to meet the reserve ratio test without the intended help of the investment credit.

\# # #

With the highest wage rates and labor costs in the world, American industry can stay competitive only through a constantly increasing investment (1) in the research required to maintain our technological superiority in productive facilities, and (2) in the technologically superior cost-reducing facilities themselves. Unless the Senate and the conferees add depreciation reform to H.R. 13270 to restore the more than $7 billion of investment that would be lost in cash flow in the next three years, there is likely to be a serious dislocation in the economy.

\# # #

There will be a slowdown in the modernization and replacement of the very industrial facilities that are so necessary to provide essential jobs in this country for American workers, and to make the United States the lower cost producer it must be in competing with other nations.

\# # #

If capital investment is not encouraged by depreciation reforms and thus is not made in the United States, more and more capital funds for plant expansion will move abroad as they have for years, and more and more U.S.-owned plants will be built abroad instead of in the United States.

\# # #

With this U.S. expansion abroad will continue to go many jobs for American workers, and in many instances an essential part of our industrial and defense base that the United States can ill afford to lose.

\# # #

The pendulum has swung too far in this bill. It has not swung too far in the commendable provisions for rate reduction or the relief from hardships provided for the lower income groups, but it has swung too far in minimizing the importance of all types of risk-taking capital investment by penalizing it and seeming to discredit it.

\# # #

Although the Ways and Means Committee and the Joint Committee staff have performed a truly remarkable job of composing and drafting a milestone tax reform bill in a very limited time, it is nonetheless a hurried measure with many errors, omissions, inconsistencies, ambiguities and no end of complexity.

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H.R. 13270 requires a major overhaul and revision and the closest kind of scrutiny by the Finance Committee since the text of the bill was not under review in the hearings of the House.

\# # #

September 5, 1969

Statement of Joel Barlow

Before The

Senate Finance Committee

on H.R. 13270

September 8, 1969

My name is Joel Barlow, and I am a member of the Washington law firm of Covington & Burling.

The national trade associations representing the machine tool industry and the tool, die and precision machining industry, and their more than 2,000 member companies in every state in the Union,[1/] have asked me to appear before the Finance Committee today to comment on one important deficiency in H.R. 13270 -- the failure to include in this major tax reform bill any part of the long promised and overdue reform of the depreciation tax

1/ The national organizations of these industries are the National Machine Tool Builders Association (NMTBA), American Machine Tool Distributors Association (AMTDA) and National Tool, Die & Precision Machining Association (NTDPMA). The size of these 2,000 member companies varies from 5 employees and $100,000 of sales to nearly 15,000 employees and more than $250,000,000 in sales.

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structure. They had thought that there was a general recognition[1/] in the Treasury and Congress that there must be immediate depreciation reform not only to tax the capital intensive industries more equitably and realistically, but also to make our tax structure as vital and as effective as the tax structures of the other industrial nations of the world with which we must compete.[2/]

1/ Innumerable legislative and administrative proposals and promises have been made over the years, and countless depreciation reform bills have been introduced. The American Bar Association has formally approved a specific legislative proposal containing some features of the Canadian "bracket" system. This was introduced as H.R. 11450 in 1965. Senators Hartke, Randolph, McCarthy and Javits jointly introduced H.R. 8363 in 1963 providing for the repeal of the reserve ratio test.

2/ Most industrial nations make their more liberal depreciation or capital recovery allowances available as a matter of right under a simple, easily administered tax structure. The allowances are provided under broad classes of facilities and are generally based (a) on the most enlightened or acceptable depreciation practices, and (b) on the amount and rate of recovery required to stimulate modernization and replacement.

In contrast, depreciation allowances in the United States are determined under a very complicated tax structure, and usually only after protracted negotiation and controversy with a revenue agent. The agent has the difficult or impossible task of conforming the tax life to the individualized service life unless the taxpayer sustains his equally difficult burden of proving that the tax life should not conform to his actual practice.

Instead of having tax allowances available to him based on the most enlightened and acceptable practices in his industry as in other nations, he may be left for years in the straitjacket of his own unenlightened practices. Smaller companies particularly have had difficulty sustaining this burden of proof and in coping with revenue agents.

These other industrial nations are deadly serious about facility modernization and replacement in their effort to capture America's traditional markets. Their more liberal tax allowances[1/] not only give their industries a great competitive advantage, but in addition encourage American industry to expand abroad instead of in the United States.

Instead of moving ahead to meet this competition, this tax reform bill steps backward to give foreign industry an even greater advantage. Quite unbelievably, H.R. 13270 represents a deliberate effort by the Treasury, to which the House has responded, to make our capital recovery tax structure even more restrictive.

The only exceptions are the special 7-year amortization provision (Section 705) limited to railroad rolling stock other than locomotives, and 5-year amortization for pollution

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1/ Germany, Japan, England, Canada, France, Italy, Sweden and other nations permit the writeoff of investment in industria- facilities in a fraction of the time permitted in the United States, making possible a much greater cash flow for both facility acquisition and research and development.

Their tax structures give their industries other competitive advantages (all with GATT approval) such as a greater reliance on indirect taxes, such as the value-added tax, which are rebated to foster exports and imposed as "border taxes" on imports to discourage foreign competition. Most of these nations also have a single integrated tax system instead of the 52 separate, overlapping systems we have in the United States. Any major reform legislation must counter these tax advantages also if the United States is to maintain its competitive position.

control facilities (Section 704). Of course, the inclusion of these necessary provisions is in itself a clear recognition of the inadequacy of our present depreciation tax structure to keep U.S. industrial facilities modern and adequate.[1/]

Unless the Senate and the conferees change H.R. 13270 to restore the more than seven billion dollars of investment American industry will lose in cash flow in the next three years, there will almost certainly be a serious dislocation in the economy.[2/] At the very least, as Treasury officials concede, there will be another slowdown in the modernization and replacement of industrial facilities. These are the very facilities that are so necessary to provide essential jobs in this country for American workers, and to make the United States the lower cost producer it must be in competing with other nations.

1/ An equally cogent case can be made by many of the metalworking industries (machine tools, aircraft, steel) for the same special amortization of the machine tools and other equipment they use. Technological change in both product and equipment is even more rapid in these industries as, for example, in numerically controlled machine tools, and the need for replacement and expansion to meet national needs is just as great. It must be kept in mind that it is machine tools that are so urgently needed to produce this rolling stock and pollution control equipment, just as it is machine tools that are so urgently needed to produce the airplanes, the steel mill facilities and other equipment in critically short supply. Machine tools are known as the "master tools of industry." Everything made of metal is made on machine tools.

2/ The Treasury estimates of revenue gain from repeal of the credit for 1970, 1971 and 1972 total $7.2 billion.

Until the present Administration gave capital recovery tax legislation such a low priority in its surprise announcement last April 21, the capital intensive industries had reason to believe from continuous discussions with the Treasury that the Government would have to reform and improve our outdated depreciation tax structure in any general reform bill. Of course, if the investment credit did not remain a permanent part of the tax structure as some had predicted, reform would be mandatory.

Both the Kennedy and Eisenhower administrations had recognized the need for reform and had moved ahead in initiating some important improvements.[1/] It was, therefore, hardly believable that the Nixon Administration would turn back the clock by eliminating the investment credit and proposing no

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1/ The Eisenhower Administration proposed the accelerated depreciation provisions which were enacted in 1954 (Section 167(b)), and the Kennedy Administration adopted the Depreciation Guidelines in 1962 (Revenue Procedure 62-21) and proposed the investment credit which was enacted in 1962. The Depreciation Guidelines moved very helpfully into the better depreciation pattern of other nations except for the effect of the reserve ratio test which will be discussed later. All of these improvements were represented as being permanent reforms of the tax structure, but they have turned out to be something less. The credit was suspended and is now recommended for repeal. H.R. 13270 would also put new restrictions on the availability of the accelerated methods adopted in 1954 (Sections 451 and 521) and their utilization in computing earnings and profits for dividend purposes (Section 452).

depreciation reforms at all or any other capital recovery improvements in announcing its reform legislation. All that has been proposed thus far is another Treasury study.[1/]

The very least the Administration could have done when it decided it could not honor the Treasury's (and the Government's) earlier assurance[2/] that the credit was to be a permanent part of the tax structure, was to make certain that the repeal would minimize the hardships of those who had made formidable commitments in reliance on the credit. It could have done this in two ways: (1) By recommending liberal transitional rules for those taxpayers who had committed themselves to long-range plans or programs even though they had not made purchase commitments,[3/] and (2) by repealing or at

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1/ Apparently, even this study may now be delayed. Under Secretary Charls Walker is quoted in IRON AGE (August 14, 1969 pp. 79-81) as saying that the Treasury "is looking at it (depreciation) in fundamental reform terms," that there will be no "quid pro quo for the repeal of the investment credit," and that the Treasury's depreciation proposals will not come before Congress "until January, 1971." This announcement and timetable cannot help but have the effect of slowing down still further the modernization and replacement of industrial facilities until 1971 or even 1972.

2/ As recently as March 21, 1969, in his address to the Business Council, Secretary of the Treasury Kennedy had said that the credit was a permanent part of the tax structure and the Treasury had no intention of tinkering with it.

3/ The Treasury reportedly acquiesced in the so-called "Lockheed Amendment" (Section 703(a) of H.R. 13270 adding Section 49(b)(10)

(contd.)

least modifying the reserve ratio test because of the difficulty or even impossibility taxpayers would now face in meeting the reserve ratio test without the intended help of the investment credit. It must be kept in mind that the Government had repeatedly assured taxpayers that the credit and the Guidelines were "a package," and that the investment credit had been designed and adopted so that taxpayers could continuously utilize it in meeting the rigorous and restrictive reserve ratio test.

Four Essential Depreciation Reform Proposals

To comply fully with the Committee's proscription on testimony relating to the investment credit, no presentation will be made, of course, on the importance of continuing the 7% credit at least until reforms in the depreciation structure can be adopted. My testimony will deal only with four specific reforms that are immediately required to correct the deficiencies in our depreciation tax structure, particularly if the investment credit is repealed:

(1) The amendment of Section 167 to make possible the elimination of the restrictive reserve ratio test from the Depreciation Guidelines because

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3/ (contd.)

to the IRC) which recognizes the hardship and inequity in the transitional rules but strives narrowly to limit the relief to one company or to a very few companies when all companies who made similar commitments in plans and programs in reliance on the credit should be granted relief.

of (a) its complexity, (b) the difficulties taxpayers face in meeting the test, and (c) the importance of following the simpler and more effective patterns of other nations so as to get rid of all the headaches and controversies involved in individualization of tax depreciation lives and service-life auditing.

(2) The inclusion of the depreciable lives of the Depreciation Guidelines by amendment in Section 167 of the Code to deter the Treasury from unilaterally (and even arbitrarily) extending depreciation lives to increase the revenues as it did in the 1930's. 1/

(3) The amendment of Section 167 to eliminate the requirement for establishing salvage or residual value for productive equipment so as to preclude adjustments by and controversies with the IRS, which are wholly unnecessary now with the advent of additional recapture provisions in Section 1245.

(4) The amendment of Section 179 to eliminate the $10,000 ceiling with a possible reduction in the rate of the additional first-year depreciation allowance from 20% to 15%. This would make U.S. capital recovery allowances more comparable to those of other nations, and it would make up in part at least for the reform bill's tremendous loss of cash flow for U.S. industry that could be so disruptive for the economy in the next few years. Unlike the investment credit, this allowance would not exceed cost and presumably would be less vulnerable to change.

1/ There is some concern that the Administration might take such action in view of (1) its announced concern with the loss of revenue in H.R. 13270, (2) its action on the investment credit, (3) its indicated attitude toward capital recovery allowances generally, (4) recent Treasury surveys and studies that reportedly indicate that the Guideline lives are too short under traditional service life concepts, and (5) trial balloons the Treasury has sent up in the past year suggesting that tax depreciation deductions should be limited to those taken for financial reporting purposes.

The NMTBA, the AMTDA and the NTDPMA have authorized me to say that if as a condition to depreciation reform the Treasury should insist that tax depreciation be booked for financial reporting purposes, they believe industry should accept the condition.

Actually, these industries are convinced that, given a reasonable transitional period under these new depreciation reforms, all taxpayers would be able "to book their tax depreciation," and industry could get rid of the stigma attached to "two sets of books."

They base this conclusion not only on their own individual experiences, and the actual practice of many other taxpayers in using the Guideline lives and the accelerated methods for both tax and financial reporting, but also on the following factors that have emerged out of their surveys and studies:

(1) Technological change will come so much faster than in the past, and obsolescence will be so much more important than wear and tear, that service lives will generally conform to (or be shorter than) the present class lives of the Guidelines. Thus there will be fewer claims of "distortions in income" and "subsidy by the Government" that have been the basis for variations in accounting treatment.

(2) This development together with the adoption of the proposed depreciation reforms themselves will bring about a change in depreciation and accounting concepts that will eliminate the

emphasis heretofore placed by both the Government and the accounting profession on the individual taxpayer's experience. Instead there will be a recognition for all purposes of the importance of industry standards (minimum lives or maximum rates) based on (a) the most enlightened replacement practices, and (b) projections of the rate of capital recovery required for replacement.

Obsolete Facilities and an Obsolete System

The Treasury in recommending no overall depreciation reform seems to be quite unmindful of the fact (and the public and the Congress are obviously quite unaware of it) that the United States has the highest percentage of overage and obsolete industrial facilities of any of the leading industrial nations;[1/] and that the United States also has the most restrictive and outdated capital recovery tax structure of any of these industrial nations.[2/]

1/ 1969 Survey of McGraw-Hill, Inc.

2/ The urgent need for a capital recovery tax structure comparable to those of other leading industrial nations and a history of the development of the United States structure are set out at some length in testimony and statements heretofore submitted by me and others on behalf of these industries before this Committee and the Ways and Means Committee: Hearings on Suspension of Investment Credit before the Senate Finance Committee (H.R. 17607), October 5, 1966, pp. 106-139, pp. 407-410, pp. 434-445; Hearings on Incentives for Investment in Urban Poverty Areas before the Senate Finance Committee (S. 2088 and S. 2100), September 14, 1967; Hearings on Tax Revision before the Committee on Ways and Means, November, 1959, Vol. 2, pp. 827-840; Hearings on the President's 1961 Tax Recommendations before the Committee on Ways and Means, May 12, 1961, Vol. 2, pp. 983-1006, pp. 1547-1549; Hearings on the President's Proposal on

(contd.)

If the investment credit is repealed with no offsetting depreciation reform, American industry will be at an even greater disadvantage in competing with other industrial nations for the export markets of the world, and in slowing down the increasingly serious inroads foreign importers are making into our own domestic market. With the highest wage rates and labor costs in the world, American industry can stay competitive only through a constantly increasing investment (1) in the research required to maintain our technological superiority in productive facilities, and (2) in the technologically superior cost-reducing facilities themselves. This investment must come principally from the cash flow of U.S. industry which the Treasury and H.R. 13270 propose to reduce by over $7 billion in the next three years.

Full Cycle to Obsolescence and Tax Controversies?

In 1934 the Treasury drastically cut back depreciable allowances across the board by approximately 25% to increase tax collections, and in addition placed an almost impossible burden on the taxpayer of proving the service or useful life

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2/ (contd.)

Suspension of the Investment Credit before the Committee on Ways and Means (H.R. 17607), September 14, 1966, pp. 208-231, pp. 396-404; Statements of the NMTBA, the AMTDA and the NTDPMA before the Ways and Means Committee, May, 1969.

of each facility.[1] This was the beginning of our present system that is so badly in need of change.

Since that time (except for the three-year moratorium under the Guidelines) tax administration has been marked by interminable and wasteful depreciation controversies, and our industrial history has been one of recurring facility shortages and pernicious obsolescence both in peacetime and wartime. It is plain that the facility investment required to keep the United States modern and strong and fully competitive will not and cannot be made under the restrictive tax structure we have at present which is based on individualized service-life auditing and negotiation.[2] We must also be aware that it is fast becoming more restrictive now that the revenue agents are applying the reserve ratio test under the Depreciation Guidelines to extend depreciable lives just as they did under old Bulletin F.[3]

1/ T.D. 4422, XIII-1 Cum. Bull. 58 (February 28, 1934); Mim. 4170, XIII-1 Cum. Bull. 59 (April 4, 1934).

2/ To reduce accumulated industrial obsolescence and to provide adequate industrial capacity, temporary emergency allowances had to be added in 1940, 1950 and 1962 to shore up our ineffectual depreciation tax structure. As already mentioned, special amortization provisions have once again had to be included in H.R. 13270 to bolster the structure and make possible certain critical industrial expansions.

3/ The three-year moratorium during which revenue agents could not lengthen depreciable lives by applying the reserve ratio test of the Guidelines is no longer in effect. Once again,

(contd.)

In insisting on a continuance of the reserve ratio test, the Treasury does not seem to realize that there simply has not been time, since the adoption of the Guidelines in 1962, for many companies (particularly smaller companies) forced to incur tremendous capital expenditures to get rid of accumulated plant obsolescence, to correct entirely the unwise depreciation practices that persisted for so many years and caused the obsolescence in the first place. These bad practices of the past were sometimes the result of unsophisticated management and poor financial and accounting advice, but always they resulted in part at least from the shortsighted tax depreciation policies of the Government that the Treasury has been so reluctant to change.[1/] Unless the reserve ratio test, which is based on the taxpayer's unfortunate experience, is eliminated, he will be forced back into the same old depreciation rut and

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3/ (contd.)

as under the old Bulletin F procedures, the taxpayer is bound by all the deficiencies of his past practices. He may lose entirely, through circumstances completely beyond his control, the right to use the more liberal Guideline lives; while at the same time his competitor, quite fortuitously, may be entitled to continue with the shorter Guideline lives with all the competitive advantage this entails.

1/ As a result of T.D. 4422, capital intensive corporations were caught up in a vicious cycle of inadequate depreciation, overpaid income taxes (and renegotiation refunds), inadequate earnings and cash flow for modernization and replacement, still less depreciation and cash flow, more obsolescence, higher cost production, still lower earnings, etc.

the same old depreciation controversies in which he was bogged down so long under Bulletin F procedures.

Any thoughtful person will be enthusiastic about many of the tax reform proposals in H.R. 13270 to minimize hardships, inequities and discrimination; and we can all agree with the high tax priorities that must be given to the demands of the Vietnam War, inflation and the pressing needs of our cities. But it seems crystal clear that the Administration unnecessarily handicaps itself in trying to provide these necessary revenues and in fighting inflation by giving no priority at all in H.R. 13270 to the investment allowances that will assure the industrial capacity and the low cost production to fight inflation, to increase exports, to improve our balance of payments, and thus to increase the revenues.[1/]

1/ According to many economists, there is a very present danger of "overkill" in the proposed tax damper on investment. There are already some ominous signs in the capital goods industry. Machine tool orders which have come to be regarded as a reliable economic barometer were down more than 22% in July from the corresponding period in 1968. Manufacturers' new orders showed their second monthly decline in June. After-tax corporate profits turned down in the second quarter. As a result of these factors and indicators, a marked leveling off in plant and equipment expenditures is now projected by business economists. Instead of the original prediction of a 13% increase in 1969 over 1968, the figure has been revised to 8-10%. The Federal Reserve Board survey as reported in the New York Times for August 20, 1969, predicts no increase in 1970 in authorizations for plant and equipment over 1969.

History Repeats Itself

President Nixon has stated quite candidly that other reasons or rationalizations to the contrary notwithstanding, the need for additional revenue to make possible the termination of the surtax as promised is the real reason he proposed a reduction in capital recovery allowances and proposes no offsetting reforms. It was this same need for additional revenue that President Roosevelt gave in 1934 as the reason for instructing the Treasury to reduce depreciation allowances across the board.

So far-reaching were President Roosevelt's 1934 disallowances (and those President Nixon proposes are of the same magnitude in today's economy) that the industrial plant of the United States has not yet fully recovered from the obsolescence and higher cost production that resulted from depreciation policies and practices the Government required and business adopted following the 1934 ruling. As I have already mentioned, even at this late date the United States has the highest percentage of overage obsolescent production facilities of any of the leading industrial nations of the world.

Despite the beneficial effects of the liberalized Depreciation Guidelines, the 7% credit, the 1954 accelerated depreciation methods and the 60-month amortization allowances

of the 1940's and the 1950's, the United States has not been able to do more than slowly narrow the obsolescence gap since World War II.[1/]

These interim remedial provisions have generally been too temporary and uncertain, or too hedged in with restrictions in both language and administration to insure the continuous modernization and replacement of the productive facilities that are so sorely needed. At no time has there been the permanent change in direction away from the restrictive 1934 policy upon which the taxpayer could rely in his long-range planning.

Surveys in the metalworking industries show that many companies (30% in one survey) were not willing to use the shorter Guideline lives simply because of the uncertainty and complexity of the reserve ratio test.

It is clear that the United States will not be able to close the obsolescence gap until it adopts a permanent capital recovery tax structure that is as liberal, realistic

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1/ Annual Surveys of McGraw-Hill, Inc., 1945-1969. While the United States has been having difficulty closing the obsolescence gap, foreign nations with their more modern industrial facilities have made considerable progress in closing gaps where they have been behind the United States in total production and exports. Taking machine tools as an example, we find that U.S. exports of machine tools decreased from $286,667,000 in 1964 to $286,034,000 in 1968. Japanese machine tool exports increased from $21,240,000 in 1964 to $60,143,000 in 1968, or an increase of 183%. West German exports of machine tools increased from $389,959,000 in 1964 to $587,500,000 in 1968, or an increase of 50%. Imports of machine tools into the United States increased from $36,364,000 in 1964 to $163,576,000 in 1968, or 349%.

and simple as the tax structures of other industrial nations such as our next-door neighbor Canada, for example.

We can criticize the subsidy policies of other nations; we can be opposed to all subsidies as a matter of principle; and we can somewhat disparagingly label every capital recovery tax allowance, including percentage depletion, "a tax subsidy" as President Nixon labeled the investment credit in his tax message; but we must not forget that the United States is no longer the self-contained and self-sufficient economic unit it once was, and if other nations subsidize investment to compete with us, we have little choice but to provide equivalents.

However, it is by no means necessary to concede that reform or liberalization of our tax structure as proposed involves any government subsidy to investment simply because tax lives do not conform to past service lives. A very persuasive case can be made that there is no "subsidy" element in the accelerated depreciation allowances permitted by the Code, and that none was injected by the enactment of the investment credit (despite the recovery in excess of cost) because the credit was required to make up for the deficiencies in the structure that precluded a reasonable capital recovery allowance in the first place. If the recovery does not exceed actual cost, as in the depreciation reforms proposed, it is

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possible to argue that no claim of subsidy should be made simply on the basis of timing. There may be, of course, a resulting disparity in treatment of taxpayers simply on the basis of timing; but it should be noted on this phase that the present system has been an utter failure not only in trying to avoid such disparity, but even in its effort to conform tax lives to service lives.

The Treasury's Defense

Although President Nixon has relied principally on revenue needs as the reason for cutting back on investment allowances, Secretary of the Treasury Kennedy has attempted to defend the Administration position on other grounds as well.

In his testimony before the Committee on Ways and Means he took the position that the 1970's will be distinguished from the 1960's in not requiring a tax structure designed to provide the same stimulus to modernization, replacement and expansion of productive facilities as was required in the 1960's.

In his testimony he seemed to be saying, to use his own words, that because "business has put close to $400 billion into new plant and equipment in the 1960's," the same high level of investment will not be required in the 1970's.

Although he recognizes that the United States has had a "sluggish rate of business investment" in the past in the absence of tax stimulation, he thinks that a high rate of investment will nevertheless continue in the 1970's with stimulation coming only from "the fundamental incentive to invest -- good prospective markets for industry's products."1/

This kind of thinking is, of course, not at all understandable to the capital intensive industries. They already see as they move into the 1970's the breathtaking rate of technological change in both products and the equipment that produces them. They also see the tremendous cash

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1/ These statements which are quoted in full below were made by Secretary Kennedy before the Ways and Means Committee on May 20, 1969. Just a few weeks before, on March 21, in his Business Council presentation, the Secretary stated unequivocally that the Administration recognized the need for tax encouragement to long-run investment. These were his words: "We have no plans for tinkering with the investment tax credit. Congress intended the credit to be a part of the regular tax system, and not a device for stimulating or slowing the economy. Moreover, the credit has been highly effective in encouraging the long-run investment that creates additional jobs and income."

His May 20 statement follows:

"Stated simply, the case for removal of the investment credit rests primarily upon the fact that the social needs and economic conditions of the 1970's will be greatly different from those of a decade ago. Stimulation of a sluggish rate of business investment was a high priority goal in the early 1960's. Since that time, business has put close to $400 billion into new plant and equipment. Even without the credit, a high rate of investment is expected to continue because the fundamental incentive to invest -- good prospective markets for industry's products -- is likely to remain strong. Instead of inducing still more business investment, additional resources will be available to meet pressing needs for housing, to aid State and local governments, and to improve the lot of the poor."

flow and expenditure demands of the 1970's for research, development, modernization and replacement to beat back obsolescence to meet foreign competition. They are convinced that the rate of technological change and capital investment will far exceed that of the 1960's. To them even the thought of returning to anything like the old sluggish rate of investment is anathema, just as it is in Germany and Japan and the other industrial nations where every government aid is being given to stimulate investment in productive facilities.

If such investment is not encouraged and made in the United States, more and more capital funds for plant expansion will move abroad as they have for years, and more and more U.S.-owned plants will be built abroad instead of in the United States. With this U.S. expansion abroad will continue to go, unfortunately, many jobs for American workers, and in many instances an essential part of our industrial and defense base that the United States can ill afford to lose.

One of the principal inducements to the many machine tool companies that have expanded abroad in the past ten years, instead of in the United States, has been the liberal foreign depreciation allowances that permit the complete writeoff of a plant in a fraction of the time allowed in the United States.

Increased Capacity and Productivity Are Disinflationary

The Treasury has repeatedly pointed out that putting tax restrictions on facility investment will dampen the fires of inflation. They seem to persist in the view that capital investment allowances can be used as short swing contracyclical measures despite the almost conclusive evidence that effective timing is impossible, and that cutting back on productivity is self-defeating and does much more harm than good.

Certainly, the experience of the 1960's in suspending and reinstating the investment credit suggests that (1) the legislative wheels move too slowly and uncertainly to achieve an effective short swing anti-inflationary effect, and (2) that cutting back on the source of future productivity simply means another round of inflation later on. The unintended, and inevitable, adverse effects of reducing investment allowances in the 1930's, 1940's, 1950's, as well as the 1960's, are already on the record.

One well known economist and editor recently answered the Treasury argument with some plain speaking:

> "How silly can you get? The only ultimate answer to inflation is more capital investment now and more productive capacity later on . . . the cries of outrage against the rise planned for private capital investment are the same as those of the farmer that killed the goose that laid the golden eggs. The stop inflation now philosophy ignores this key fact.

> "The best and most successful way to halt inflation is to increase the supply of available goods and services over and above demand, to modernize and automate, to cut the unit costs of production, and to decrease the amount of natural resources used in production. And that's what we're doing now. Hail our secret weapon against inflation: capital investment." 1/

Industry Looks to the Finance Committee

Quite understandably, depreciation and other technical tax allowances for business investment seldom if ever enjoy a very high priority in the public mind or in the world of politics, principally because their essential function is not understood. It is only when the President, or the tax-writing committees of the Congress provide the necessary leadership to educate the public and the Congress, as they did in wartime and in 1954 and 1961, that major reforms and improvements can be made in the tax depreciation structure to reduce industrial obsolescence and provide adequate facilities for both peacetime and wartime economies.

At a time when the public and even the Congress are somewhat understandably emotional about tax reform, 2/ it

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1/ Statement of P. A. Rinfret, Rinfret Boston Associates, letter dated April 28, 1969.

2/ When a Secretary of the Treasury announces that without immediate tax reform there is likely to be a taxpayers' revolt, the thought, if not father to the deed, can be father

(contd.)

is easy to discredit business investment allowances in the public mind, no matter how essential they may be to the nation's economic health, by labeling them tax subsidies, tax preferences and tax loopholes.

The much more difficult task that is so essential for this Committee at the moment is to make the public and the Congress understand that it is not in the national interest in this competitive world to put further restrictions on investment, or to postpone any longer the enactment of the proposed depreciation reforms.

The pendulum has swung too far in this bill. It has not swung too far in the commendable provisions for rate reduction or the relief from hardships provided for the lower income groups, but in the wholly unwarranted exercise of minimizing the importance of all types of risk-taking capital investment by penalizing it and seeming to discredit it.

Not only is capital investment penalized unduly, but security investment as well, and also the high risk-taking investment involved in developing natural resources. Some

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2/ (contd.)

to some emotional tax reform, particularly in an election year. The Secretary was entirely right in pointing to some long overdue tax reforms that have now been included in H.R. 13270, and it may be that the inordinate delay in overall reform warranted his impassioned plea. It must be said, however, that a less dramatic call might have resulted in somewhat less imbalance in this tax bill between what might be called reform <u>for</u> consumers and reform <u>of</u> investors.

reforms and changes in these areas are entirely justified, but they should not take the form of somewhat extreme penalties emotionally imposed across the board on the basis of isolated examples of unusual tax avoidance. Even "investment" in our schools, our churches, our museums and our art galleries can be said to be penalized together with the institutions themselves, in some of the extreme restrictions placed on charitable contributions.

With the leadership this Committee can provide in educating the public and the Congress, there will be no "taxpayer revolt" if the pendulum swings back to recognize the essentiality of capital investment in a capitalistic economy, and the necessity for taxing different kinds of income differently. These truisms are too often overlooked and ignored.

Even the emotional furor stemming in part at least from some misunderstanding of percentage depletion may subside so that a sensible solution on a transitional basis can be found for this controversial problem. Disruption of our economic system is the exorbitant price all taxpayers are likely to pay for a hurried and emotional application of tax theory.

General Comments on H.R. 13270

By way of a lawyer's comment on H.R. 13270, I feel constrained to say that although the Ways and Means Committee

and the Joint Committee Staff have performed a truly remarkable job of composing and drafting a milestone tax reform bill in a very limited time, it is nonetheless a hurried measure with many errors, omissions, inconsistencies, ambiguities and no end of complexity. As the tax-writing committees and their staffs know full well, H.R. 13270 requires a major overhaul and revision and the closest kind of scrutiny since the text of the bill was not under review in the hearings in the House.

I think we must all reluctantly agree when we contemplate the 368 pages before us that any remaining notion that simplicity can be attained in reforming our tax structure, or that a taxpayer can any longer prepare his own return, has been pretty well dispelled by all this fine print and complexity. Algebraic computations are now required, and even computers will have to be used by accountants and other advisers in the preparation of individual as well as corporate returns.

One of the great virtues of the proposals we have made here today for depreciation reform is the simplicity and ease of understanding and administration they will bring to the tax law.

On the following pages of Appendix A is a more detailed and somewhat technical explanation of the proposal to eliminate the reserve ratio test and include the Guideline lives in Section 167.

Appendix A to Statement

by Joel Barlow on

H.R. 13270 Before the

Senate Finance Committee

September 8, 1969

* * *

Discussion of Proposed Amendments of Section 167 to Eliminate the Reserve Ratio Test and to Include the Depreciable Lives of the Guidelines in the Code

It is generally recognized by tax authorities both in and out of the Government that the reserve ratio test cannot be eliminated without a change in Section 167. The courts have repeatedly interpreted Section 167 as requiring that depreciation allowances be based on the taxpayer's individual experience.

There was some indication at the time the Guidelines were adopted in 1962 that the reserve ratio test would not have been included if it had not been for the courts' interpretation of the statutory requirement. It was recognized at the time that the U.S. system had been notably unsuccessful in trying to conform tax lives to service lives under similar depreciation reserve tests that had been used, and it was thought that the proposed reserve ratio test would be no more successful.

The Guidelines represented what has been referred to as a "noble effort" to get away from the complexities and controversies of service-life audit procedures. The Treasury officials who conceived them deserve great credit for going to the broader class life approach and for resolving doubts in favor of more liberal allowances in determining class lives. Even the reserve ratio test was a well intended and ingenuous formula. The only difficulty is that even with its transitional rules and "brownie points" it is much too restrictive to say nothing of its great complexity.

The test is so restrictive, so complex and so inapplicable to certain types of depreciation accounts that it has discouraged many taxpayers, particularly small taxpayers, from using the Guidelines. It is clear now that if this test is not eliminated, its application will give rise once again to a repetition of the wasteful and needless tax controversies that have plagued the administration of the tax laws for so many years.

The Treasury in the past has disputed the test's complexity, and even the present Administration may do so in view of its announced interest in postponing depreciation reform so as to avoid any diminution of the revenues. But, unfortunately, it seems clear from extensive discussions with businessmen and their accountants that the test's complexity is the deciding factor for many businesses that do not adopt

the Guidelines. This was confirmed in recent surveys in the metalworking industry in which most of those responding referred to this complexity as an important or even controlling factor in their decisions to continue to use non-Guideline lives.

It is no answer to the complexity argument to suggest, as the Treasury has in the past, that other provisions of the Code -- for example, Subchapter C and Subpart F -- also are complex. Usually, in cases involving reorganizations and foreign-based company income, large corporations are involved, and tax specialists are in control. Moreover, many of these questions are not of a continuing nature, and taxpayers are more inclined to call in professionals' help in such circumstances. The Guidelines, on the other hand, frequently must be mastered by small individual proprietors and by factory accountants on a day-to-day basis, and this is where the principal difficulty arises.

In recent industry surveys of depreciation practices, a number of companies stated that although they could pass the reserve ratio test currently, they did not adopt the Guidelines because they did not want to expose themselves to possible future adjustments under the reserve ratio test. In other words, they would take what they conceived to be the certainty of inadequate depreciation against

the uncertainty of additional depreciation, and particularly the uncertainty in the timing of depreciation deductions under the Guidelines. This uncertainty in timing -- because of the application of the reserve ratio test -- has deterred these taxpayers from adopting the Guidelines in the first instance.

The argument has been made that the threat of depreciation adjustments under the Guidelines will stimulate taxpayers to invest in order to meet the reserve ratio test. This may have some force once a taxpayer has adopted the Guidelines, but the taxpayer's feet cannot be held to the fire until the fire is lit. I have found no businessman, tax lawyer or accountant, who believes that the threat of depreciation adjustments has any significant effect upon investment decisions.

Probably the most compelling reason next to its complexity for getting rid of the reserve ratio test is the benefit to be gained by both the Government and the taxpayer in getting away from the individualization of tax depreciation. As I have stressed in the accompanying statement, most countries have learned that trying to arrive at service lives based on the taxpayer's experience is an expensive administrative exercise in futility. They have also learned that there is just about the same disparity in treatment in individual service-life auditing as there is in permitting

the unrestricted use of minimum Guideline lives (or maximum Guideline rates) for broad classes of facilities based on industry surveys. Revenue Procedure 62-21 without the reserve ratio test falls into the simpler, more administrable pattern adopted by other nations.

It must be pointed out that the Treasury has opposed any suggestion that depreciation should be based other than on the taxpayer's own experience despite the fact that it was the Treasury that injected the capital recovery concept into the tax law in the form of the investment credit. The Treasury in subsequently focusing only on the depreciation aspect has pointed out that it believes more is involved than simple interest on the tax saving if experience is not the test. The Treasury stresses that for a taxpayer engaged in a growing business, the allowance of additional depreciation means a permanent tax saving, and from the fiscal standpoint, a permanent revenue loss.

The Treasury's basic objection to a new statutory system without an experience test is that it would permit a taxpayer to depreciate its assets at a rate faster than it is replacing. As a result of the so-called "excess" depreciation, the taxpayer would earn a higher after-tax rate of return and be subject to a lower effective tax rate on its investment in the assets than would a second taxpayer whose depreciation deductions correspond to its acquisition and

retirement cycle. This is no different, the Treasury says, than purposefully taxing some taxpayers at one rate and others at a different rate.

The Treasury goes on to point out (although somewhat uncertainly) that the consequence would be that investors would tend to invest in slowly replacing companies, and this, of course, is undesirable from an economic standpoint.

Moreover, according to the Treasury, because non-depreciable assets like inventory and accounts receivable would be taxed at a higher effective rate and produce a lower after-tax return than depreciable assets, there would be too much investment in depreciable assets and too little in non-depreciable assets.

All of this, the Treasury concludes, would result in a misallocation of economic resources and ultimately a slowdown in economic growth. The Treasury insists that to avoid this, the reserve ratio test must be retained to ensure that a taxpayer's depreciation deductions are consistent with its replacement cycle.

It is indeed true that different after-tax rates of return result where two taxpayers claim the same depreciation for tax purposes but in fact use identical assets for different periods of time. However, the implication of the Treasury position is that such differences

do not presently exist. This is not the case. Today's differences arise from two principal factors:

1. Where the Guidelines are not in use, or where it becomes necessary to resort to the "facts and circumstances" under the Guidelines, Revenue agents in different districts or offices, or even in the same district or office, usually have completely different views (often uninformed and erroneous) as to the proper lives for various depreciable assets. The conclusions reached may even be influenced by the number of other issues in dispute and the respective "horse-trading" abilities of the representatives of the taxpayer and the Revenue Service.

2. Whether or not the Guidelines are applicable, rate of return differences result from the option given to taxpayers to use the straight line, the declining balance, or the sum-of-the-year's digits method of computing depreciation.

Furthermore, as to the problems of inventory and receivables that the Treasury also has raised, we should remember that there already are significant after-tax rate of return differences among taxpayers under the existing rules.

For example, some taxpayers use prime or direct cost accounting while others cost on a full-absorption basis. Some will treat a particular expense as part of the burden

pool; others will treat it as G & A. Some taxpayers use FIFO, others LIFO. Some taxpayers charge off bad debts using the specific charge-off method and others the reserve method.

Finally, while most taxpayers report on the accrual basis, there are some who use the installment or cash methods. Each of these methods affects the after-tax return with respect to inventory or receivables, and in some instances, the differences resulting from the use of one method or another may be as much as, or more than, the differences that would be created with respect to depreciation charge-offs if the reserve ratio test is scrapped.

It should be noted also that neither the reserve ratio nor any other test which relies on past experience can be of real assistance in determining the proper life of an asset in advance. This was proved over and over again in the depreciation controversies and cases following the adoption of Bulletin F.

It is easy, of course, for the Treasury to demonstrate its rate of return and effective tax rate computations with the use of hindsight. For example, the Treasury can point to two taxpayers who purchase identical assets on the same day and dispose of them ten years later, but one has depreciated on a ten-year basis and the other uses a five-year life. The fact that

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the taxpayer using the five-year life has in the Treasury's view obtained an undue benefit does not even become apparent until after the fifth year and does not become absolutely clear, because of normal deviations from an average, for some time thereafter.

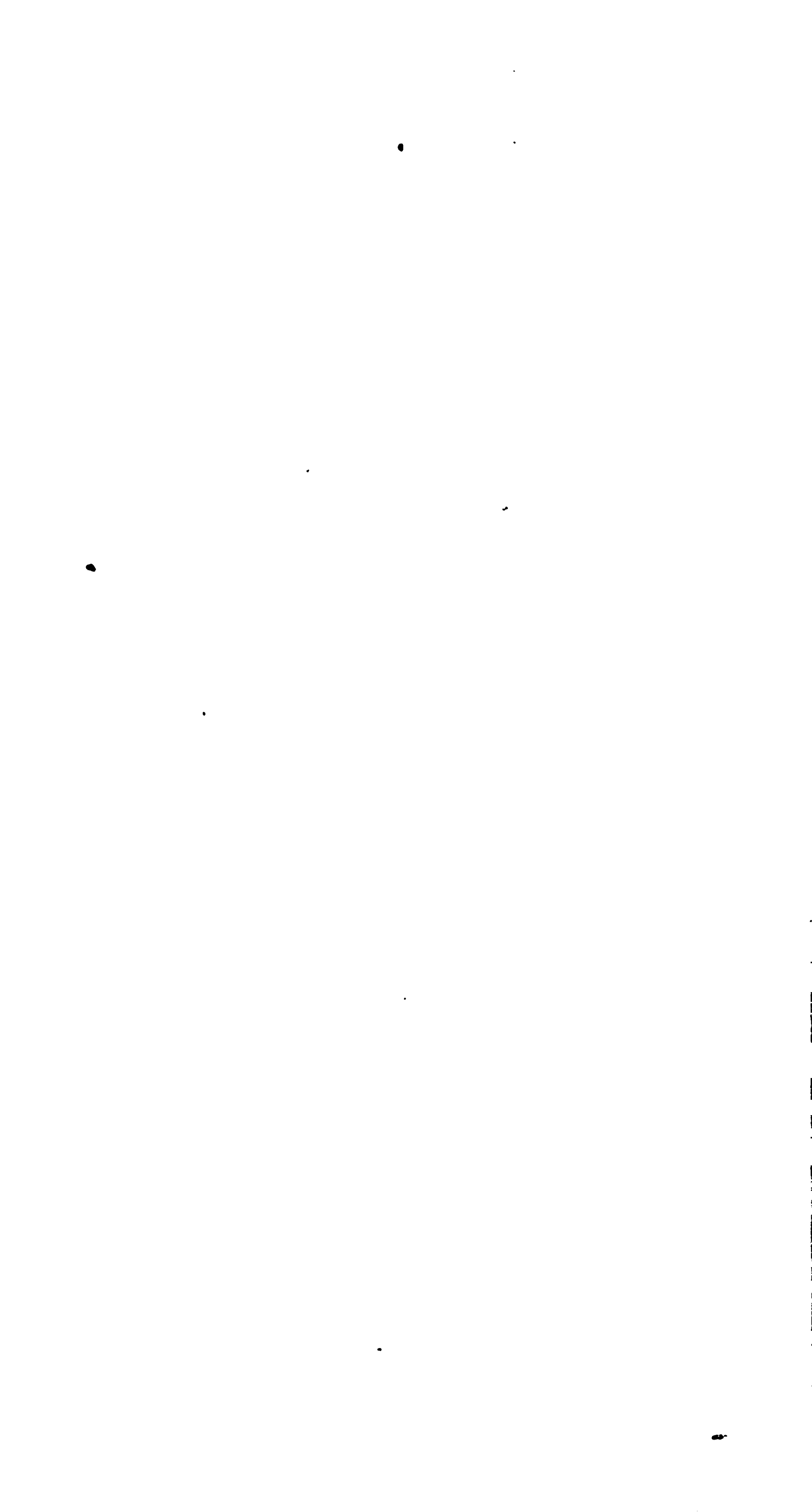
The point is that even under the reserve ratio test, a taxpayer may be subject to adjustments which prove to be unwarranted by his future experience. To put this another way, the taxpayer is penalized under the reserve ratio test after the fact, for it is only after the fact that it can be known with certainty that too rapid depreciation has been claimed. The result is, of course, that even under the reserve ratio test, there is no assurance at the time depreciation on any asset is claimed that the rate of return and effective tax rate with respect to that asset are appropriate from the economic standpoint.

Under the Canadian bracket system of depreciation, use of the double declining balance method with multiple asset accounts is mandatory. While this combination of methods does not eliminate the rate of return and effective tax rate problems referred to above, it does have the tendency to produce roughly identical depreciable charges after a period of years, regardless of the life that is used. This is not true of either the straight line or the sum-of-the-year's digits methods. Thus, by requiring the

use of double declining balance-multiple asset accounting, a measure of general equality or rough justice can be introduced into our depreciation system, and, at the same time, rate of return and effective tax-rate differences can be kept within reasonable limits.

It must be conceded that differences in the effective after-tax rates of return earned by similarly situated taxpayers may result in "uneconomic" investment. But it must also be conceded that application of the reserve ratio test cannot eliminate these differences. Nor would its abandonment significantly increase them if taxpayers are required to use double declining balance-multiple asset accounting.

In view of the experience under the Guidelines since 1962, it seems clear that the stimulation to capital goods investment resulting from the elimination of the uncertainty and complexity caused by the reserve ratio test would do the economy more good in the long run than whatever benefits may be derived from penalizing taxpayers for having claimed excessive depreciation in prior years. It would also greatly improve and simplify the administration of the tax laws by the IRS, and increase taxpayer confidence in the IRS and in our unique self-assessment system.



Statement of the
Machinery and Allied Products Institute
to the Committee on Finance, U.S. Senate
on the Proposed Tax Reform Act of 1969
September 8, 1969

Summary of Comments and Recommendations

1. General

The bill is subject to criticism on a number of broad grounds. It is being rushed through the legislative mill in a manner which has not permitted thus far appropriate consideration of either the technical aspects of the proposal or its full implications from a broad public policy view. A thorough review by the Senate Finance Committee is therefore very much in order. H.R. 13270 is essentially a negative bill insofar as the balance between tightening and liberalizing provisions is concerned. The bill is not only excessively complicated, but it makes no progress toward simplicity; indeed, it adds to the typical super-technical approach to tax legislation. It makes certain changes adverse to the taxpayer on a retroactive basis. It is badly unbalanced in terms of its treatment of corporations as compared with individuals. A most serious aspect of the bill is the fact that it punishes investment versus consumption. Finally, certain sections of the bill seem to ignore inflation and the prospects for its continuance.

We spell out the disparate impact on investment versus consumption, calling attention in some detail to the great investment needs of the economy and the limitations on sources of funds for investment. The void which would be created by the repeal of the investment tax credit is very substantial and its impact will be extremely serious unless it is filled promptly by an equivalent substitute. Various alternative approaches to providing such a substitute are discussed briefly, including five-year amortization for equipment across-the-board which would be roughly equivalent to the present combination of the depreciation guidelines and the investment tax credit.

2. Deferred Compensation

We oppose the deferred compensation provisions in the bill and recommend their deletion; if not deleted, they should be substantially modified along the lines suggested.

3. Restricted Stock Plans and Stock Options

The Institute opposes the changes contained in the bill which would tighten the current tax treatment of restricted

stock plans; existing rules concerning restricted stock plans should be continued in force. Code provisions relating to stock options should be liberalized to extend the period during which options may be outstanding from five years to ten. The currently required holding period of three years should be shortened to at least 18 months and preferably one year.

4. Moving Expenses

So far as the moving expense provisions go, we support the broadening and liberalization of the moving expense deduction but suggest that the objective in this tax area should be to make the employee whole--without tax penalty--as to all moving expenses ordinarily and necessarily incurred in connection with an employment-related move. Certain of the specific limitations on time and money included in the bill are neither practical nor reasonable. If full relief is not provided at this time, a supplemental and complete relief provision should be enacted as soon as possible.

5. Taxation of Foreign Earnings

a. Foreign tax credit.--We recommend deletion of the foreign tax credit provision in the bill which would mean in essence that any tax advantage derived from a loss with respect to foreign operations would be recouped by the Treasury out of additional taxes imposed on future profits derived from the country within which such losses were incurred. The "deemed credit" should be made available with respect to foreign taxes paid by any second- or lower-tier foreign subsidiary if there is at least a 10-percent voting stock ownership by a first- or upper-tier foreign subsidiary in which the American taxpayer holds at least a 10-percent interest.

b. Subpart F.--The Committee should consider the interrelationship between Subpart F and Section 482 regulations with a view to eliminating any unnecessary overlap.

c. Double taxation of foreign earnings.--Existing treaty provisions have not provided an adequate solution to double taxation problems. The matter deserves priority attention by this Committee and, we hope, by the Treasury Department.

d. Section 367 rulings.--The Section 367 requirement for advance rulings in connection with the reorganization, etc., of foreign subsidiaries should be dropped and have substituted for it authority for an after-the-fact justification by the taxpayer. In addition, Section 367 should be included in a comprehensive legislative investigation of the taxation of foreign earnings.

6. Real Estate Depreciation

The changes in the bill permitting only straight-line depreciation or declining-balance depreciation limited to 150 percent should not be applied to industrial real property, that is real property used in connection with the manufacturing process. Similarly as to industrial real property, we oppose tightening of the rules regarding "recapture" in the event of gain on the sale of such real property.

7. Capital Gains and Losses

The proposed changes affecting capital gains and losses should not be enacted. They are defective on substantive grounds and in addition represent a "hit and run" attack on a major area of tax policy without proper evaluation of the widesweeping tax policy considerations. The repeal of the alternative 25-percent maximum rate for capital gains and the lengthening of the holding period from six months to one year would have perverse effects on investment both in terms of blunting the incentive to take risks and decreasing fluidity in investment markets. For similar reasons, we oppose the change in the deductibility of capital losses. Finally, we recommend deletion of the provision as to lump-sum distributions to an employee from a qualified pension, profit-sharing, stock-bonus, or annuity plan. The proposal would be disruptive as to such plans, might create severe tax results if the recipient were pushed into higher tax brackets, and would discourage the establishment and growth of the types of plans affected.

8. Tax Accounting Problems

a. Advance payments.--By legislative action, the Congress should overrule misapplication of the Hagen rule which involves taxation of advance or progress payments when received, at least insofar as industrial goods are concerned. Technically, such legislation should permit tax deferral on advance payments as to industrial goods until the sales transaction is completed. This legislative action is critically necessary on accounting

grounds, because current taxation of advance and progress payments poses a threat to the financial structure of the capital goods industries, and because taxation of such payments on receipt as distinguished from the time when the transaction is completed will have perverse effects on Treasury revenues and cause corporations to resort to external financing and possibly increase prices.

b. "Methods of accounting".--Section 481 should be amended to authorize a ten-year spread of the tax impact of changes in accounting method.

c. Inventory valuation.--We oppose a proposed Revenue Ruling which would render unacceptable for tax purposes both the "prime cost" and the "direct cost" methods of inventory valuation.

9. Accelerated Earnings Tax

It is timely for the Congress to reevaluate the present law, regulations, and tax administration of the accumulated earnings tax. We suggest certain specific areas of inquiry for the Congress.

10. Charitable Contributions

The provisions in the bill affecting charitable contributions, including repeal of the unlimited deduction and change in the tax treatment of the appreciation in value of property contributed, should be carefully reexamined. Particular attention should be given to the adverse effect which we believe such changes will have on the pattern of contributions upon which our society strongly relies in connection with social, educational, and similar causes.

Statement of the
Machinery and Allied Products Institute
to the
Committee on Finance, United States Senate
on the Proposed Tax Reform Act of 1969
(H.R. 13270)

Presented by
Charles W. Stewart, President
September 8, 1969

THE TAX REFORM BILL NEEDS REFORM

We appreciate this opportunity to present our views to the Committee on Finance of the United States Senate on H.R. 13270, the proposed Tax Reform Act of 1969. The Machinery and Allied Products Institute and its affiliate organization, the Council for Technological Advancement, represent the capital goods and allied equipment industries of the United States. These industries naturally have a deep interest in the provisions of any comprehensive tax revision bill such as that now pending before the Committee. That interest relates not only to the direct impact of certain proposed changes on individuals and corporations but also includes a deep concern and sense of responsibility to address the public policy implications of provisions of the current bill. With our commitment to research in the economics of capital goods, technological advancement, and investment, we hope that some of the study work carried on by the Institute will be helpful to this Committee and to others concerned with tax legislation both in the Executive Branch and the Congress.

General Observations

It is with considerable reluctance that we state our general and strong objections to the overall character of the tax reform bill before the Senate Finance Committee because we fully appreciate the complexity of the legislative process, particularly when it is applied to federal tax changes. Moreover, we are sensitive to the tremendous work load carried in the Executive Branch, in the House Committee on Ways and Means, and by the very able staff of the Joint Committee on Internal Revenue Taxation, in connection with development of the content of the proposed Tax Reform Act of 1969. At the same time we do feel an obligation to underline our substantial reservations about the philosophy, the approach, and the content of this bill, so that the Senate Finance Committee, giving consideration to the views of others and the results of its own study, may be assisted in taking whatever action it feels is appropriate to modify H.R. 13270.

First, we have concern as to how this bill was developed. It is true that extensive hearings on tax reform were conducted by the Ways

and Means Committee but the witnesses at no time had an opportunity to address themselves to all of the proposals contained in the bill as passed by the House and at no time had before them detailed bill language for consideration. The bill which was reported favorably by the Ways and Means Committee is long and complex. Debate on the floor was very limited by rule, amendments on the floor were precluded, and we believe it is fair to say that many members of the Congress had no opportunity to study and reflect on the detail and the implications of the contents of the bill. These hearings, therefore, take on critical importance because for the first time the views of interested parties can be addressed to the specifics of the Tax Reform Act of 1969 and the philosophy underlying it.

Giving due deference to the tremendous work load carried by those responsible for the development of the provisions of this bill and recognizing the political judgment that was apparently made that passing a tax reform bill promptly is a must, we submit that this is not the way to legislate in the tax area. Tax legislation is difficult enough when considered by the Congress under the best possible circumstances; it becomes almost impossible to produce a sound result when it is rushed through Congress and neither the technical aspects of the proposals nor the full implications from a broad public policy view can be given appropriate study.

Characteristics of the Bill
and Its Approach

The thrust of the proposed legislation seems to be that without any particular pattern or overall criteria the Congress is attempting to identify a significant number of so-called "tax preferences" or "tax loopholes" and attack them. In many cases with respect to individual provisions of the bill there does not appear to have been an adequate examination of the probable policy implications of the tax action being taken. There seems to be too much of an atmosphere of a judgment that "we have to pass a bill which we can call a tax reform bill."

We have additional objections to the overall approach embodied in this bill. They can be summarized briefly as follows:

1. Tax reform cuts both ways. It should result in some tightening where justified and clearly liberalization should be considered where appropriate. This bill is essentially negative with the primary exception of the proposed reductions in personal rates.

2. The bill is terribly complicated. It does not take one constructive step toward simplicity; indeed, it adds complexity to an already terribly complex Internal Revenue Code. It is not only complex from the standpoint of its detailed provisions but the

regulations and the interpretations which must follow will pile complexity and difficulty on top of the chaos which we already have under the present tax laws. In this connection, perhaps the Committee would like to have the record include an article in The Wall Street Journal of Wednesday, September 3, 1969, by a prominent tax attorney, Rene A. Wormser, entitled "Tax Reform: Adding Hodgepodge to Hodgepodge." Reference should also be made to the "Separate Views" of Congressman James B. Utt in House Report No. 91-413 (Part 1), page 216, on H.R. 13270. The Congressman's opening statement deserves most careful consideration:

> I have reservations about this legislation, not because I am opposed to tax reform, but because I realize it is so essential. The ostensible purpose of this bill is to comprehensively reform our Federal income tax law, and it is being heralded as the broadest and most comprehensive tax reforms that have been enacted since 1954. The actual result may be to introduce greater complexity and inequity into our tax laws.

3. It reflects the typical supertechnical, overprecise approach which has characterized tax thinking in the federal government for so many years. Simple solutions seem to be rejected out of hand, lint picking, fussy qualifications or exceptions are once again spread throughout the bill.

4. There seems to be a growing tendency to reject what for many years was a long-standing principle in tax legislation; namely, that changes adverse to the taxpayer would not be made retroactively. There are a number of retroactive effective dates in the present bill.

5. The bill clearly is unbalanced in terms of its treatment of corporations versus individuals. Not only is relief provided primarily for individuals but the negative provisions of the bill are balanced heavily against corporations. We deal with this in more detail below.

6. A most serious aspect of the bill is that it punishes investment versus consumption. This point is developed later in this statement.

7. Finally, certain sections of the bill seem to ignore inflation and the prospects for its continuance.

Discrimination Against Corporations

H.R. 13270, the bill currently before the Committee, would extend the surcharge at a 5-percent rate for the first half of 1970. In addition, the 7-percent investment tax credit would be repealed with respect to property acquired, constructed, or placed under a "binding contract," after April 18, 1969.

Further, in the case of depreciation on industrial buildings, the corporate taxpayer would be required, with respect to buildings acquired after July 24, 1969, to use either the straight-line or the 150-percent declining-balance methods of depreciation instead of the double declining-balance method or the sum of the years-digits methods which are available under present law. In addition, the depreciation "recapture" on the sale of industrial buildings would be stepped up considerably.

Finally, the capital gains tax rate for corporations would be increased from a 25-percent rate to a 30-percent rate, an increase of 20 percent.

It seems to us that this treatment illustrates a very serious weakness in the bill. Under the statistical information which was made available by the House Ways and Means Committee during House consideration of the bill, there would be a total tax relief provided under the bill of $1.7 billion in the calendar year 1970, $6.8 billion in calendar year 1971, and $9.3 billion in 1972 and future years. This is to be counterbalanced by a revenue increase from other provisions of the bill which would amount to $4.1 billion in 1970, and would gradually increase to $6.9 billion by 1979. A major item in this revenue increase would, of course, be the repeal of the investment credit which would increase federal tax revenues $3.3 billion by 1979. Beyond the repeal of the investment credit, it seems clear that corporations would be required to make up most of the remaining $3.6 billion in increased federal revenues.

This raises a very serious question of equity in our minds. We recall that, in connection with the Revenue Act of 1964 in which substantial rate reductions were accomplished, corporations were afforded approximately one-third of the total of $14 billion in reduced federal revenues (the 4-point corporate rate reduction, plus the effect of the investment tax credit and the depreciation guidelines). Now this earlier division of benefits is being offset by proposed repeal of the investment credit and the new bill as a package has a very negative impact on corporations. Beyond the question of equity, however, there is the very fundamental problem of the impact of the House bill on corporate investment generally. It seems clear to us that the effect of this legislation will very clearly be to discourage investment.

Disparate Impact on Investment
Versus Consumption

It follows from the discussion above regarding the impact on corporations that the bill bears much more heavily on investment than on consumption. This, of course, would have a very negative effect on economic growth in the United States. The corollary to that proposition is that economic growth not only supports prosperity but is the principal contributor to the creation of jobs. It is a major prop to tax revenues. It is essential to our national security. Yet this bill, seemingly on a deliberate basis, punishes investment. Repeal of the investment credit has already been discussed before congressional hearings at length. Its negative investment implications, at least over the long run, are clear and largely conceded. Continuation of the surcharge and the other provisions affecting corporations as briefly referred to above and discussed in more detail later in this statement all add up to a very unfavorable effect on investment. Certain of the provisions affecting individuals have negative investment implications also.

Especially bad timing.--The timing of this action seems to be especially poor. The country is fortunate to be enjoying an accelerated rate of technological progress. Investment opportunities are not only plentiful and challenging but in terms of some of the competitive pressures confronting this country domestically and internationally and the cost-push pressures, notably a skyrocketing increase in cost of labor per unit of output, the necessity for investment at a high level seems obvious. The investment needs of the economy are also traceable in significant measure to the accelerated rate of growth in the labor force, a labor force which must be equipped with tools to produce, and an accelerated rate of growth in household formation which in turn will increase the demand for goods and require increased production to meet that demand.

Limitations on sources of funds for investment.--If we proceed from the premise that the investment needs of the economy are very large and will grow and can be expected to grow further, and perhaps at an even more accelerated rate in the 1970s, it is logical to inquire into the extent to which there are limitations on the sources of funds to support this needed investment.

In brief, with respect to the supply of funds for investment, the following points are critical:

1. Corporations rely primarily on internal funds--capital consumption allowances and retained earnings.

2. Retained earnings have been declining since 1966.

3. Capital consumption allowances for tax purposes are likely to rise at a diminishing rate hereafter, especially if the reserve-ratio test of tax depreciation lives is continued in effect.

4. Moreover, such allowances, being based on historical cost, become increasingly inadequate because of inflation. Corporate tax depreciation will be deficient next year by something like $8 billion for this reason.

5. If forecasts are realized, corporate internal funds next year will cover only 80 percent of plant and equipment expenditures, the lowest ratio for more than 20 years.

Ratio of fixed investment to internal funds.--Let us discuss the question of internal sources of funds for corporate investment in a bit more detail. General indications from preliminary studies now being conducted by MAPI are that internal sources of nonfinancial corporate financing are falling well short of fixed investment. Historically, investment tends to be approximately determined by the availability of internal funds as indicated by the fact that fixed investment has averaged out at roughly 100 percent of internal funds (corporate depreciation plus retained earnings) over most of the post-war period.

During 1966-68 the ratio of fixed investment to internal funds has substantially exceeded 100. This clearly reflects the urgent need felt by business to offset rising production costs (wages, interest, and materials prices) through the use of modern, cost-cutting machinery. It may also reflect some recognition of the expected growth in demands to be put on our productive capacity as the U.S. Government increases its efforts to meet expanding social needs.

Yet, however high the urgency ratings assigned to prospective investments, business cannot go on indefinitely increasing their reliance on external sources of financing at present rates. Ultimately, they will be forced to cut back to levels more consonant with internal sources of financing in spite of future needs to further reduce costs and increase productive capacity.

At the same time there are indications that the future growth in internal funds may be adversely affected by a reduced rate of growth in capital consumption allowances which represent the major component of the total. This growth will be reduced further from the increasing impact of the reserve-ratio test as it serves to extend tax lives of depreciable plant and equipment over the next several years.

Fundamental fallacy in the bill.--Yet, in spite of these indications of growing investment requirements in excess of the growth in the means for financing these investments, this bill is essentially anti-investment in thrust.

The Void Created by Investment
Credit Repeal

In his hearing instructions, the Chairman of the Finance Committee has made it clear that the Committee does not wish to have the question of proposed repeal of the investment tax credit reargued. This is understandable in view of the fact that extensive hearings were recently conducted by this Committee on that subject, but we do wish to call attention to the Institute's testimony on July 11, 1969, during those hearings which is published beginning at page 296 of the printed hearings. It does seem not only appropriate, however, but necessary, and perhaps even an obligation, to underline the fact that although this is not the forum for rearguing the pros and cons on investment credit repeal--as strongly as we feel that repeal will prove to be a national blunder--repeal will create a void in our programs to support capital investment and that void is of massive proportions.

Persuasive government testimony.--One of the most persuasive and thoroughly documented presentations bearing on this point was submitted by then Secretary of the Treasury Douglas Dillon in connection with hearings before this Committee in 1962 on the Revenue Act of 1962. In Part 1 of those hearings covering April 2, Secretary Dillon compared the United States with other leading industrial countries with particular reference to capital expenditures and the need for a continuing permanent support for such expenditures through our tax system. It should be noted that among other observations Secretary Dillon pointed to the fact that capital expenditures constitute a smaller percentage of the Gross National Product in the United States than in any major industrial nation in the world. On page 82 of those hearings he submitted a very interesting table which we ask be included in the record of these hearings. The data presented in the table demonstrated clearly that even a drastic downward revision of depreciable lives would still not bring capital allowances in the United States to a level comparable with that permitted by our foreign competitors. It was his conclusion that only the combination of the depreciation guideline system and a special incentive with the same impact as the investment tax credit would place United States business firms on substantially equal footing with their foreign competitors in this respect.

A proper substitute for the investment credit.--What should be considered as a proper substitute for the investment tax credit if it is to be repealed on a permanent basis? In addition to the study referred to above which involves an examination of sources of funds for capital investment, the Institute has been reviewing again the impact of the reserve-ratio test under the depreciation guideline system and approaches which might be taken by the federal government to fill the gap which will be created should investment credit repeal take effect. Very high on our list is the necessary revocation of the reserve-ratio test which is a qualification to a taxpayer's entitlement to use the guideline lives provided under the depreciation guidelines. We have documented our criticisms

of the reserve-ratio test at length. They are set forth in the MAPI pamphlet entitled "The Reserve-Ratio Test--A Palpable Delusion" and this publication is available for study by the Committee and its staff. We do not feel, however, that scrapping the reserve-ratio test should be considered as one of the principal alternatives to the investment tax credit. This revocation should take place as a minimal move regardless of what choice is made among the various alternatives to be considered in lieu of the investment credit.

Some of these other substitutes which deserve very careful consideration and might be undertaken as alternatives, or possibly to some extent in combination, include the following:

1. The 20-percent additional first-year writeoff provided under Section 179 of the Code for up to $10,000 in new depreciable property could be amended to remove the $10,000 ceiling or at the very minimum to increase it to some more realistic level.

2. Triple-declining-balance depreciation.

3. Five-year special amortization applied across-the-board to productive equipment as distinguished from the limited application of this device under the proposed bill to pollution control facilities and to certain railroad rolling stock.

4. Consideration of further and substantial liberalization of the depreciation system with perhaps some streamlining in structure such as that embodied in the Canadian system.

How to achieve an equivalent impact.--The Committee will be interested in knowing that our preliminary examination of alternatives to the investment tax credit indicate that in order to achieve the same level of capital investment support that is attained from the combination of the depreciation guidelines and the investment tax credit presently in effect, the country would probably have to go to five-year amortization. For certain assets grouped by useful lives, five-year amortization might be a bit more potent than the present combination in effect, but generally speaking the result would be in the same ball park. There should be no misunderstanding on the part of the Congress that when it repeals the investment tax credit it is creating an almost frightening gap in the federal program to support capital investment in the United States and that at least for the long run this gap will have to be filled. By no means is it too early to be thinking and studying as to how the substitute device or system should be shaped. As a matter of fact, if the anti-inflation program of government is constructive to any significant degree, even from the government point of view, we will need this substitute system in a matter of months. Without it we

might very well turn an economic adjustment or a moderate recession into something considerably more serious.

The need is immediate.--In brief, we suggest strongly that if the Congress continues on its present track toward repeal of the investment tax credit, working with the Executive Branch Congress should begin immediately to develop a satisfactory substitute. The studies which we are now conducting on sources of funds for investment, on the comparative impacts of various approaches to capital investment support, some of which we have referred to, and on the impact of the reserve-ratio test, we trust will be helpful as government deals with the serious implications of its act, assuming it pursues repeal of the investment tax credit and especially if it compounds that misadventure by enacting other anti-investment provisions contained in H.R. 13270.

* * *

We now address ourselves to specific sections of the bill and to certain additional tax areas which deserve consideration in the context of current tax reform.

In order to conform to requirements of the Committee regarding delivery of copies of statements in advance of oral testimony, it was necessary to finalize this written presentation before Secretary of the Treasury David M. Kennedy testified on Thursday, September 4. For this reason any comments that we may have on the Treasury testimony will be offered in our oral presentation.

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Deferred Compensation
(Section 331)

We oppose the deferred compensation provisions in the bill and ask that they be deleted in their entirety; if not deleted, they should be substantially modified.

Under the provisions of the bill, deferred compensation in amounts in excess of $10,000 paid out under unfunded deferred compensation plans would be subject to a "minimum tax" on payment at the rate which would result from adding that amount to the employee's taxable income in the taxable year in which that amount was deemed to have been earned. This requirement would not apply to any deferred compensation payment which is made under a written plan which meets the current Code requirements of being nondiscriminatory or which would meet such requirements but for the fact that the plan is unfunded, or under a plan in existence on August 4, 1969, which is amended to meet these requirements before January 1, 1972. Deferred compensation payments not in excess of $10,000 would continue to be treated as under present law. It is to be noted that the $10,000 exception would apply to the rate of payout and not to the rate of accrual.

The "minimum tax" would be the lower of two alternative amounts:

1. The aggregate increase in tax resulting from adding to the employee's taxable income for each taxable year in which such excess over $10,000 is deemed to have been earned, the portion of such excess deemed to have been earned in each such year; or

2. The average increase in tax computed by adding to the employee's taxable income for the three taxable years for which his taxable income is highest during the last ten years of the earning period, the portion of the excess over $10,000 deemed to have been earned in those three years.

The minimum tax would not apply to the ratable portion of any deferred compensation payment attributable to a taxable year beginning before January 1, 1970. It also would not apply to the ratable portion of any deferred compensation payment attributable to a taxable year beginning before January 1, 1974, if paid or made available pursuant to an obligation which was binding on July 11, 1969, and at all times thereafter, without regard to the effect of any possibility of forfeiture by the employee. Thus, if an employee receives in 1976 a $25,000 payment under a contract now in effect, only that portion of the $15,000 attributable to service performed after December 31, 1973, would be subject to the minimum tax.

These provisions would be effective with respect to taxable years ending after June 30, 1969.

Our opposition to this proposed change in the tax treatment of deferred compensation is unequivocal. If a participant in a deferred compensation plan is willing to defer receipt of a portion of his compensation until he retires, dies, or leaves the company, and if the company is willing to forego a tax deduction for the part of the compensation deferred until such compensation is actually paid to the individual, we can see no reason why the individual should not be taxed at the regular tax rates which are applicable when he receives such compensation. What government appears to be trying to do in this case is to get around the requirements of the "constructive receipt" doctrine under which an individual on the cash basis is not taxable on income not actually reduced to his possession unless that income is credited to his account or set apart for him so that he may draw upon it at any time. Even though the tax is not owed until such time as the deferred compensation is actually paid to the individual, the tax rate to be used would be that applicable to the earlier years in which the deferred compensation was deemed to have been earned. This treatment is contrary to sound accounting principles. Its difficulties are particularly apparent when the individual earning the deferred compensation has died, and the compensation is to be paid to his estate.

A part of this problem may result from the fact that there seems to be a belief that deferred compensation is substantially limited to large companies and to highly paid executives within such companies. This theory is not in accord with the facts. Many of the companies using deferred compensation plans are in the medium-sized and smaller range. Moreover, such compensation is frequently made available to a much wider group than the company's top management team. Deferred compensation can often be a critically important incentive to an employee who realizes that his ultimate receipt of the deferred compensation depends on his company's success in the period before the payment comes due.

Beyond the principles involved, the provision would clearly be difficult to administer from the company's point of view. The difficulties would be even more formidable for the individual. An individual affected by these provisions would have to engage in very elaborate record-keeping so that he would be able in appropriate instances to reconstruct his income situation with respect to prior years.

In any event, adoption of the proposal would clearly be disruptive in the extreme, requiring major changes in many deferred compensation arrangements. Another major problem is the continuing inflation we are likely to experience which is completely ignored in this proposal. The inflation factor would work particular hardship because the payments when technically received would in most cases be taxed at rates considerably in excess of those which would apply at the time of actual income receipt.

Assuming (which we do not concede) that some form of tightened taxation should be imposed on deferred compensation, the method followed

in the House bill does not seem to be the best way to accomplish this goal. For example, the $10,000 exemption appears hardly adequate. It would be much more desirable to set this figure at perhaps $25,000.

The method to be used to calculate the so-called "minimum tax" seems unduly complicated. We think it desirable to abandon completely the concept of computing the tax on the basis of the rates which would have applied in earlier years. It would seem much more sensible to handle this by a modest surtax.

Another special problem would occur when the incentive compensation in question takes the form of a "phantom stock" plan. Under such a plan, the compensation to be credited to an individual's account would be so many unit equivalents of company stock. These equivalents would appreciate or depreciate in value as the market value fluctuates. The problem is that the proposal would not only tax appreciation in phantom stock as ordinary income but it would also bunch such appreciation so that it would be taxed at the highest rate brackets in that individual's lifetime. Another problem that would be particularly acute with respect to the phantom stock plan would be the "throwback" standard under which the years would be identified to which payments would be attributed or "thrown back." The Internal Revenue Service would have the power under these standards to determine that the deferred compensation was earned during only a portion of the individual's employment period rather than during his complete employment period. It would be helpful to make sure that any such "throwback" is to be limited only to the amount which would have been paid in cash at the time the deferred compensation was earned, thus ensuring that any appreciation in value would not be included.

Still another major problem with the text of the bill is that the term "deferred compensation" is not defined. This becomes important because it is not clear whether bonuses payable under incentive compensation plans are to be considered deferred compensation simply because they were not actually paid within the year earned. It would appear that such payments should be considered current compensation. This problem can probably be substantially cured by deeming all payments for services made within 2-1/2 months following the close of the employee's taxable year in which the services were rendered, as not constituting "deferred compensation." In addition, it would be desirable to treat payments made to a retired individual or to an individual's estate as being current compensation if they would be so treated if paid to a person still in the active employment of that company.

The above comments on technical defects in the deferred compensation proposal should not be interpreted as departing in any way from the Institute's complete opposition to the proposed changes in the tax treatment of deferred compensation plans. We strongly recommend that Section 331 of the bill be stricken.

Restricted Property (Restricted Stock Plans)
(Section 321)

The Institute opposes the bill's changes in the tax treatment of restricted stock plans.

Under present law, no tax is imposed upon the transfer of stock to an employee pursuant to a restricted stock plan until such time as the restrictions lapse. At that time, the employee is taxed at ordinary income rates on the market value of the stock at the time of transfer or the value at the time the restrictions lapse, whichever is the lesser amount. Any increase in the value of the stock between the time of transfer to the employee and the time the restrictions lapse is treated as a capital gain.

The bill includes a provision relating to restricted property generally, which would change the current tax treatment of restricted stock plans. Under its provisions, the person who receives a beneficial interest in property by reason of the performance of services would be taxed on the fair market value of the property at the time of receipt, either if his interest in the property is transferable or if it is not subject to a substantial risk of forfeiture. The operative phrase "substantial risk of forfeiture" is defined by the Committee report only to the extent of asserting that "[a] substantial risk of forfeiture will be considered to exist where the person's rights to the full enjoyment of the property are conditioned upon his future performance of substantial services." The alternative of referring the question of whether there is a substantial risk of forfeiture to the facts and circumstances of the case is hardly more definitive.

Generally, these rules would apply to property transferred after June 30, 1969, except for property transferred:

(1) pursuant to a binding written contract entered into before April 22, 1969,

(2) upon the exercise of an option granted before April 22, 1969, or

(3) before February 1, 1970, pursuant to a written plan adopted and approved before July 1, 1969.

We object to this provision for some of the same reasons governing our opposition to the provision on deferred compensation. In general, this proposal tries to do equity by ending supposed tax discrimination in favor of large companies and highly salaried individuals. Here again, we believe that the premises on which this theory is based are in error. The fact is that restricted stock plans, like deferred compensation generally, are of great significance to medium-sized and smaller companies which wish to attract and retain executives without paying them full compensation for services rendered in the taxable year in which such services were rendered.

We think that the proposal would certainly be disruptive; it hardly seems likely that there would be much future utilization of restricted stock plans if this proposal is enacted into law. It is also quite clear that there would be no revenue gained by the Treasury from enactment of this proposal. Indeed, it is likely that in most cases there would be a significant revenue loss which would result from the fact that the appreciation of the stock, although taxed at ordinary-income rather than capital-gain rates to the individual, would then become fully deductible as additional compensation paid by the employer. No such employer deduction is available, it should be noted, when the appreciation is treated as a capital gain rather than as ordinary income with respect to the individual employee.

From a technical standpoint, one of the major problems with the House provision is the fact that continued capital gains tax treatment would be available with respect to the restricted property only when there is a "substantial risk of forfeiture." As noted, although there is some description of that term in the House Ways and Means Committee report, no precise statement of meaning and scope is offered. Clearly, without substantial modification of the bill on the Senate side, Treasury regulations would have to deal in detail with this term. Until that time, of course, there would be substantial uncertainty as to what the term really means, and resulting uncertainty as to whether or not specific restricted stock plans would be subject to the new provisions.

There are additional arguments against this proposal. In a very basic sense, the appreciation in value of the restricted stock which would be subject to ordinary income taxation is really capital appreciation. Furthermore, there is the very practical problem of the individual's ability to pay the tax when, in many cases, the restricted property in question can not be sold or disposed of in order to get the money to pay the tax. Finally, we believe that the straitjacketing effect which results from Treasury's continual nibbling at restricted stock options and stock options as well, on the assumption that compensation is compensation regardless of the form in which it is distributed, is totally unsound. It misses the point. While it would be naive to argue that such plans are not designed with the tax laws in mind, it is important to recognize that compensation dollars are not homogeneous in either the eyes of those being rewarded or those providing the remuneration. The stock form of compensation has a much more important impact than ordinary compensation. Stock in whatever manner received represents an ownership affiliation which is absolutely key to providing proprietorship motivation to employees.

Stock Options

At the same time that the Congress examines the tax status of restricted stock plans, some consideration should be given to stock

options. We feel there is a need for liberalization. In our judgment, the adjustments made in 1964 have swung the pendulum too far in the direction of those who see "tax fairness" as requiring ordinary income tax on every compensation dollar. At this time we suggest two relatively modest amendments. First, the maximum period during which the stock option can be outstanding should be stretched out beyond the current five-year maximum. We think in light of the long-term commitment impact of an option plan coupled with the "vagaries" of the market that the old 10-year rule makes more sense. It would reduce pressure on the employee to exercise his option before it is convenient to do so. Second, the current three-year holding period for optioned stock is too arbitrary and artificial a restriction because it is totally unrelated to the dynamics of the marketplace. Because a stock option plan is encouraged through the tax laws on the grounds it is an incentive to good management doesn't remove the nagging reality that stock prices are not wholly related to managerial performance. We recommend a holding period of not more than 18 months and preferably one year.

Moving Expenses (Section 231)

In brief, it is our view that Section 231 of the bill on moving expenses is a step in the right direction but much bolder relief is warranted and technical deficiencies in the proposal should be avoided.

Before considering the specifics of the bill's provisions on moving expenses and in order to lay a foundation for our recommendations, it may be useful to sketch briefly the nature and history of this problem as it affects industry.

To remain competitive and to adjust to continually changing circumstances, corporations frequently find it necessary to relocate employees. One important impediment to maintaining the mobility of the corporate work force is the reluctance of employees to accept the financial and psychological burdens involved in company-directed moves. Most companies attempt to minimize at least the financial burden by reimbursing employees for all or a major part of the moving expenses incurred. However, the tax laws, as now written and interpreted, present serious obstacles.

At the present time, allowances or reimbursements with respect to an employee already on the payroll are considered nontaxable to the extent that such payments are limited to the so-called "direct costs," i.e., the costs of moving the employee, his family, and his household goods. In the case of a "new" employee, such payments must be included in his gross income, but he is provided a tax deduction for the reasonable expenses actually incurred in these so-called "direct" moving expense categories. The deduction is also available in the case of an employee who receives no such allowances or reimbursements from his employer. In addition, payments for such moving expenses are not

subject to withholding of federal income taxes or federal social security or unemployment compensation taxes to the extent that it is reasonable for the employer to believe that the expenses to which these payments relate are within the scope of the existing deduction for moving expenses. Finally, under the present law, the deduction is available only if the taxpayer's new principal place of work is located at least 20 miles farther from his former residence than was his former principal place of work. In addition, it is required that the taxpayer be employed full-time during at least 39 weeks of the 52 weeks immediately following his arrival at the new principal place of work.

The federal judiciary to which Congress confided this problem at the time of its last legislative action has restricted deductibility to the three classes of "direct" expense, administratively sanctioned by Treasury and noted above, and has indicated that further deductibility must depend upon congressional action. We believe that Congress should now act to recognize that reimbursements for expenses ordinarily and necessarily incurred in the course of an employment-related move are not truly income.

The pending bill would take only limited action by expanding the allowable categories of deductible moving expenses to include the following:

(1) expenses of pre-move house-hunting trips;

(2) temporary living expenses at the new job location, incurred within any 30 consecutive days after obtaining employment; and

(3) residence sale, purchase, or lease expenses, including a real estate agent's commission, escrow fees, appraisal fees, title costs, etc.

These additional categories of moving expenses would be subject to an overall deduction limitation of $2,500, and the expenses related to house-hunting trips and temporary living expenses at the new location would be limited to $1,000 of the $2,500.

Unfortunately, the existing rules granting a tax exclusion for payments attributable to the "direct" categories of moving expenses would in effect be repealed by this legislation, so that all allowances or reimbursements for moving expenses would be considered items of gross income. Finally, the 20-mile test--one of the two limitations relating to qualifying for the deduction--would be modified to require that the new job location be at least 50 miles farther than the old job location from the former residence. In the case of the other limitation--the 39-week test--the bill would permit its waiver in some cases.

These provisions would apply with respect to taxable years beginning after December 31, 1969.

So far as it goes, the broadening and liberalization of the moving expense deduction which would result from enactment of this proposal should be commended. In general, we feel that the employee should be made whole--without tax penalty--as to all moving expenses ordinarily and necessarily incurred in connection with an employment-related move. Moreover, we question the practicality of some of the specific limitations on time and money included in the bill. There may well be instances in which the 30-day limitation on temporary living expenses at the new location is inadequate. We think that 60 days, or at least 45 days, would be a more reasonable limitation under such circumstances. Secondly, we are concerned about the use of dollar limitations in connection with house-hunting trips, which do not take into consideration the distance involved between the old and the new location. For example, it is reasonable to assume that the cost of a single house-hunting trip across the country by an employee and his wife would consume the entire $1,000 allowance and indeed a substantial part of the total $2,500 allowance. Finally, it would seem only reasonable that any limitations on the allowance for expenses relating to the purchase and sale of homes should be based at least to some extent on the market values of those homes. We fear that if the rigid dollar limitations are not removed, the form of relief which has been proposed will prove to be grossly inadequate. This, of course, is the type of problem that is always present with a dollar limitation, especially when one considers that any such limitation, even if adequate at the present time, will almost surely become inadequate simply because of the continuing general increases in price levels.

We are strongly opposed to the proposed change from a "20 mile" to a "50 mile" standard. This refers to the provision in the present law under which the deduction is not available unless the taxpayer's new principal place of business is at least 20 miles farther from his former residence than was his old place of business. This requirement is apparently designed to deal with what the House has regarded as abuses when a person might move from one point to another in a suburban area within which the individual's place of business is located. To increase the "20 mile" standard to 50 miles seems to be a niggling and unreasonable type of change. Take the case of an employee who lives within walking distance of his company's location; the company decides to move 45 miles from the former residence of the employee in question; under the new rule, he would not qualify for the moving expense allowance even though he considers it mandatory to move his residence. We strongly urge that if such a test is to be employed at all, it should not be increased to 50 miles.

A final point should also be made with regard to proposed relief on moving expenses. The proposals currently before the Committee are based upon a "deduction" approach. This sort of approach is intended to do equity as between "old" and "new" employees and as between employees who receive moving expense reimbursements from their employers and those who do not. On the other hand, to require reporting of moving

expense allowances and reimbursements as gross income even when it is relatively certain that these amounts will be fully deductible, would add greatly to the detail and complexity of the individual employee's tax return. In this connection, we suggest that the Committee should consider the simplified approach taken with respect to the somewhat similar problem of travel and entertainment expenses. In the latter area, if a taxpayer indicates that he has fully accounted to his employer with respect to such expenses, he is not required to report his expenses and reimbursements in detail. We see no reason why such a simplified "exclusion" approach cannot be adopted with respect to an employee's reporting of such moving expense advances and reimbursements, so long as he accounts fully to his employer with respect to the expenses relating to such advances and reimbursements.

Finally, we take note of the related problem of the loss on the sale of a home resulting from an employment-connected move.

It is our hope that enactment of legislation concerning moving expenses will provide full relief at this time; if only limited action is taken, a further and complete relief provision should be enacted as soon as possible.

Foreign Tax Credit and Other Tax Problems Relating to Foreign Earnings (Sections 431 and 432)

We oppose this section of the bill; what is needed is an overall rethinking of foreign source income taxation, including a reexamination of certain specific matters to which we call attention.

Under present law the credit against U.S. taxes for foreign taxes may be computed on the basis of either the "per country" limitation or the "overall" limitation. The bill would provide that, in the case of a U.S. taxpayer who uses the "per country" limitation, any tax benefit resulting by reason of a loss from a foreign country is to be recaptured when income is subsequently derived from that country. This would be accomplished by reducing the taxpayer's taxable income from that country (or his foreign source taxable income if the "overall" limitation is being used in the subsequent year) by the amount of the loss previously sustained in that country. However, the amount subject to recapture in this manner would be limited to one-half of the taxpayer's taxable income in the subsequent year from sources within the country in which the loss was previously sustained, with any remaining amounts of the loss to be recaptured in years following.

The loss recapture rule contained in this provision would be applicable with respect to losses sustained in taxable years beginning after December 31, 1969.

This provision would mean in essence that any tax advantage derived from a loss with respect to foreign operations would be recouped

by the Treasury out of additional taxes imposed on future profits derived from the country within which such losses were incurred. In effect, such losses would be only temporarily recognized. It would seem to us that if taxes are to be increased in subsequent years to reflect the loss deduction, there should be further liberalization to reduce the impact of such increased taxes.

This provision seems particularly inequitable to us because both the House and the House Ways and Means Committee appear to have ignored the problem of the availability of the "deemed" foreign tax credit with respect to second- and lower-tier subsidiaries in which an American corporation owns less than a 50-percent stock interest. In its original announcement concerning the tax reform hearings, the House Ways and Means Committee expressed interest in whether or not there should be a revision of the "deemed" foreign tax credit in the case of a corporation receiving dividends from a foreign subsidiary.

Presently, the deemed credit is available to an American company with respect to foreign taxes paid by its first-tier foreign subsidiary when the parent company owns at least 10 percent of the voting stock of the first-tier subsidiary. However, a credit is available with respect to a second-tier subsidiary only when the first-tier subsidiary owns at least 50 percent of the voting stock of the second-tier subsidiary.

We recommend that pertinent Code provisions be amended to make the deemed credit fully available with respect to foreign taxes paid by any second- or lower-tier foreign subsidiary so long as there is at least a 10-percent voting stock ownership by an upper-tier foreign subsidiary in which the American taxpayer holds at least a 10-percent interest. In our judgment, the information-reporting requirements imposed by Code Section 6038 and under Subpart F are sufficiently extensive in nature as to assure that adequate information will be available to justify the claim for the foreign tax credit in the case of second- and lower-tier foreign subsidiaries.

Subpart F.--We believe the Committee should consider whether Subpart F of the Code is still serving any valid purpose in preventing alleged tax abuses through the use of foreign subsidiaries. Much has taken place since enactment of Subpart F as part of the Revenue Act of 1962 to prevent any abuses that may have existed. Most significantly of all, transactions between an American parent company and its foreign subsidiaries are now governed by comprehensive Treasury regulations issued under Section 482. At the very least, we urge the Committee to consider the interrelationship between Subpart F and the Section 482 regulations and the extent to which there now exists an unnecessary overlap in these two areas.

Double taxation of foreign earnings.--The new and far-reaching Section 482 regulations have accentuated those problems arising from the

fact that a foreign country in which an American taxpayer does business does not treat an item of income for tax purposes in the same manner in which it is treated by the Internal Revenue Service. For example, in some cases, a foreign country will not permit a tax deduction for a payment made by a foreign subsidiary to an American parent company in circumstances under which a deduction would be available under American tax law. In some measure, such problems can be resolved under pertinent double-tax provisions of a tax treaty between the United States and the foreign country in question. Under treaties presently subsisting with other major industrial countries, double-tax problems of this character are to be adjusted through negotiation by the "competent authorities" of both countries.

We are informed that these treaty provisions have not led to a satisfactory resolution of double-tax problems affecting individual companies. Although we recognize the inherent difficulties of such negotiations and the need for U.S. Government representatives to gain experience, some problems appear to have resulted from dilatoriness or less-than-vigorous pursuit of reasonable settlement by the U.S. "competent authority"--the Office of International Operations of the Internal Revenue Service. In addition, there is the overriding question as to whether the double-taxation problem should be left to negotiation by country representatives. This issue is of such importance--involving both equity to a U.S. taxpayer and equity to the U.S.--that, in our judgment, it deserves priority consideration by the Congress and the Treasury Department.

Section 367 rulings.--The present Code Section 367, dating back to 1932, requires a U.S. taxpayer to obtain an advance Treasury ruling that tax avoidance is not a principal purpose in certain types of transactions which relate to the organization, reorganization, or liquidation of foreign subsidiaries. In the absence of such a ruling, the taxpayer must recognize as a gain for tax purposes the difference between the value of the property transferred and the cost basis of the property.

To repeat a point made earlier, much has happened in recent years--particularly during the 1960s--to avert alleged tax abuses relating to income earned abroad by foreign subsidiaries of U.S. parent companies. These include, for example, Subpart F enacted as part of the Revenue Act of 1962, the comprehensive regulations under Section 482 issued last spring, and the very extensive regulations implementing the information-reporting requirements relating to foreign business operations under Code Sections 6038 and 6046.

Serious practical difficulties result from the necessity for literal compliance with Section 367. One of the major problems, of course, is the delay normally incident to a Section 367 ruling. Business opportunities often cannot await the four to five months typically required to obtain such a ruling. Another problem arises where the U.S. company does not have sufficient advance notice of a transaction which might fall within the scope of Section 367, and this difficulty

is often compounded by the fact that the U.S. parent company may not have effective day-by-day control of the management of the foreign corporation.

It is true that the Service has recently issued general guidelines with respect to criteria relating to Section 367 rulings, but it would appear that such guidelines do not solve the basic problem under Section 367. In our judgment, the primary difficulty lies in the fact that the Service normally will exact some type of "toll" as it were, in the form of a taxpayer agreement to recognize some gain and pay some tax, in connection with the transaction.

For the reasons indicated above, we recommend that Section 367 be amended to drop the advance ruling requirement and that there be substituted for it authority for an after-the-fact justification by the taxpayer. In addition, we urge that Section 367 be included as a part of a comprehensive and urgently needed congressional study of the taxation of foreign earnings and what might be done to improve present policies and procedures in this area.

In conclusion, beyond reemphasizing the need for an overall reexamination of foreign source income taxation by the Congress, we call attention to a dangerous drift in U.S. policy of which foreign source income tax policy is only a part. This drift adds up to significant interference with private foreign investment decision making and free capital flows. Other elements in the picture include the enactment and repeated extension of the Interest Equalization Tax Act, foreign investment controls, the termination of which is not in sight, an apparent desire on the part of our government to favor, by regulation or by providing incentives, investment in developing versus developed countries, etc.

Real Estate Depreciation
(Section 521)

The House bill would permit only straight-line depreciation or declining-balance depreciation limited to 150 percent to be taken with respect to depreciable real property. However, there would be a specific exception for new residential housing which would continue to be eligible for the accelerated methods of depreciation--double declining-balance and sum of the years-digits. In all cases, however, any gain on the sale after July 24, 1969 of new real property would be taxed as ordinary income to the extent of depreciation in excess of straight-line depreciation taken after July 24, 1969. Under present law, any such recapture is limited to property held for 20 months or less; beyond that period of time, recapture is reduced by 1 percent per month for each full month the property is held over 20 months, and when the property is held for 10 years or more the amount recaptured is zero.

Our remarks are limited to the impact of this provision on industrial realty.

We oppose this provision because it fails to recognize the special problems relating to industrial real property--that is, real property used in connection with the manufacturing process. In our view, such a provision, if adopted, would increase the existing discrimination against industrial real property implicit in the investment credit provisions of the Code under which buildings and the structural components of buildings may not qualify for the investment credit. Even assuming that this Committee concurs in the House action repealing the investment credit and putting aside the fact that the investment credit provisions have discriminated against industrial realty for as long as they have been effective, it should be noted that under the depreciation guidelines promulgated by the Treasury in 1962 (Revenue Procedure 62-21), there is no general reduction in useful lives for buildings comparable to that provided for machinery and equipment. For example, useful lives for productive machinery and equipment were reduced by 33-1/3 percent while the life for factory buildings was reduced by only 10 percent.

We urge the Committee to instruct the staff of the Joint Committee on Internal Revenue Taxation to investigate what appears to be a continuing discrimination against industrial realty. In this connection, the Committee should bear in mind that modern buildings and building components are essential to dynamic technological development. Machinery modernization must be coordinated with plant modernization and design. This is especially true in the "systems" approach to manufacturing. It is fair to say that worker safety and comfort are also involved.

Capital Gains and Losses (Sections 511-516)

Significant changes would be made under the provisions of the bill in the present system of taxing long-term capital gains. We oppose the proposed changes both on substantive grounds and because, like certain other sections of the bill, they seem to represent a "hit and run" attack on a major area of tax policy without an overall review of the widesweeping tax policy considerations involved and without a careful balancing of public policy impacts. As to the latter, the bill reflects an apparent desire to narrow an alleged area of tax preference without fully considering the public policy objectives of favorable treatment of capital gains and losses under our tax system.

Tax policy affecting capital gains and losses has been the subject of extensive study over the years. The area has been addressed from the standpoint of equity, national economic objectives, and considerations of tax administration. It seems to us that economic goals in connection with capital gains taxation are central. In his book Federal Tax Reform, McGraw-Hill Book Company, Inc., 1961, at page 125,

the distinguished tax scholar and former government tax official Dan Throop Smith puts it this way:

> . . .Capital gains represent a reward for risk investment, and risk investment is especially important for economic growth. Capital gains also represent a form of "income" which is most likely to be saved; in fact, realized capital gains are automatically reinvested along with the rest of one's capital when one sells one security and buys another. . . .

There is a further argument for special tax treatment of capital gains which is a threefold economic one in character. Dr. Smith continues:

> . . .Special taxation [of capital gains] is advocated to increase the total amount of capital, to encourage its use in more risky investments, and to prevent successful investments from being frozen into their existing form. These are all significant points.
>
> Increased savings are needed to finance new capital investment which may increase labor productivity and national income. . . .
>
> It is also important to have capital go into new ventures and equity investment which is necessary for economic development. . . .
>
> Finally, there is the economic argument for fluidity in investment markets. A willingness to shift from successful ventures permits risk-minded investors to finance new ventures. More importantly, fluidity will help to prevent overvaluations in market booms. . . .

In a later book entitled Tax Factors in Business Decisions, Prentice-Hall, Inc., 1968, at page 80, Dr. Smith underlines the fact that the capital gains tax is probably paid out of capital to a greater extent than any other tax except the estate and gift taxes. Some carry this point one step further and argue that the capital gains tax is a capital levy and therefore if capital gains are taxed at all the impact should be minimized.

Turning to the views of another tax authority as expressed in the book Federal Tax Policy by Joseph A. Pechman, published by The Brookings Institution, Washington, D. C., 1966, Mr. Pechman concludes at page 63: "Numerous studies have demonstrated that the opportunity to earn income in the form of capital gains stimulates investment and risk taking." He also points out that much of the nation's investment is undertaken by large corporations, a fact which has considerable bearing on the thrust

of the proposed changes in the treatment of capital gains taxation as contained in the current bill; these changes affecting both capital gains to individuals and to corporations.

<u>Proposed Changes Affecting Rates and Holding Period</u>

Turning to the specific provisions of the bill, in the case of individuals the 50-percent deduction from ordinary income for long-term capital gains would continue to apply but the alternative of a 25-percent maximum rate on such capital gains would no longer be available. Since the bill otherwise provides for lowering the top rate on individual income from 70 percent to 65 percent this would mean that the maximum rate on long-term capital gains for individuals eventually would be 32-1/2 percent. The repeal of the alternative 25-percent maximum rate would apply to sales and other dispositions after July 25, 1969. With respect to corporations, the capital gains rate would be increased from 25 percent to 30 percent, for sales and other dispositions after July 31, 1969.

The holding period for qualification of a capital gain as a long-term capital gain (and thus eligible for favorable capital gains tax treatment) would be changed from six months to one year. This provision would also apply to taxable years beginning after July 25, 1969.

Applying the considered judgments quoted above, an increase in the capital gains rates affecting individuals (and clearly they would be increased in the upper brackets of the personal income tax structure) and for corporations will have a deleterious effect on risk investment, particularly as to new ventures and equity investment, on economic growth, and on the element of fluidity in investment markets. As to individuals, for example, the changes in capital gains treatment would clearly induce holding down on the number of capital transactions. In the case of an individual in the top bracket (assuming that in accordance with the House bill the maximum rate for individuals on the ordinary income is reduced from 70 percent to 65 percent) the increase in the capital gains rate from 25 percent to 32-1/2 percent would amount to an increase in the capital gains tax rate of nearly one-third. When this result is coupled with the change in the required holding period, how can this bill fail to cause a slowdown in the number of capital transactions with its adverse effect on the economic considerations to which we have referred? There also is the question as to whether the changes in the capital gains structure contained in the current bill will have a perverse effect on tax revenues. Clearly, the impact on corporate investment flowing from the increase in capital gains rates is bound to be adverse, particularly as to marginal projects.

In general, to evaluate the pros and cons of the proposed changes in the taxation of capital gains requires an overall examination of the whole capital gains picture and, as we have said previously, a careful weighing of all of the public policy objectives underlying

present tax treatment. We venture to suggest that this job of study has not been done and that the piecemeal and, in our judgment, ill-conceived changes now contained in the pending legislation if enacted into law will represent a disservice to the country. They are particularly dangerous if they serve to establish a precedent for further and more severe tightening of capital gains taxation.

Finally, although there may be some debate under normal economic conditions as to the degree to which the capital gains tax is a capital levy, during periods of inflation the effect of a capital levy certainly seems to be present. It is not at all unreasonable to suggest that a very high percentage of the so-called capital gain computed on the basis of original cost without allowance for inflation is illusory.

Capital Losses

Another major change in the bill would apply to the deductibility of capital losses in the case of individuals. The present Code provisions specify that such losses are fully deductible against ordinary income up to the amount of $1,000, after first being offset against capital gains. Any excess may be carried forward for an unlimited number of future taxable years. The bill would change this treatment to the extent that only 50 percent of net long-term capital losses would be deductible against ordinary income subject to the $1,000 limitation, effective for taxable years beginning after July 25, 1969.

We are opposed to this provision. As we understand it, this proposal is intended to equalize the treatment between long-term capital losses and long-term capital gains to reflect the fact that only 50 percent of such gains are required to be included as taxable income. But this overlooks the fact that a long-term capital loss is deductible against ordinary income only to the extent of $1,000 in any particular year. Accordingly, the proposal would seem to make no sense logically unless it also included a repeal of the $1,000 limitation.

Beyond the question of logic, however, it seems to us that the proposal can be faulted on the grounds that it will discourage capital transactions and thus in the long term reduce federal revenues. Even more importantly it clearly will deter investments entailing high risk of loss, simply because tax recognition of such losses would be drastically limited. Much of what we have said above about the economic policy underlying special treatment of capital gains applies here also.

Distribution From Qualified Employee Pension, Profit-Sharing, Stock-Bonus, and Annuity Plans

The bill would also change the current tax treatment as a capital gain of a lump-sum distribution to an employee from a qualified pension, profit-sharing, stock-bonus, or annuity plan. Such

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distributions, to the extent of benefits paid within one taxable year and to the extent of employer contributions made on or after January 1, 1970, would be treated as ordinary income. These provisions would be effective with respect to employer contributions to qualified plans made during plan years beginning on or after January 1, 1970.

Our opposition to the capital gains sections of the bill extends to this provision also. The current capital gains treatment has now been in effect since 1942. To impose an ordinary tax on the full amount of lump-sum payments would cause a severe tax result if the recipients were pushed into much higher tax brackets. Moreover, the present rule, in our opinion, has worked reasonably well in encouraging the establishment and growth of such plans. This is, we think, a desirable public policy goal. Unquestionably, this proposal, to the extent that it calls for increased taxes, would discourage the continuance of the existing widespread utilization of such plans. Moreover, the provision would have a particularly adverse effect upon profit-sharing plans because this type of plan relies very heavily for its success on lump-sum distributions. In most instances, employees have an option to choose between a single lump-sum distribution of these benefits or distribution in installments over a period of years. The suggested change in tax treatment would weigh so heavily against a lump-sum distribution as to make it impracticable for employees to exercise that option. We feel that such a result would be highly unfortunate because it would tend to decrease the usefulness of profit-sharing plans. Our opposition to the proposal for full ordinary income treatment for unrealized appreciation on employer stock is based primarily on the fact that we feel that such a change would mean the end of stock distribution plans from a practical point of view.

Tax Accounting Problems

In recent months the Treasury and the Internal Revenue Service have taken major administrative steps in respect to certain fundamental accounting questions. They are of such importance, both currently and prospectively, as to justify comprehensive legislative review. Each is discussed briefly below.

Advance Payments

We wish to call the Committee's attention to efforts of the Internal Revenue Service to apply in inappropriate cases the rule of the Tax Court in the Hagen case in which that court held that a manufacturer of advertising signs, who received advance payments from customers in a taxable year prior to that in which the goods are received, must include such payments in income in the year they are received. This decision, which has recently been affirmed by the U.S. Court of Appeals for the Sixth Circuit, has been applied in cases involving the sale of equipment which is frequently purchased under long-term contracts.

In our view there is very considerable doubt as to the merits of a general rule taxing advance payments received in connection with the sale of tangible property. But, of much greater significance is the undesirability of imposing any such rule with respect to the receipt of advance payments in connection with the sale of medium- to long-production cycle items of capital equipment at relatively high cost as distinguished from the high-volume sale of retail goods at relatively low cost. Because of the high unit cost and production cycle characteristic of capital goods, advance payments have by custom and usage come to be regarded as an essential means of financing production.

We think that the time has definitely arrived for a comprehensive review by the Committee of accounting rules and problems under the Code with a view toward making some fundamental changes in this area. We are, of course, familiar with the abortive experience with respect to Sections 452 and 462 in the Code. These provisions, permitting the deferral of tax on prepaid income--including, of course, advance payments--and the accrual of reserves for estimated expenses, were a part of the original Internal Revenue Code of 1954 but were repealed rather suddenly in early 1955 at the urgent request of the Treasury. At the time of the repeal, it was indicated that the accounting problems which these provisions were designed to deal with would continue to undergo intensive study in the Congress with the eventual goal of bringing federal income taxes into harmony with generally accepted accounting principles.

Reverting to the Hagen case specifically, as previously indicated, we believe the rule of the case is being administratively applied to inappropriate situations. The problems involved are so diverse that judicial decisions alone are not likely to solve them. We submit that legislation is needed and that Congress should follow through on its original commitment to consider the matter. There is much merit, in our opinion, to suggestions that legislation be enacted permitting tax deferral on advance payments with respect to the sale of tangible goods and products. Among the advocates of this position is the American Institute of Certified Public Accountants.

In concluding our observations on this issue, we summarize our objections to the overapplication of the Hagen rule to advance or progress payments on sales of industrial goods:

1. It violates good accounting in two respects.

   a. By taxing receipts at a time when it is uncertain as to whether or not they will result in any taxable net income, and

   b. It poses almost insuperable problems of matching costs and related revenues.

2. The taxation of advance and progress payments poses a threat to the very structure of the capital goods industries inasmuch as such payments are characteristically contracted for to provide working capital to finance long-production cycle projects.

3. Finally, producers, in effect denied the use of advance or progress payments when they are taxed on receipt, must resort to external financing, the cost of which is tax deductible. In revenue terms the result could well be disadvantageous to Treasury and the tendency would be to force prices upward.

May we also submit for the record a copy of an analytical memorandum published by MAPI on April 25, 1969 entitled "Taxation of Advance Payments."

"Methods of Accounting"

Last December the Revenue Service released for public comment proposed regulations under Section 446 of the Code on changes in "methods of accounting," which for the first time spell out what constitutes a change in accounting method. Only a limited number of accounting changes are recognized as changes in accounting method by the new proposal. Presently, if a change in a taxpayer's accounts represents a "change in accounting method" within the meaning of the Code and pertinent regulations, Code Section 481 provides a partial amelioration of the tax impact of any such change by authorizing in effect a "three-year spread" for accounting gains realized from the change in method.

In February 1964, the Revenue Service issued Revenue Procedure 64-16 which authorizes taxpayers, with permission of the Commissioner, to make certain changes in accounting "practices"--not "methods"--with any resulting tax adjustments to be taken into account ratably over a 10-year period. It is to be assumed that final regulations concerning "changes in accounting method" will probably modify--in the direction of making the two directives compatible--the existing Revenue Procedure 64-16 relating to "changes in accounting practice."

Although highly technical in character, these regulations, existing and proposed, can so seriously affect a taxpayer in the individual case as to justify congressional oversight of their realignment. We urge that consideration be given to revising Sections 446 and 481 of the Code. Specifically, we recommend that the "three-year spread" authorized for absorbing the impact of changes in accounting method by Section 481 be amended to permit a "ten-year spread" as now permitted for changes in accounting practice by Revenue Procedure 64-16. Additionally, we recommend that final regulations should substantially broaden eligibility for the types of changes qualifying as a "change in accounting method."

Inventory Valuation

Another Internal Revenue Service proposal which would affect established accounting practice is now under active consideration by the Service. Although not published officially pursuant to the Administrative Procedure Act, a draft revenue ruling defining permissible--and impermissible--methods of inventory valuation has been circulated by the Service to various interested groups for review and comment. In brief, this proposal would declare as unacceptable for income tax purposes the "prime cost" (excluding all overhead) and the "direct cost" methods of inventory valuation. Conversely, the "normal capacity" method of inventory valuation, under which the ratio of actual capacity or production attained in the current year to the normal or maximum practical capacity attainable is used as a basis for allocation of fixed expenses properly includable in indirect manufacturing cost to inventories, would be considered acceptable for tax purposes.

Adoption of this proposal in final form would cause extensive and costly changes in inventory valuation procedures long employed in industry and sanctioned by professional accounting authority. It would amount to a substitution by the Revenue Service of its judgment for that of the taxpayer as to the accounting method best adapted to the taxpayer's situation. We do not believe this directive should be issued in its present form and we recommend the subject for inclusion in the legislative review suggested above.

Reserves for Estimated Expenditures

Finally, we believe that there should not only be statutory sanction for the deferral of tax on prepaid income but that accrual of reserves for estimated expenditures should be authorized by statute. Such provisions (consistent with the now repealed Section 462) should permit a deduction for additions to reserves for estimated liabilities to customers, including, for example, liabilities for trade and cash discounts, allowances of product guarantees, advertising allowances, sales returns and allowances, etc. Taxpayers on the accrual basis should be permitted an option, as in the case of bad debts, of deducting such expenses when incurred or electing to deduct additions to reserves for such expenses. Such an election would in itself reduce the revenue loss which would result if taxpayers were required to adopt an all-inclusive treatment for all possible items of qualified estimated expenses.

Accumulated Earnings Tax

A significant number of the members of the Machinery and Allied Products Institute are closely held enterprises and thus particularly

concerned with the application of the accumulated earnings tax.[1] In our judgment, the statutory provisions calling for imposition of such a tax as well as administrative regulations and their application in the field require at least periodic review by the Congress. Some years have passed since Congress has considered this matter, and we think it timely for such a review. Such reconsideration should as a minimum include consideration of the following questions:

1. Is the administration of the law inhibiting growth and development?

2. Are the burden-of-proof provisions in the 1954 Code working as intended and/or can they be improved?

3. Does it make any sense to provide for a shift of burden of proof in the Tax Court but not in cases before a United States District Court or the Court of Claims?

4. Are specific "business needs" such as "redemption of stock," "contingency funding," "future needs," "investment needs," etc., given proper weight in the light of current operating conditions?

5. Is the intent of Congress to protect the continuity of small business, as illustrated in Section 303, being achieved?

6. Is further liberalization required in order to assure the future growth and development of smaller firms?

Charitable Contributions (Section 201)

Although tax treatment of charitable contributions is not within the area of tax policy to which the Institute has given special attention over the years, we should like to make a few brief comments and suggestions as to the pertinent provisions in the bill. In our judgment, this section of the bill is a perfect example of the fallacy of attempted loophole closing without careful consideration of possible or probable counterproductive impact on public policy objectives. For example, the proposed repeal of the unlimited deduction provision and the change in the treatment of the appreciation in value of property which is contributed may very well have exceedingly adverse effects on the pattern of giving by the category of individuals upon whom our system has depended heavily for support of social, educational, and other

1/ See The Accumulated Earnings Tax--Reasonable Business Needs Versus Tax Avoidance, MAPI, 1967.

charitable causes. James Reston of the New York Times has underlined this concern in his column on August 31, 1969, and he reports widespread apprehension by the universities and their administrators.

In addition to this general observation one specific and technical point should be made. We understand that some companies have followed the practice of entering into commitments to contribute at some future date, as in the case of donation of equipment to educational institutions. The effective date provision of this new tax treatment might therefore have a significant retroactive effect as to such agreements if changes are finally legislated along the lines of the pending bill. In our judgment, this point should be sympathetically considered.

In brief, we believe that the whole section on charitable contributions needs a hard second look. Public policy considerations must be given a heavier weighting in the decision; this loophole closing effort should be put in perspective and carefully reexamined.

* * *

This concludes the formal statement of Machinery and Allied Products Institute on H.R. 13270. If the Institute and its staff can be of further assistance to the Committee, we hope you will call on us.

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PRINCIPAL POINTS

STATEMENT OF JOHN C. DAVIS, III
for the
NATIONAL ASSOCIATION OF WHOLESALERS
before the
SENATE FINANCE COMMITTEE
Washington, D.C. September 8, 1969

1. The Treasury Department proposal to impose a 25% capital gains tax on unrealized appreciation of assets at time of death would effectively limit small, closely-held, family-type wholesale distribution firms to one generation of existence, forcing many distress sales upon death of the owner or principal stockholder.

2. The Treasury proposals do not comprehend the fundamental difference between a "portfolio" of regularly traded and instantly marketable stock in public corporations and a "portfolio" consisting entirely of stock in one, closely-held, family-type wholesale distribution business. Part of the former can be liquidated to meet the demands of the tax collector without depreciating the value of the remainder of the "portfolio." Not so with a going distribution business -- if you have to sell and not replenish inventory, your "out of business" and factoring of receivables inevitably leads to a "business embolism."

3. Unrealized capital asset appreciation in the wholesale distribution business produces business profits, and, as a basis for income tax revenue, should not be destroyed or impaired through forced liquidation to satisfy an income tax on "unrealized income."

4. The Treasury proposal of a 100% marital exclusion would delay payment of transfer taxes until demise of a spouse, but would not permit transfer of our typical wholesale business to the next generation.

5. We recommend increasing the basic Estate Tax Exemption, which has remained at $60,000 for over 25 years, to $155,000 to fairly refleot a value comparable to $60,000 in 1940. However, this action would not, of itself, offset a capital gains levy on unrealized appreciation of capital assets, nor provide for perpetuation of small, closely-held, family-type businesses, from one generation to another.

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Testimony of
JOHN C. DAVIS, III

for
THE NATIONAL ASSOCIATION OF WHOLESALERS
before the
SENATE FINANCE COMMITTEE
Washington, D.C. September 8, 1969

My name is John C. Davis, III, and I appear here today as a Past Chairman of the Board of the National Association of Wholesalers, and a member of its Executive Committee. NAW is a federation of 63 national commodity line wholesaler-distributor associations with approximately 16,500 member firms, representing over 23,000 merchant wholesale establishments or warehouse operations in the fifty states.

We are vitally concerned with Federal estate and gift taxes and State inheritance tax matters as we are predominantly small businesses. Of the 460,000 wholesale establistments enumerated by IRS in 1966, 61% are proprietorships, 6% partnerships and 33% corporations.

Of the $213 BILLION of business receipts reported by IRS for 1966 for those 460,000 wholesale businesses, the 151,000 corporations (33% of the total) had business receipts of $182 BILLION or 85%. Most of these businesses are what the Bureau of Census defines as "Merchant Wholesalers" who actually buy, break bulk, store, sell, deliver and extend credit to retailer-dealers and industrial, commercial, institutional and contractor business users, every conceivable type of product manufactured, mined or grown in the nation.

The number of wholesale firms listed on the major stock exchanges can be counted

on the fingers of your two hands. A few others of the corporations have their stock traded over-the-counter on local stock exchanges but they, too, constitute a very few, certainly less than 1% of all corporations in our industry.

In other words, Mr. Chairman, most wholesale businesses are small, closely-held, family-type businesses. Many are in the second and third generation of family ownership and succession. We are thus very vitally concerned with the tax consequences of the death or physical incapacitation of an owner, partner or principal stockholder in our businesses, and how the tax will affect the chances of survival of that business.

Thus, lacking access to capital markets, we are primarily small, closely-held, family type businesses. We are persuaded that the Treasury proposals in the estate and gift and capital gains tax areas would doom us to certain demise at the end of the first generation if they were enacted into law. We favor increased estate tax exclusion and are unilaterally opposed to taxation of unrealized capital gains as if the assets were sold the day of death of the owner.

A brief description of our type of business and business operation will illustrate the reasons for our deep concern that the Treasury proposals will cause the most common form of wholesaler-distributor organization, the closely-held, family owned business, to become extinct.

In 1966, 85% of the sales volume of wholesaler-distributors was handled by incorporated businesses. Their stock is owned principally by one or two family members -- very seldom ten or more shareholders. The tens of thousands of first generation companies, founded since World War II, are presently owned and managed by the founders.

A business generation in wholesale distribution would average between twenty and thirty years -- probably twenty five years of continuous management by one person. A business generation in larger, publicly-held corporations, by comparison, would probably

not exceed five to seven years -- the period of actual Presidency or Chairmanship of one of a constantly changing line of professional managers.

Second generation wholesale companies, ie., those founded between World Wars I & II, are presently owned and managed by the sons or sons-in-law of the founders, in the fortieth to fiftieth year of existence of the company. There are many tens of thousands of these companies now engaged in wholesale distribution. The balance of wholesaler-distributor firms were founded before World War I, some in the late 1800's.

Our economic function is to market the products of from a dozen to hundreds of manufacturing suppliers to hundreds of retailer-dealer or industrial, commercial, institutional and/or contractor and business users -- the output of our nation's factories, mines and farms. In the performance of this vital economic function of giving time, place and possession utilities to products that have been given form utility by our factories, mines and farms, we add value to each product we handle. This "value added" by merchant wholesaler-distributors has been measured by the government, Bureau of the Census, as equal to $17.30 out of every $100 of goods handled or sold by us.

As we are the primary marketing arm of our suppliers, they are naturally vitally concerned about our managerial succession and viability. In 20 to 60 or more years of selling representation of our suppliers in our areas of primary market responsibility, we have demonstrated our ability to distribute their products for them more economically and efficiently than direct distribution systems of their own.

Their future is thus dependent upon our ability to survive and grow -- grow faster than the built-in inflation of the economy, dollar wise, plus population growth, plus the growth in product proliferation of an affluent society. No business organization, be it publicly owned or closely-held, can survive in these times if it does not grow -- at least keeping pace with growth in the economy as a whole.

The nation's merchant wholesaler-distributors are no exception. In fact, in the

past decade, these small businesses have been growing at a rate almost double the growth in Gross National Product (GNP). The managerial know-how of these small business owner-managers is the key to their success and to the American low cost, fast distribution system which is the envy of the whole world.

With the best planning and training possible, of a succession management team, the death of a principle shareholder, owner-manager -- even without drastic tax consequences to the survivors, individually and as a business often wreaks havoc and all too frequently leads to forced sale of distribution businesses. When the major shareholder is the owner-manager, the value of the business is drastically depreciated -- diluted through the loss of an owner-manager. Our suppliers and larger customers, who are dependent upon our continued successful operation, are justifiably concerned about this.

It is the uncertainty and fear of these eventualities that is causing a rash of mergers and acquisitions in wholesale distribution in the 1960's and the tax consequences under present law are minimal when compared to what they would be under the Treasury Department Studies and Proposals in the capital gains, estate and gift tax areas.

As long ago as January, 1958, we wholesalers explained our tax and capital accumulation problems to the Congress and urged an increase in the Estate Tax Exemption to at least $120,000. We are now persuaded that $155,000 would be a more realistic figure as $60,000 in 1940, according to the Bureau of Labor Statistics Index of the purchasing power of the dollar, translated in 1969 dollars would be $156,600.

We note that the Treasury Department Studies and Proposals do not contemplate any increase in the Estate Tax Exemption but rather propose a series of other changes, many of which we are very fearful would sound the death knell for small businesses such as those engaged in wholesale trade.

Philosophically, the Treasury proposal concludes that unrealized appreciation of capital assets, regardless of kind, is income and for tax purposes should be taxed as

if realized. They propose to levy a tax on an assumed gain -- an unrealized gain that may not actually exist or may quickly disappear. (Witness what has happened to publically traded stocks in the last six months on the U.S. exchanges. The estate of anyone who died in January or early February would have been taxed on 25% to 30% of unrealized gain that doesn't exist today, a short six months later.) Upon the death of an owner-manager a wholesale business could depreciate 50% or more, overnight.

The proposed tax is not on income but rather on property, solely because of its change in ownership. An unrealized increase in the value of an asset is not income, regardless of who holds it or why.

In wholesale distribution, between 80% and 85% of all our assets are inventory and accounts receivable. One of the intents of the Treasury proposals is to tax that portion of a decedent's appreciated assets "which have escaped income taxation", to use their language. Since 80% to 85% of our "appreciated" assets are inventory and accounts receivable, let us take a look at how they are accumulated.

In the average wholesaler-distributor firm, about 45% of the assets are accounts receivable and 40% is inventory--the ratio varies between commodity lines. Under current IRS regulations covering the creation of taxable income, beginning inventory, plus purchases, less closing inventory represents cost of goods sold. Net sales, less cost of goods sold becomes gross income from which costs of operation of the business are deducted to get net income for tax purposes.

Under this system of business tax accounting it could be argued that increases in the value of inventory, on the asset side of the balance sheet, come from before tax earnings. However, inventory has to be paid for, in most cases long before it is sold. Where does the money come from to pay for the increased level of inventory necessary to service a growing volume of sales? There are two sources only, other than current earnings, and they are new capital contributions or borrowings. New capital contributions are after-tax

monies and borrowings must be paid back out of after tax earnings, only the interest is deductible.

For every dollar of increased sales in the typical wholesaler-distributor business, there must be a 20¢ increase in average investment in inventory and accounts receivable. In 1966, according to the latest available IRS Statistics of Income report, the average wholesaler-distributor business corporation made net profit BEFORE taxes of only 2.1% of sales. It can readily be seen that this level of earnings leaves little after tax earnings for reinvestment in the business. All increases in investment in accounts receivable MUST come from after tax earnings, either retained or newly invested.

Therefore, in our business, in a sustained period of inflations, we need increased investment every year to keep up with the inflationary spiral -- to just stand still. If we are fortunate enough to expand our share of the market and thus experience absolute growth in excess of the inflationary growth that is taking place in the economy, as we have been doing recently, we must have heavy plowback of earnings as we lack access to outside capital markets.

I risk burdening the Committee with these industry problems, Mr. Chairman, to set the stage for what I have to say with respect to our fears for the effect of the proposals of the Treasury Department on the future of our businesses. If you should accept the recommendations of the Treasury Department and (1) fail to increase the estate tax exemption, (2) tax unrealized appreciation of assets transferred at death or by gift even though you would reduce the effective estate tax rates by the 20% they propose--even though you leave the income and estate tax payment period in hardship cases for closely-held, family-type businesses at ten years and extend 100% exemption to spouses -- in our opinion you would effectively eliminate the possibility of transfer of these types of business from one generation to another. You would force their sale or liquidation.

This is a most undesirable economic effect, in our opinion. We are absolutely persuaded that in the wholesale segment of the economy at least, you would multiply anticipatory

mergers, a trend we have been watching closely and are very concerned about, under present law. In fact, Mr. Chairman, four years ago we became so concerned about the trend toward mergers and acquisitions of all types in our industry -- vertical, horizontal and conglomerate-- that we made a nation wide survey.

We undertook a study of merchant wholesaler-distributors' methods of stock valuation for estate tax purposes and the IRS attitudes and rulings as well as tax court cases. We have circulated almost 10,000 copies of this Wholesaler-Distributor Stock Valuation Study, a copy of which I would be glad to leave with you for the information of your staff and ot the Committee.

The study documented the overwhelming difficulty of determining the decedent's "basis" when his assets were acquired 10,20 or 30 or more years before, and determining, "fair market value!' for assets in limited demand. If the Treasury proposal were to be enacted and everyone given a 1969 or 1970 basis as is proposed in the grandfather clause, the task of determining an equitable basis 10,20 or 30 years from now seems hopeless, particularly when business records are required to be kept only seven years, barring litigation.

We are also persuaded, as a result of this study, that few small business wholesalers actually make adequate plans in advance for that "day certain", when the principal owner or stockholder dies. Even under present law, those who do study this problem are often persuaded that the best solution is to sell out of some publicly-held firm on a tax exempt exchange of stock basis. They do this to convert their own closely-held, unmarketable, illiquid stock into a liquid asset that will be taxed on appreciation as, if, or when the stock is sold -- and for which there is always a ready market, in whole or in part, as the heirs may require.

We believe that taxing appreciation of assets at death, as if sold the day before death, would not only complicate this problem of economic concentration, but the statistics seem to indicate that the revenues that would result would be relatively small. We have never looked upon estate and gift taxes as revenue raising measures. We do not believe the Congress

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has done so in the past.

Being a drug wholesaler, Mr. Chairman, I would suggest that we have a look under the sugar coating in the Treasury pill and determine the long range effect. By sugar coating, I mean the forgiveness of taxation on all unrealized appreciation of assets that has taken place before the date of enactment of their proposals. Those of us in this business generation might say, "Fine", but our concern for the next generation, and the next, forbids this approach. Let me explain exactly what we believe would happen to an average wholesale firm in the next twenty-six years, under the Treasury proposals, based on what has happened to the average wholesale firm in the past twenty-six years.

Please keep in mind that our spouses are really not capable of managing our businesses after we are gone, as they do not possess the energy, ability, and business acumen to actively manage a going business. The 100% exemption to them merely delays the tax impact and may multiply the problems, we fear.

My family-owned wholesale drug business, if it is to be perpetuated, must be run by my son or my brother's son or our sons-in-law or nephews, not our wives or daughters. Despite the recent social trends in the United States, I believe we can all safely assume that the situation will be quite similar for at least the next twenty-six years, which I am using in the following examples.

My point is that the 100% spouse exclusion in no way helps solve the long-term problem of perpetuating the family-type business from one generation to the next. We have already witnessed the demise of the family farm. Not due wholly to tax problems, mind you, but because many of the sons left the farm. We are trying hard to persuade our sons to stay with our wholesale businesses but it isn't easy in view of our poor earnings record in past years, as you will see from our example.

Turning now to Exhibit I, appended to my statement. The average wholesale corporation, as reported in 1966 Preliminary Statistics of Income by IRS, has assets of $417,097.

If we examine the Bureau of Labor Statistics Purchasing Power of the Dollar statistical series, we find that in terms of 1940 dollars this average wholesale corporation's assets would have been $175,104 in 1940 IF it had just kept up with devaluation of the dollar in the twenty-six year period, without any real appreciation in the value of its assets.

Now, let's suppose that the Treasury proposals are enacted into law in 1969 and that we have an asset base for a wholesale corporation of that same $175,104 and that the next twenty-six years will witness no greater rate of depreciation in the purchasing power of the dollar than the last twenty-six years. In other words, let us assume that the asset value of our corporation will be $417,097 in 1995. What we want to know is, could our 1995 sons or grandsons take over the business on the death of the owner, under the Treasury proposals, pay the proposed capital gains tax at today's rates, the estate tax at the suggested rates of the Treasury proposals, and pay off the tax bill in ten years (IF the estate could qualify as a hardship case in the view of the Commissioner) at the proposed new higher interest rate?

The capital appreciation would be $241,993 on which the capital gains tax would be $60,498*. This could be deducted by the estate, plus the $60,000 estate tax exemption from the $417,097 valuation for the estate tax base--which would leave $296,599 as the amount subject to the new Estate and Gift Transfer Tax. The recommended new Transfer Tax Rate on that size estate would be 25% or a tax liability of $74,150.

If we add the Capital Gains Tax of $60,498 to the Transfer Tax of $74,150, we have a total death tax liability arising against the estate of $134,648. If our heirs could prevail upon the Commissioner to agree that theirs was a hardship case (which few have been able to do in the past under the present payment plan, I might add) the estate could divide that amount into 10 equal payments, plus interest possibly at 6% (probably more) on the unpaid balance.

The first year's payment would then be $13,465 plus interest of $7,271 or $20,736.

* At the present 25% rate, NOT the H.R. 13270 rate of 30%

Now the average wholesaler-distributor business gets a three times turn over on assets, only, a very poor rate but these are the facts. This means that our average wholesale firm would have sales in 1995 of $1,251,291. The average net profit before taxes on sales of wholesaler-distributor corporations in 1966, according to the IRS Statistics of Income, was 2.1% so, our 1955 corporation would earn $26,277 before taxes. At today's corporate rates, including the surtax, the income tax liability would be $6,724. If we deduct that from the earnings, there remains $19,553 net income after taxes available for distribution to shareholders (to the estate). The estate liability to the government is $20,736 for the first installment on death transfer taxes, plus interest, so the estate is farced with a $1,183 deficit, and, there had been no reinvestment to finance necessary growth, on the employment of $417,097 of assets to support $1,251,291 of sales. Moreover, the estate is also faced with paying income tax on the $19,553 it received as dividends from the business.

Can it survive? We think not.

Now, let us look at Exhibit II. This is a more typical wholesaler-distributor corporation, according to the 1966 IRS Statistics of Income of wholesale corporations. They separate the returns by asset size and the greatest percentage of total dollar sales fall into the $1 to $5 MILLION asset size corporation. We have chosen the mid-point in that asset size bracket, namely, $2,500,000.

Using the same set of assumptions, our 1995 wholesale corporation with assets of $2,500,000 would be a 1966 corporation with $1,050,000 in assets.

The assumed appreciation subject to tax in 1995 in this case would be $1,450,000; the capital gains tax $362,500 and the taxable transfer base $2,077,500. The recommended rate for this size of estate would be 41% or $851,775. When the capital gains tax is added to the transfer tax, the total tax liability of this estate, when turned over to the sons, would be $1,214,275. Assuming again that they could convince the then Commissioner of Internal Revenue that they were a hardship case and he would permit them to pay the tax

in ten equal yearly installments plus interest at 6% (or higher) on the unpaid balance, the first yearly installment, including interest, would be $186,999.

Our $2,500,000 asset corporation in the wholesale business would be having sales of $7,500,000 and at today's earnings rate, net profit before taxes of $157,000. Its income tax liability would be $76,010. Take that amount off net profit before taxes and you have $81,490 income after taxes available for dividends to shareholders (the estate). BUT, the estate owes Uncle Sam $186,999 first year payment including interest. The estate faces a net deficit of $105,509 -- plus estate income tax on $81,490 on the dividends it received from operation of the business.

We submit, Mr. Chairman, that both the small, average wholesale corporation, and his larger, more typical counterpart WOULD HAVE TO SELL, AT FORCED SALE PRICES UPON THE DEATH OF THE OWNER OR PRINCIPAL STOCKHOLDER, if the deceased is a widower father or a widowed mother under the proposals of the Treasury Department as we interpret them.

In both of the exhibits, I have assumed that the business ONLY APPRECIATED IN VALUE IN AN AMOUNT EQUAL TO THE DEPRECIATION IN THE VALUE OF THE DOLLAR.

Our original premise was that no business can stand still. It either grows or fails. If these two example wholesaler-distributor businesses grew at all, in absolute dollars in assets and sales, their predicament would be that much worse.

The Treasury proposal promises to give some relief by permitting the accumulated

earnings of the business after death to be used for stock redemption of the decedent's stock. However, if the business is already short of working capital, as most distribution businesses are today, or if there are no such earnings, then this solution is a nullity. The final nail in the coffin of the small business will be driven by the "adequate collateral to secure the payment of taxes" to the Treasury Department, as indicated at page 405. The Treasury Department would take a lien upon the business assets which would preclude the business from borrowing. Thus the lien would destroy the borrowing capacity and paralyze financial operations. In addition, it is stated at page 405 of the Treasury report that "the District Director is entitled to 90 days notice of sales of corporate assets of value greater than $1,000 (other than sales in the ordinary course of business), to notice of the declaration of a divident, and to notice of any other action calculated to have a substantial effect upon the liquidating value of a firm, including changes in the salaries of officers or directors. Failure to furnish such notice will constitute a default, which will authorize the District Director to enforce his security interest." It is a certainty that the District Director will be either running or liquidating every small business within his district if this proposal is enacted.

In closing, we would urge again that (1) the present estate tax exemption, to spouses, orphans and sons or other heirs be increased to a more realistic figure--at least to a flat dollar amount that would represent a 1969 reflection of a $60,000 1942 exemption ($155,000), (2) that unrealized capital gains NOT be taxed at death but rather that the law should provide for the carry over to the heirs of the decedent's basis for property included in the estate, at least insofar as closely-held, family-type businesses that continue in operation are concerned, and (3) that the present 10 year extended payment period for estate taxes be retained and that the rules be relaxed, by law if deemed necessary, so that the Commissioner of Internal Revenue does not, in effect, become the financial manager of the business, to whom the heirs have to turn for approval every time they want to spend a few dollars for improvement in plant, equipment or additions to inventory, etc...

Indeed the Treasury study admits that the ten years payment period has not been taken advantage of by many taxpayers because of the stringent rules and regulations that are applied in such cases by the Commissioner.

It might also be desirable to increase the Federal Estate Tax credit for State inheritance and other death taxes, to ease the shock of death taxes on the Nation's smaller, independent businesses. We believe it is the genuine desire of this Committee and the Congress, yes AND the Administration, to perpetuate these businesses from one generation to another. Complete exemption for spouses will not do this.

The Treasury assertion that the 100% marital exclusion "will give the surviving spouse more time to plan for the disposition of an illiquid asset at the best possible price ...."is fallacious. Disposition of our "illiquid assets", inventory and receivables, without replenishment in a like or greater amount means liquidation of the business, pure and simple.

The Treasury assertion that "Freezing of investment position (holding onto appreciated assets rather than selling them during lifetime) deprives the economy of the fruits of an unencumbered flow of capital toward areas of enterprise promising larger rewards" simply is not valid with respect to the perpetuation of closely-held, family-type wholesale distribution businesses. Our investment, frozen as it may be, is in a constantly changing, evergrowing group of products that are needed every day of the year by consumers to survive and other businesses to operate. If our investment is forced to be liquidated by tax law, to meet the demands of tax collectors, other, perhaps less efficient entrepreneurs will have to take our places with equal or greater amounts of capital investment to satisfy the insatiable appetites of American consumers and American business for food, clothing, shelter, raw materials, maintenance and repair and replacement parts and equipment. Of that your Committee may be sure, Mr. Chairman.

What the Treasury Studies and Proposals do not comprehend is the difference

between a "portfolio" of regularly traded and instantly marketable stock in public corporations and a "portfolio" consisting entirely of stock in one, closely-held, family-type wholesale distribution business. Part of the former can be liquidated to meet the demands of the tax collector without depreciating the value of the remainder of the "portfolio". Not so with a going distribution business- if you have to sell and not replenish inventory, your "out of business" and factoring of receivables inevitably leads to a "business embolish".

We have not dealt with the gift tax proposals as the Treasury study reports that less than 10% of taxpayers with small estates ever use gifts in any way in their estate planning. We believe this is especially true in the wholesale industry.

We appreciate your kindness and attention, Mr. Chairman and Members of the Committee, in granting this opportunity to present these views. We are not experts in tax policy matters, I assure you, but we have developed some expertise in figuring the tax impact on our businesses, under the watchful eye and careful guidance of the Treasury Department and more particularly the IRS.

That concludes my remarks, Mr. Chairman

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EXHIBIT I

EXAMPLE OF EFFECT OF TREASURY RECOMMENDATIONS ON ASSETS AND OPERATIONS OF AN AVERAGE WHOLESALE DISTRIBUTION CORPORATION
(Based on Statistics of Income 1966 -- Internal Revenue Service)

Assets of Average Wholesale Corporation[1]	$417,097
1940 Basis[2]	175,104
Appreciation	$241,993
Capital Gains Tax (25%)	60,498
Assets	$417.097
Less Capital Gains Tax	60,498
	$356,599
Less Overall Exemption	60,000
Taxable Transfer	$296,599
Transfer Tax (25%)[3]	74,150
Capital Gains Tax	$ 60,498
Transfer Tax	74,150
Total Taxes	$134,648
First Installment of 10 year payment	$ 13,465
6% interest, first year	7,271
TOTAL FIRST YEAR PAYMENT BY ESTATE	$ 20,736

Average Business Receipts Equal 3X Average Assets[4]	$1,251,291
Average Net Profit Before Taxes =2.1%[5] of Business Receipts	26,277
Taxable Income	$ 26,277
Corporate Income Tax (22%)	$ 5,500
(48% of remaining $1,277	613
Surtax (10%)	611
Total Corporate Income Tax	$ 6,724
Net Profit Before Taxes	$ 26,277
Less Income Tax	6,724
Net Profit After Income Taxes	$ 19,553
Dividend to Estate (assuming no retained earnings)	$ 19,553
First Year Payment, including interest	$ 20,736
Deficit (Not Including Estate Income Tax Due on $19,553)	$ (1,183)

1 Total wholesale trade assets divided by the number of Income Tax Returns. Source: page 19, Preliminary Statistics of Income, 1966, Corporation Income Tax Returns, Internal Revenue Service, U.S. Treasury Department

2 Purchasing Price of the dollar (1957-59=$1.00) in 1940 $2.326 vs. 1966 $.944. It would take $2.382 in 1966 dollars to equal the purchasing power of one 1940 dollar, or, one 1966 dollar is worth the equivalent of 42/100 1940 dollar. Thus,1966 assets worth $417,097 would have been valued at 42/100 that amount ($175,104) in 1940. Source: Bureau of Labor Statistics, U. S. Department of Labor.

3 Proposed unified transfer tax rate from schedule on page 356 of the Joint Publication, Committee of Ways and Means Part 3.

4 Source: Same as 1. Total Assets $63,423,325,000 vs. total business receipts of $188,424,712,000 or, a ratio of 1 to 2.97

5 Source: Same as 1. Business Receipts $188,424,712,000 vs. Income Subject to Tax $3,937,726,000 or, 2.089%

EXHIBIT II

EXAMPLE OF EFFECT OF TREASURY RECOMMENDATIONS ON ASSETS AND OPERATIONS OF A TYPICAL WHOLESALE DISTRIBUTION CORPORATION

(Based on Statistics of Income 1966 -- Internal Revenue Service)

Assets of Typical Wholesale Corporation [1]	$2,500,000
1940 Basis [2]	1,050,000
Appreciation	$1,450,000
Capital Gains Tax (25%)	362,500
Assets	$2,500,000
Less Capital Gains Tax	362,500
	$2,137,500
Less Overall Exemption	60,000
Taxable Transfer	$2,077,500
Transfer Tax (41%) [3]	851,775
Capital Gains Tax	$ 362,500
Transfer Tax	851,775
Total Taxes	$1,214,275
First Installment of 10 year payment	$ 121,428
6% interest, first year	65,571
TOTAL FURST YEAR PAYMENT	$ 186,999

Average Business Receipts Equal 3X Average Assets [4]	$7,500,000
Average Net Profit Before Taxes 2.1% [5] of Business Receipts	157,500
Taxable Income	$ 157,500
Corporate Income Tax (22% of first $25,000)	$ 5,500
(48% of the remaining $131,500	63,600
Surtax (10%)	6,910
Total Corporate Income Tax	$ 76,010
Net Profit Before Taxes	$ 157,500
Less Income Tax	76,010
Net Profit After Income Taxes	$ 81,490
Dividend to Estate (assuming no retained earnings)	$ 81,490
First Year Payment, including interest	$ 186,999
DEFICIT (Not including Estate Income Tax Due on $81,490	$ (105,509)

1 Source: Preliminary Statistics of Income, 1966, Corporation Income Tax Returns, Internal Revenue Service, U. S. Treasury Department.

2 Purchasing Price of the dollar (1957-59=$1.00) in 1940 $2.326 vs. 1966 $.944. It would take $2.382 in 1966 dollars to equal the purchasing power of one 1940 dollar, or, one 1966 dollar is worth the equivalent of 42/100 1940 dollar. Thus, 1966 assets worth $2,500,000 would have been valued at 42/100 that amount ($1,050,000) in 1940. Source: Bureau of Labor Statistics, U. S. Department of Labor.

3 Proposed unified transfer tax rate from schedule on page 356 of the Joint Publication, Committee of Ways and Means.

4 Source: Same as 1. Total Assets $63,423,325,000 vs. total business receipts of $188,424,712,000 or, a ratio of 1 to 2.97

5 Source: Same as 1. Business Receipts $188,424,712,000 vs. Income Subject to Tax $3,937,726,000 or, 2.089%.

Summary of Recommendations

by

John T. Higgins

on behalf of the

American Textile Manufacturers Institute, Incorporated

before the

Committee on Finance

United States Senate

on

The Subject of Tax Reform

H. R. 13270

September 8, 1969

1. Foundations

The proposed stock ownership limitations imposed on private foundations should be dropped because of their detrimental effect upon continuity of ownership and management of many small corporations. The requirement in the bill that private foundations distribute the requisite amount of income or capital yearly to active charities should by itself be sufficient to eliminate the tax abuse that may have arisen in this area.

2. Moving Expenses

1. The overall dollar limitation of $2,500 on the three new categories of deductible moving expenses should be dropped, either immediately or, if budgetary considerations preclude this, after a two-year period.

2. The 20 mile test of existing law should be retained. The substitution of a 50 mile test assumes an unreasonably long commuting pattern for employees whose principal place of work is changed.

3. The new moving expense rules should apply beginning with calendar year 1969 rather than with 1970 as proposed in the bill.

3. Deferred Compensation

1. Existing rules covering unfunded, non-qualified deferred compensation arrangements should be continued without change.

2. If the deferred compensation provisions are not deleted, the bill should be amended to provide that the new "minimum tax" shall apply to deferred compensation payments received in any year which are in excess of the higher of $10,000 or 50 percent of the average of the employee's earned income in the highest five of the last ten years of his period of employment.

3. In order to avoid an unintended inequity, §802 of the bill, dealing with the maximum marginal tax on earned income, should be amended to provide that deferred compensation attributable to years beginning after December 31, 1969 shall be considered earned income.

4. Original Issue Discount and Convertible Indebtedness Repurchase Premiums

Convertible debentures should be treated the same as bonds issued with warrants attached for purposes of determining the tax effect of original issue discounts and repurchase premiums. In both situations a portion of the purchase price for the convertible debenture should be allocated to the conversion feature.

5. Tax Treatment of Stock Dividends

1. ATMI objects to the broad legislative power delegated to the Treasury Department to treat as a dividend an increase in a stockholder's proportionate interest in the assets or earnings and profits of the corporation because of a change in a conversion ratio, a change in redemption price, a redemption treated as a taxable dividend, or any similar transaction. If these transactions are to be covered, the rules should be provided in the statute.

2. The grandfather clause applicable to stock outstanding on January 10, 1969 should be expanded to cover holders of rights or convertible securities which were outstanding as of such date.

6. Earnings and Profits

1. ATMI is opposed to the general requirement that earnings and profits of all corporations be determined by the use of the straight-line method of depreciation. This would add unnecessary complexity to the tax law, and should be limited to the tax-free dividend situation.

2. In any event, it should be made clear that the earnings and profits changes are not to apply to the various provisions of the Code dealing with foreign corporations which use as their starting point earnings and profits of the foreign corporation.

7. Capital Gains

1. Instead of imposing a 30 percent tax rate on corporate capital gains, ATMI recommends that one-half of the capital gain be subjected to the regular corporate tax rate.

2. The 50 percent portion of capital gains subjected to tax should decrease as the holding period lengthens.

8. Real Estate Depreciation

1. The manufacturing segment of the economy should not be denied the use of accelerated depreciation methods for new plant simply because "some high-income individuals" have used real estate investments as a tax shelter.

2. For corporations generally, and particularly for those primarily engaged in manufacturing, the proposed amendments to the depreciation recapture provisions would appear to take care of any problems that may have arisen with respect to disposition of depreciable real property.

9. Repeal of Investment Credit and Amortization of Certain Railroad Rolling Stock

These provisions point up the need for more adequate depreciation allowances for American industry. Specifically, ATMI recommends the elimination of the Treasury's "reserve ratio test". As provided in the Bill for railroad rolling stock, taxpayers should be allowed to use specified depreciation lives as a matter of right. Only those taxpayers claiming depreciation

lives shorter than the specified life or lives for their industry should be subjected to the complicated rules of Rev. Proc. 62-21 (the Treasury's "Depreciation Guidelines").

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Statement of John T. Higgins

on behalf of the

American Textile Manufacturers Institute, Incorporated

My name is John T. Higgins. I am Vice President of Burlington Industries, Inc., of Greensboro, North Carolina. I am appearing before you today as Chairman of the Tax Committee of the American Textile Manufacturers Institute, Inc. I am accompanied by Mr. Rowland F. Kirks, General Counsel of ATMI, and Mr. Jay W. Glasmann of Ivins, Phillips & Barker, which firm represents our Committee in tax matters.

Our Association represents some 300 corporations which have about 85 percent of the spinning, weaving and finishing capacity in the cotton, silk and man-made fiber industry. The textile industry employs 984,000 people in 42 states, has an annual payroll of $5 billion and last year had shipments valued at over $21.5 billion.

This statement is directed to a number of the provisions of H. R. 13270. We had a meeting of our full Committee last month and the unanimous decision of the Committee was to make the following representations to you with respect to several parts of the House-passed bill.

Section 101 - Tax Treatment of Private Foundations

We understand that many, many other witnesses will appear before you to discuss the implication of each section of Title I of the bill, and therefore I shall not impose upon your time to that purpose.

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We do recognize that the major impact of Title I would be to deprive private charity in its established flow of funds, by the application of provisions almost impossible to administer, with consequent primary effect upon the poor and underprivileged among us.

We sincerely believe that enactment of Section 4942, the provision entitled "Taxes on Failure to Distribute Income", into the Code would provide, in conjunction with Code sections 503(c) through 503(j), a practical deterrent to the tax abuses which have been considered to justify the fundamental sweep of Title I.

We are aware that the Ways and Means Committee concluded that it was objectionable for private foundations to be used to maintain control of businesses, particularly small and medium-sized family corporations. On this issue, ATMI is in complete disagreement with the conclusions of the Committee. We believe that retention of control of family business should be fostered rather than curtailed and that if private foundations can be utilized to assist in such retention, such practice is not reprehensible so long as the foundations are distributing to active charities the requisite amount of income or capital required under §101(d) of the bill. We believe that the proposed stock ownership limitations with respect to foundations and so-called disqualified persons under the bill will have a detrimental effect on the continuity of ownership and management of many small corporations in this country without in any

way promoting the legitimate interests of charity.

Section 231 - Moving Expenses

The present deduction for employee moving expenses (transporting the taxpayer, members of his family, and their belongings from the old residence to the new residence, including meals and lodging en route) would be expanded to allow the deduction of expenses for house-hunting trips, living expenses up to 30 days at the new job location, expenses related to the sale of a residence or the settlement of an unexpired lease, and expenses related to the purchase of a residence at the new job location or the acquisition of a lease on property to be used as the new residence. The deduction for these additional categories as moving expenses is subject to the overall limit of $2,500 per move, with the further limitation that the deduction for house-hunting trips and temporary living expenses cannot exceed $1,000. Under present law, a deduction for moving expenses is allowed if the taxpayer's new principal place of work is located at least 20 miles further from his old residence than was his former principal place of work. The bill increases the 20 mile test to 50 miles. The proposed changes are to apply to taxable years beginning after December 31, 1969.

ATMI supports liberalizing legislation with respect to moving expenses. Reimbursed moving expenses are not in the nature of salary or wages and employees should not be taxed on their receipt. It is patently unfair to tax an employee on reimbursed expenses which would not have been incurred if the

employee had not relocated to accommodate his employer. Accordingly, ATMI supports the liberalizing changes included in the bill with respect to moving expenses. We believe, however, that the $2,500 limitation for the new deductible moving expense categories is grossly inadequate. The proposed ceiling barely covers closing costs, including selling commissions on a $30,000 home, and leaves little or nothing for the other important categories of moving expenses, namely, house-hunting trips, temporary living expenses, and out-of-pocket expenses attributable to the acquisition of the new home. Moreover, with the inflation that has taken place in the last two years, and which appears likely to continue in the immediate future, the overall limit of $2,500 appears unrealistically low. We recommend, therefore, removing the dollar limitation entirely, with the deductible expenses in the new categories being limited to reasonable amounts under all the facts and circumstances. In the alternative, if budgetary considerations compel the retention of the $2,500 limitation at this time, we believe that the bill should provide for the automatic elimination of this limitation at the end of a two-year period, with the reasonable expense concept taking over at that time.

We strongly recommend that the present 20 mile limitation that is contained in §217 of the Code be retained. We can see no justification for changing the limitation to a 50 mile test which can only generate hardship and ill-feeling for affected taxpayers. For example, assume an employee is working in

Washington for the Federal Government and lives 10 miles south of the Capital in Virginia. Assume his employer transfers him to Baltimore, which is approximately 45 miles from Washington. Under the bill, such an employee would not be able to deduct his moving expenses if he attempted to relocate in the Baltimore area. In effect, the bill, as drafted, assumes that commuting to Baltimore from the Virginia side of Washington is a normal pattern of existence. We believe this not to be the case and urge that the bill be changed accordingly.

The question of enlarging the moving expense provisions of the Code has been before Congress since at least 1963. The Treasury Department, in its April 1969 tax reform recommendations to the Congress, proposed that the new rules should have an effective date with respect to years beginning after December 31, 1968. The Ways and Means Committee gave no indication in its report why the Treasury's effective date recommendation was not accepted. At any rate, ATMI recommends, at a bare minimum, that the liberalized moving expense rules should apply to calendar year 1969. Further, we believe that consideration should be given to making the provisions retroactive back as far as 1964 because of the uncertainty and unfairness which have existed with respect to the tax treatment of moving expenses since Congress last considered the subject in connection with the Revenue Act of 1964.

Section 331 - Other Deferred Compensation

The bill would change the tax treatment of unfunded, non-qualified, deferred compensation payments in excess of $10,000

a year received by key employees, whether the arrangement giving rise to the payment be a simple contract on an individual ad hoc basis or a complex plan (deferred cash bonus, phantom share, etc.) applying to all or most of a company's executive group. Under present law, an employee does not report income on deferred compensation of this type until it is actually received in cash, frequently after retirement when the employee expects to be in a lower tax bracket.

The bill provides that when a deferred compensation payment in any taxable years ending after June 30, 1969 exceeds $10,000, a "minimum tax" is to be imposed on the excess. The minimum tax would be the lower of two alternate amounts computed under complex formulae, except that if the tax computed under the regular rules should be higher than the minimum tax so computed, the regular rules are to apply.

ATMI believes the proposals to alter the existing rules for taxation of unfunded deferred compensation arrangements are inadvisable for the following reasons:

1. Deferred compensation is a key element in the overall compensatory programs of most corporate employers, large and small. Deferred compensation has been found appropriate and most useful in obtaining the services of talented scientific, technical and other highly-specialized personnel, as well as general executives. The prospective employee who has

demonstrated such ability often would sacrifice or forfeit pension or profit-sharing credits established in present employment to accept a new and more constructive employment. He may have attained a sufficiently advanced age to bar him from, or limit his potential, in establishing corresponding credits in comparable qualified plans of the new employer. Many employers have used unfunded, non-qualified deferred compensation plans as a means of affording such talent an adequate and reasonable retirement benefit. It has worked well, and we see no reason why the method should be abolished.

2. The present taxation of unfunded deferred compensation arrangements is not a loophole. The present rules are based on the simple concept of cash basis taxation. An individual is taxed on income only when he receives it or has a right to receive it. Failure to tax him in or by reference to an earlier year is not a loophole in the law. The proposed change will not have its most important impact on the wealthy, who will usually be in a high tax bracket even after retirement. Instead, it strikes at the middle-income executive who ultimately retires without a business or private fortune to support him in retirement.

3. The proposal would necessarily be irrational and inequitable in operation. Taxation of deferred compensation at rates determined by reference to a year or years other than a year the cash is actually received, may make little sense when applied to any particular arrangement in the broad spectrum of deferred compensation.

4. Administration of the proposal will be extremely complex and burdensome for both the taxpayer and the Government. It is inherent in the proposal that record-keeping will be required for a period of forty or more years. Furthermore, because of the difficulty in many cases of determining when a payment is "deferred compensation" (a term not defined in the bill), enforcement of a proposal of this type will undoubtedly be uneven and fraught with costly litigation.

While ATMI believes the arguments against imposing a new minimum tax on deferred compensation far outweigh the arguments advanced by the Ways and Means Committee in justification of the proposed changes (see Summary, Tax Reform Bill of 1969, prepared by the Staffs of the Joint Committee on Internal Revenue Taxation and the Committee on Finance, August 18, 1969, p. 53), if §331 of the bill should be retained, a number of changes should be made. We suggest, for example, that the Bill be amended to

provide the new minimum tax shall apply only to deferred compensation payments received in any year which are in excess of the higher of $10,000 or 50 percent of the average of the employee's earned income in the highest five of the last ten years of his period of employment. Such an amendment would enable small and medium-sized firms in our industry to compete with larger corporations in acquiring executive talent.

We also recommend, in order to avoid an inequity which could hardly have been intended, that §802 of the bill pertaining to the maximum tax on earned income be amended to provide that deferred compensation payments attributable to years beginning after December 31, 1969 be treated as earned income. As drafted, §802 of the bill would provide that the 50 percent limit is not applicable to deferred compensation. If this provision is not changed, it could result in an employee paying a higher tax on deferred compensation than he would have paid had there been no deferral.

Section 413 - Original Issue Discount
Section 414 - Convertible Indebtedness Repurchase Premiums

§414 of the bill provides that where a corporation repurchases its convertible debentures at a premium, the portion of the premium paid for the convertible privilege cannot be deducted as being analogous to an interest expense. Without arguing the point that principle compels such treatment, ATMI, on behalf of several of its members, submits that this principle of viewing the conversion feature as separable from the underlying

indebtedness should be consistently applied. In other words, convertible debentures should be treated the same as bonds issued with warrants attached, both for purposes of the bond premium provisions of the bill (§414) and the bond discount provisions of the bill (§413).

We recommend, therefore, that §413 be amended to provide, in effect, that a corporation issuing a convertible debenture shall be treated as having issued an "investment unit" as is now provided under the bill when debt is issued with stock warrants. Thus, it should be recognized in §413, in the case of a convertible debenture issue, that the stated interest rate should be adjusted upwards to reflect the effective interest rate after attributing a portion of the issue price to the convertible feature of the bond.

Section 421 - Tax Treatment of Stock Dividends

Section 421 of the bill amends §303 with respect to nontaxability of stock dividends. The bill goes on to provide specifically that a stock dividend shall be treated as a taxable dividend if the distribution, or series of distributions, results in receipt of property by some stockholders and in an increase in the proportionate interest of other stockholders in the assets or earnings of the corporation. The bill also provides that, by regulations to be prescribed by the Secretary or his delegate, a change in a conversion ratio, a change in redemption price, a redemption treated as a taxable dividend, or any similar transaction, will automatically be treated as a dividend to other shareholders whose proportionate interests in the assets or earnings

of the corporation are increased. Thus, a redemption which results in a taxable dividend to the redeemed stockholder would appear to result (under regulations to be prescribed) in constructive dividends to the other stockholders whose proportionate interests have in any way been increased.

Under the effective date provisions, a grandfather clause protects distributions of stock, including distributions which result in a receipt of money for property by some shareholders and an increase in the proportionate interests of others with respect to stock outstanding on January 10, 1969, or issued pursuant to a contract binding on that date. The grandfather clause covers distributions of stock (or rights to acquire stock) made prior to January 1, 1991, but the grandfather clause is not made specifically applicable to changes in conversion ratio, redemption prices, etc., which are to be covered under regulations to be prescribed.

ATMI objects strongly to the legislative powers delegated to the Secretary or his delegate to prescribe, by regulation, transactions not described in the statute which shall be treated as dividends under the bill. No yardsticks are set forth in the bill to guide the exercise of the Secretary's discretionary powers. The difficulty we see in such delegation of powers can be illustrated by the following:

Under §101 of the bill, dealing with private foundations, the foundation must dispose of stock in a corporation if

the combined ownership of the corporation's voting stock held by the foundation and all disqualified persons amounts to more than 20 percent. In many instances, the only place this stock can be marketed is to sell it back to the corporation itself. Thus, §101 of the bill compels a redemption of the stock and §421 (under regulations yet to be issued) may impose a dividend tax upon the remaining stockholders because of the redemption.

Finally, there is an effective date problem which should be corrected. There are many convertible debenture issues which were outstanding on January 10, 1969, which provide for changes in the conversion ratio with the passage of time. Certainly the grandfather clause applicable to outstanding stock as of such date should be expanded to cover holders of rights or convertible securities which were outstanding as of January 10, 1969.

Section 452 - Earnings and Profits

Under the heading "Depreciation Allowed Regulated Industries; Earnings and Profits Adjustments for Depreciation", the bill would require all corporations, not just regulated utilities or real estate corporations, to use the straight-line method of depreciation for purposes of determining the earnings and profits of the corporation. The justification for the proposed change is that for a number of companies, especially among utilities and those investing heavily in real estate, distributions of tax-free dividends are permitted where accelerated depreciation methods are utilized in determining earnings and profits.

ATMI is opposed to the general requirement that earnings and profits of all corporations be determined by the use of the straight-line method of depreciation. This adds an unnecessary complexity to the tax law for the great bulk of corporations (probably in excess of 99 percent) which have not been and will not be, in a position to distribute tax-free dividends merely because their earnings and profits are computed through the use of the accelerated depreciation methods permitted in determining the taxable income of the corporation.

Furthermore, while not announced as a foreign tax credit modification, the proposed amendment requiring corporations in years beginning after June 30, 1972, to use the straight-line method of depreciation in computing earnings and profits, could have a significant effect on the determination of Subpart F income of controlled foreign corporations, as well as upon the computation of the "deemed paid" foreign tax credit under §902 of the Code. If §451 is not limited to utilities and real estate corporations, the bill should be amended to make it clear that the earnings and profits changes are not to apply to all of the various provisions of the Code dealing with foreign corporations which use as their starting point earnings and profits of the foreign company.

Section 461 - Capital Gains

We have two suggestions to make with respect to the capital gain tax as it relates to corporations. We think that if it

is sound to tax 50 percent of the gain to an individual at ordinary income tax rates, the same idea should be equally applicable to corporations. Accordingly, instead of a 30 percent tax rate with respect to corporate capital gains, we suggest that 50 percent of the gain be taxed at the regular corporate tax rate. This would have the effect of giving relief to small corporations with respect to capital gains. We also recommend for both corporations and individuals a graduated rate of tax on capital gains similar to that included in the 1936 Act where, as the holding period increases, the rate of tax decreases. This could be done by providing that 50 percent should go into taxable income for holding periods of one to three years, 40 percent from three to five years, 30 percent from five to ten years, etc.

Section 521 - Real Estate Depreciation

On the ground that the present tax treatment of real estate has been used by some high-income individuals as a tax shelter to escape payment of tax on substantial portions of their economic income, accelerated methods of depreciation would be denied with respect to new buildings (except in the case of new residential housing) where a construction begins on and after July 25, 1969. The bill also provides for the recapture of the excess of accelerated depreciation over straight-line depreciation on the disposition of depreciable real property to the extent of depreciation taken after July 24, 1969.

ATMI is strongly opposed to any provision which would prohibit manufacturing corporations from using the double declining balance and sum-of-the-year's digits methods of depreciation with respect to new buildings and other depreciable real property. To the extent there are abuses in the real estate field with respect to "some high-income individuals", ATMI recommends that Congress strike directly at the target of the abuse and that it not make changes which are of substantial detriment to corporations generally and to the industrial segment of the economy in particular - where the abuse does not exist.

It is noteworthy that the Tax Reform Act of 1969 proposes a substantial reallocation of the tax burden between corporations and individuals. The largest revenue increase under the bill, for example, comes from the repeal of the investment credit, practically all of the cost of which falls upon corporate taxpayers. Under such circumstances, we urge that the manufacturing segment of our economy not be further penalized by denying it the use of accelerated depreciation methods for new plant, where the primary rationalization for the change is simply to take away a tax shelter for a few high-income individuals.

For corporations generally, and particularly for the manufacturing industry, the proposed amendments to the recapture provisions of §1250 would appear to be adequate to take care of any problems that may have arisen outside the so-called tax

shelter area. Accordingly, ATMI approves of the proposed amendments to §1250 of the Code, but objects vigorously to the proposed elimination of accelerated depreciation methods for depreciable real property used by manufacturing corporations.

We would further point out that when the Treasury's depreciation guidelines were promulgated in 1962, the Department indicated that it was not providing for shorter lives than old Bulletin F on buildings because of inadequate depreciation recapture provisions with respect to dispositions of depreciable real property. As a consequence, industry in this country is now confronted with the fact that lives on buildings and other depreciable real property are unrealistically long and we are about to lose the right to compensate in part for this factor through the use of accelerated depreciation methods. We think this is unjust and inequitable.

Section 703 - Repeal of the Investment Credit
Section 705 - Amortization of Certain Railroad Rolling Stock

We have combined these two sections together because they point up both the need for and a possible solution to the single most important reform needed in the field of depreciation generally.

We are not objecting to the repeal of the investment credit as such, although we must advise that it accomplished a great deal in the textile industry and helped considerably in bringing new machinery into our plants which greatly improved our efficiency. This modernization of obsolete plant and

equipment was much needed in view of the increasing competition from textile products imported from abroad. However, the investment credit did not last long enough to permit completion of much needed modernization programs. We still have a considerable way to go in order to be better able to compete with low-cost foreign imports. In this connection, one of the problems that is beginning to plague our industry is the application of the reserve ratio test contained in the Depreciation Guidelines of the Treasury Department.

The reserve ratio test is extremely complicated and it is very difficult to apply. We find that there is no uniformity with respect to its application in various parts of the country and no taxpayer knows just where he stands with respect to his depreciation allowance. It is, of course, very important that taxpayers in our industry be able to plan on definite depreciation deductions in order that they can know what they can spend for new machinery. We think the answer to this problem is indicated by §705 of the bill dealing with depreciation on railroad rolling stock. The bill specifies a set period of years over which such rolling stock can be depreciated by the railroad industry. The Guideline rate of the railroad industry is 14 and the bill reduces this period to 7 years.

We are not necessarily asking that our Guideline Life of 12 to 14 years be reduced to 7 years, but we are asking that we be allowed to count on the 12 - 14 year life with accelerated

methods of depreciation. We do not want our depreciation to be subject to repeated adjustments through the use of the reserve ratio test. We ask Congress by legislation to allow taxpayers to use the guideline lives of their industry as a matter of right. Under this recommendation, the reserve ratio test of Revenue Procedure 62-21, and the various administrative procedures for adjusting lives if the test is not met, would be dropped, except for the case of taxpayers who use depreciation lives which are shorter than the applicable guideline life.

Conclusion

This concludes our written statement. I wish to thank the Committee for giving ATMI an opportunity to be heard.

SENATE COMMITTEE ON FINANCE
HEARINGS ON H.R. 13270
TAX REFORM ACT OF 1969
STATEMENT OF JAMES B. IRVINE, JR., C.L.U.
ASSOCIATION FOR ADVANCED LIFE UNDERWRITING
SEPTEMBER 8, 1969

SUMMARY OF PRINCIPAL POINTS

A. Deferred Compensation (§331).

Section 331 generally is detrimental to the public policy of encouraging retirement programs. Specific problems are:

1. the failure to define "deferred compensation" and eliminate non "bargained-for" compensation from the reach of the statute;

2. the unwarranted application of the statute to supplementary pension benefits, disability benefits, and death benefits;

3. the inadequacy of the $10,000 annual exclusion;

4. the tendency to generate excessive tax return preparation complexities.

B. Restricted Property (§321).

The recognition of restricted property arrangements as constituting a form of deferred compensation is

helpful and warranted. However, §321 can be improved in the following ways:

1. apply full deferred compensation rules to restricted property;

2. remove the reliance on forfeitability considerations;

3. emphasize that the restricted property rules apply to all property, including insurance policies, and not merely stock.

C. Deduction for Compensation

The §331 deferred compensation provisions and the §321 restricted property provisions, both of which provide rules for the recognition of income, should contain coordinate deduction allowance rules.

SENATE COMMITTEE ON FINANCE
HEARINGS ON H.R. 13270
TAX REFORM ACT OF 1969
STATEMENT OF JAMES B. IRVINE, JR., C.L.U.
ON BEHALF OF
ASSOCIATION FOR ADVANCED LIFE UNDERWRITING
SEPTEMBER 8, 1969

My name is James B. Irvine, Jr. I am a Chartered Life Underwriter from Chattanooga, Tennessee, and appear before you today as President of the Association for Advanced Life Underwriting (AALU). I am accompanied by Leonard L. Silverstein and Gerald H. Sherman, our counsel.

AALU is an organization of more than 500 of the leading life insurance agents in the United States. By the designation "leading life insurance agents," we mean agents who, because of the large amounts of insurance with which they are concerned, tend to utilize the more complex and sophisticated financial planning arrangements.

AALU's larger parent organization, the National Association of Life Underwriters (NALU), a 100,000 member group of life insurance agents, will be appearing before you today to present its views on a number of the current tax reform proposals -- those to which we will specifically refrain from speaking. Our failure to join NALU in a detailed consideration of such proposals does not indicate our

disinterest in them, but rather it reflects our deference to the Committee's request that duplication of testimony be kept to a minimum and, if possible, eliminated. We would like, however, to assure the Committee that we fully support and commend to the Committee, the positions set forth in the NALU testimony.

Our testimony will focus solely on the subject of deferred compensation (section 331 of H.R. 13270) and its close relative, restricted property (section 321).

We in the life insurance industry devote our entire working lives to assisting others to provide adequate financial protection for themselves and their families after their normal working lives have been concluded, whether by death, disability, or old age retirement. In a sense, then, our entire focus is on the provision of deferred compensation in one form or another. At the very least, the establishment of deferred compensation arrangements constitutes a major activity of the life insurance industry. We, therefore, are greatly interested in the manner in which deferred compensation is subjected to our taxing system.

A. Deferred Compensation (§331).

Section 331 of H.R. 13270, as passed by the House and submitted to this Committee for consideration, attempts to remove "the possibility of shifting income to taxable

years after retirement when the major tax bracket is expected to be lower" -- a shifting of income that has heretofore been "available to employees who are in a position to bargain for deferred compensation arrangements."*/ We believe that the Ways and Means Committee has overstated the case for its suggested change in the treatment of deferred compensation. Further, such a change will be detrimental to the important public policy of encouraging economically secure retirement programs. However, we can sympathize with the attempt (as a function of tax equity), to limit the possibilities for the otherwise economically fruitless activity of shifting income between years in order to minimize the effect of our graduated income tax rate structure.

Assuming, then, that the section 331 deferred compensation proposal of H.R. 13270, as submitted to this Committee, can find support in its broad application, we would like to direct the Committee's attention to a number of considerations that were either overlooked or inadequately treated in the current legislative draft.

1. Definitional Problems.

Perhaps the major omission of section 331 is its failure to contain a definition of the term, "deferred

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*/ H.R. Rep. No. 91-418 (Part 1), 91st Cong., 1st Sess. 90 (1969).

compensation." Neither the Bill nor the Committee Report gives any guidance as to when compensation is deemed to be deferred.

The mere fact that income is received in retirement years (the kind of compensation which seems to have been in the minds of the drafters) should not be conclusive on the question of whether it qualifies as compensation of a deferred kind for purposes of the legislation. Employers often insist that compensation be paid in retirement years so that employees will have little difficulty in maintaining reasonable standards of living during those years. In this way the employer is protected from having to make difficult decisions respecting which employees should receive the benefit of ad hoc assistance during retirement. In effect, the employer relieves itself of a pastoral function for which it is normally ill suited. The employee must accept the compensation after retirement and can, in no event, receive it during the normal working years. The income is deferred at the employer's pleasure, not the employee's. The deferral of the compensation is not "bargained for" in the words of the Ways and Means Committee report.

Another definitional problem arises from the fact that compensation can and often is, deferred as between different years during which the employee is working and receiving other taxable compensation income. The statutory language would appear to reach this kind of arrangement, although it can be questioned that this was or should have been the intention of the House.

We, therefore, recommend to the Committee that a workable definition of deferred compensation be developed for inclusion in the legislation. Such a definition would recognize that involuntarily deferred income should not be penalized.

2. Overreaching of the Provision.

The deferred compensation which appears primarily to have been in the minds of the legislative draftsmen is that type which defers large amounts of income of high bracket taxpayers. The provision for a $10,000 annual exclusion seems clearly to be in pursuance of this legislative purpose. Another way of stating the same thesis is that section 331 was not promulgated to impede supplementary pension benefit plans that are

designed for middle income employees. Rather, it was intended to eliminate "jumbo" transfers of compensation by high bracket executives to their lower bracket, retirement years. A totally on-target satisfaction of this purpose was unfortunately not achieved.

a. Disability Benefits. For example, there seems little purpose in legislating tax strictures on disability benefits which are often a part of deferred compensation arrangements. The carefully conceived tax rate deferral approach upon which a specific, retirement motivated, deferred compensation arrangement may have been based is not even germane to the taxation of disability benefits. Although, by some lights, it can be argued that all disability benefits constitute deferred compensation, it is doubtful that the disability benefit paid to a given employee is ever fully funded in amounts that might otherwise have been reported in income in earlier years. The major portion of disability benefits arises through insuring arrangements that entail the sharing of costs and risks among many persons.

Additionally, irrespective of considerations involving the technically accurate measurement of the extent of deferral, the receipt of disability benefits

never represents an advertent attempt to manipulate the graduated tax rate structure. Little purpose can be served by making it more difficult for a man to use the benefit to its fullest and most efficient extent during the period of disability. The new rules of section 331 should specifically be made nonapplicable to disability benefits.

b. Death Benefits. The disability benefit reasoning is similarly applicable to death benefits, or at least that portion of death benefits which exceeds the funded or putatively funded amount. Although the language of the House-passed bill seems to encompass death benefits within its scope, the Ways and Means Committee Report speaks solely in terms of retirement benefits. We again here suggest that the statutory language be amended to limit the provisions of the bill to deferred compensation which is received as retirement income by the employee who earned it. Death benefits, for widows and orphans, as well as disability benefits, should be removed from the legislation's coverage.

c. Annual Exclusion. We can appreciate the tax equity of excluding an annual amount of deferred compensation from the reach of section 331. However, we

strongly suggest that the $10,000 annual amount is inadequate to the task. It is always difficult, probably impossible, to arrive at a total equitable, objectively stated amount. However, in lieu of the $10,000, we can recommend to the Committee the utilization of other standards employed elsewhere in the Bill. For example, under section 221, taxpayers may deduct annually $25,000 of investment interest before being concerned with disallowances resulting from lack of investment income. Another approach might be the coordination of an absolute dollar amount exclusion with a fifty percent test, such as that utilized in the tax preference limitation provision of section 301. To illustrate, the recipient of deferred compensation might be entitled to a stipulated annual minimum amount, but in no event less than an amount equal to fifty percent of the deferred compensation received.

Yet another approach to this problem would be to focus on the amount of retirement benefit needed to provide middle echelon executives with reasonable amounts of retirement benefits. For example, in the major American metropolises, such as New York, Chicago and Los Angeles, minimum monthly deferral compensation of $1000 to $1500 would not seem unwarranted, i.e., $12,000 to $18,000 per year. Middle management executives, who during their working lives earned

$25,000 to $30,000 per year, would currently have difficulty managing on retirement benefits of less than $12,000 to $18.000 annually. In numerous cases the deferred compensation is the employee's only source of retirement benefits. Many employers have no pension plan, have pension plans providing limited benefits, or, with respect to newly-hired older employees, provide minimal benefits because of years of service-based formulas.

A reasonable increase in the $10,000 annual exclusion would not constitute an interference with the Bill's avowed purpose of eliminating tax-motivated deferral of compensation from one year to another.

3. Complexity.

In concluding our remarks directed solely to the section 331 treatment of deferred compensation, we would urge the Committee to continue to seek a mechanically more simple means of solving the tax rate manipulation problem -- a means that would not have recourse to the kinds of tax return complexities which are inherent in section 331, which the average citizen will not understand,and to which he will have no sympathy. Granted that the concept of a minimum annual exclusion will eliminate the problem for many taxpayers, there still will be a substantial number of deferred compensation recipients who will have to deal with what to them will simply be nonrelevant and nonintelligible computations.

B. Restricted Property (§321).

As we previously stated, the failure of H.R. 13270 to contain a definition of the term, "deferred compensation," presents certain serious problems. In addition, this failure, or more particularly the failure to define the phrase, "deferred compensation arrangement," a liberally used term throughout the Ways and Means Committee Report, leads us back into a dependence on existing law which, itself, constitutes a thicket of conflicting rules. The varying approaches of the judicial decisions and the Revenue Service administrative positions are often contradictory and irreconcilable.

There are a series of different consequences that could arise, depending upon whether the deferred compensation arrangement is funded or unfunded, utilizes the intercession of a trust, or reflects the actual delivery to the employee of property subject to restrictions having an effect on value. Under existing rules it is difficult to determine the appropriate set of legal consequences. One might have recourse to such a divergent group of rules as section 72 respecting annuities, section 404(a)(5) respecting deduction aspects of certain funded plans, Regs. sections 1.61-2 and 1.421-6 respecting restricted property, and Rev.

Rul. 60-31 respecting certain described kinds of deferred compensation arrangements. In addition, it has been necessary to master (if that is even remotely possible) the doctrines of constructive receipt and economic benefit.

1. Relationship to Deferred Compensation.

The Ways and Means Committee seemed to recognize this situation, at least in part, in promulgating a special new provision for so-called restricted property arrangements, i.e., situations in which an employee receives property subject to restriction. The Committee Report specifically acknowledged that restricted stock arrangements, one form of restricted property, are not designed as a means of allowing key employees to become shareholders in a business but are more particularly designed as a form of deferred compensation.

Having faced the issued that restricted property arrangements are merely another form of deferred compensation, the Ways and Means Committee and the House failed to reach the logical conclusion that similar tax rules should apply to both situations. Such a conclusion would have substantially assisted in clearing the morass of conflicting rules and would have led the way to an understanding of the common characteristcs of almost all forms of deferred

compensation. As the Bill now stands, we are left with a situation similar to that under existing law where taxpayers can pick and choose (free of relevant economic considerations) from among similar arrangements in order to reach the kind of tax result which is most beneficial. Furthermore, although the Bill appears to apply separate rules for restricted property as contrasted to deferred compensation, it does not provide us with clear guidance in the situation of funded deferred compenstion which does not quite fit within the restricted property category. Here we are left in the same unfortunate haze as under existing law.

2. Identity of Treatment Proposed.

To eliminate these close and not totally relevant distinctions among the tax treatments of various types of deferred compensation, we would urge the Committee to apply to restricted property arrangements whatever rules it finally decides upon for deferred compensation arrangements.

H.R. 13270 would now impose tax on the full value of nontransferable property (without consideration of depletion in value by reason of the existence of the nontransferability restriction) simply because the property may

not be subject to forfeiture for failure to perform substantial future services or may not be subject to some other substantial risk of forfeiture. Compare this to the Bill's deferred compensation approach where an employee may have a binding and nonforfeitable right to receive the deferred compensation. Despite the nonforfeitability of the right, it is wisely recognized in the Bill that the income should not be taxed until received. Thus, for some reason not fully articulated in the Committee Report, H.R. 13270 imposes substantially more onerous tax consequences to the holding of nonforfeitable property than it does to the holding of a nonforfeitable promise.*/

3. Forfeitability Considerations.

Although the Ways and Means Committee Report suggested no explanation of the meaning of the term "substantial risk of forfeiture", we would assume that the term does not include such commonly used forfeiture provisions as noncompetition clauses and consulting service arrangements. No evidence has been offered, of which we are aware, indicating that such provisions do not represent

*/ There is nothing in section 321 which limits the definition of property to tangible property or to certain types of nontangible property. Why then couldn't the right to deferred compensation be deemed to be property for purposes of that section?

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limitations of subsistence. If such data does exist, it should be made available for public inspection. In any event, the forfeiture standard is essentially immaterial if we are faced with a situation in which the employee cannot in any significant way realize upon his nonforfeitable rights. If he cannot transfer the property his possession of it is simply not worthy of taxing incidence.

The drawing of fine distinctions between restricted property and deferred compensation may demonstrate a virtuosity in close analysis. However, such distinctions bear no consequential relationship to tax equity. If we start with the assumption that the rules respecting deferred compensation as decided upon by this Committee, are founded on equitable underpinnings why not apply those rules to all forms of deferred compensation, including restricted property? The "sauce for the goose, sauce for the gander" analogy is most appropriate and applicable here.

4. Relationship to All Forms of Property and Funding Approaches.

In order to implement a more complete unity in the tax treatment of deferred compensation arrangements, we would

suggest further additions to the legislation. The Bill refers to restricted property while the Ways and Means Committee Report speaks primarily of restricted stock. It should be made amply clear that the restricted property provisions encompass all manner of property and not merely stock. There are many forms of property, including the insurance policies with which members of my organization concern themselves on a daily basis. We ask this Committee to eliminate any inference that would support an unduly limited definition of the term property. The intent of the statute is clear. It should be reflected in the legislative language or, at a minimum, in this Committee's Report in order to counterbalance the possible inference to the contrary that might be derivedfrom the Ways and Means Committee Report.

In addition, the legislation should further clarify that funded deferred compensation plans are to be treated no differently than unfunded plans. This is, of course, simply on an a priori conclusion from the premise that restricted property should be treated under normal rules applicable to deferred compensation.

Lastly, we urge that the legislation contain specific rules for the coordination of deferred compensation payment deductions with the taxability of deferred compensation receipts. Employers should be permitted a deduction at the same time and in the same amount as the employee's income must be recognized.

We appreciate the opportunity to appear and make our views known, and hope that we have been of some assistance to the Committee. Thank you.

NALU NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

1922 F Street, N.W., Washington, D. C. 20006 • 202/628-3122

September 3, 1969

Hon. Russell B. Long, Chairman
Committee on Finance
United States Senate
Washington, D. C.

Dear Senator Long:

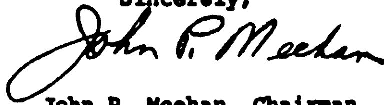
In accordance with your instructions, enclosed are fifty copies of our statement on H.R. 13270. Following is a summary of the points covered in that statement:

1. Tax Option (Subchapter S) Corporations. In conjunction with the National Small Business Association, we are saying that there is no probative evidence of tax abuse or intent to avoid taxes by these corporations with respect to retirement income plans for their shareholder-employees. Even ten years from now the proposed change for these 200,000 corporations would produce only four hundredths of 1% of the revenue expected to be raised by H.R. 13270. In the case of retirement plans of these corporations which are funded by life insurance, the proposed limitations might require surrender of existing policies and purchase of new ones at considerable additional cost.

2. Lump-Sum Distributions from Pension Plans. The House is concerned that "highly compensated" employees are taking advantage of the capital gains treatment afforded lump-sum distributions. They cite an example where the difference in the present and proposed tax rate is 41%. However, if the capital gains tax is increased from 25% to 32.5%, and the maximum income tax is set at 50%, this differential will be only 17.5%, thus substantially closing this so-called "loophole" without touching the tax treatment of lump-sum distributions at all. Millions of employees who are not highly compensated should not be penalized even if it is true that a relatively small number of highly compensated employees are "taking advantage" of the current law.

3. Advertising Income of Tax Exempt Organizations. Contrary to the conclusion reached by the Treasury Department and the Ways and Means Committee, advertising in a journal published by an exempt organization can be very definitely related to the organization's exempt function, and when it is the revenue produced by that advertising should not be taxed. Virtually all of the advertising in our publication, Life Association News, is institutional or geared toward informing NALU's 100,000 members about life insurance companies, life insurance company products, and the numerous services available to life insurance agents. The unsubstantiated conclusion of the Treasury and the Ways and Means Committee that such advertising does not "contribute importantly" to the exempt function -- which in NALU's case is to inform and assist agents -- is not warranted by the facts.

Sincerely,



John P. Meehan, Chairman
Committee on Federal Law & Legislation

Enc.

STATEMENT OF JOHN P. MEEHAN
ON BEHALF OF
THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS
TO THE
SENATE COMMITTEE ON FINANCE
REGARDING
THE TAX REFORM ACT OF 1969
H.R. 13270

The following comments concerning the Tax Reform Act of 1969 (H.R. 13270) are made on behalf of The National Association of Life Underwriters (NALU). I am John P. Meehan of Boston, Massachusetts, a Trustee of NALU and Chairman of its Committee on Federal Law and Legislation.

The National Association of Life Underwriters (NALU) is a trade association composed of 949 state and local life underwriter associations representing a membership of over 100,000 life insurance agents, general agents and managers residing and doing business in virtually every locality in the United States.

While NALU, as a part of the business community, is generally interested in many of the proposals contained in H.R. 13270, it is particularly concerned with proposed reform in three areas:

1) The proposed tax treatment of retirement plan contributions on behalf of shareholder-employees of Tax Option Corporations (Subchapter S Corporations);

2) The proposed tax treatment of lump-sum distributions from pension or profit-sharing plans, and

3) The reorientation of the application of the unrelated business income tax.

The comments following are confined to these three areas.

On the subject of Subchapter S corporations I am pleased to be able to tell your Committee that we are also speaking for the National Small Business Association which, as your Committee knows, is made up of over 36,000 small businesses in this Country, which are vitally concerned with this aspect of the tax reform bill.

I would like to note at this point that NALU is also concerned with the proposed reform in the areas of deferred compensation, stock dividends, and multiple and accumulation trusts. With a view to consolidating testimony, NALU is not commenting on these sections, but would like to associate itself with the statement presented to this Committee by James B. Irvine, CLU, President of the Association for Advanced Life Underwriting (AALU) and Vice Chairman of our Committee on Federal Law and Legislation on these subjects. The AALU is a conference of NALU.

I. Tax Option (Subchapter S) Corporations

Section 541 of H.R. 13270 proposes to amend Subchapter S of the Income Tax Chapter of the Internal Revenue Code by adding

a new section 1379 which would require a shareholder-employee of a Subchapter S corporation who also owns more than 5% of the corporation's stock to include in his gross income contributions made by the corporation on his behalf under a qualified retirement income plan to the extent such contributions exceed 10% of his salary or $2500, whichever is less. These proposed limitations are similar to those contained in the Self-Employed Individuals Tax Retirement Act of 1962 (the Keogh Act).

In reporting the bill, the Ways and Means Committee explained its rationale in recommending this provision by emphasizing the similarity between this kind of a corporation and a partnership or proprietorship. The Committee felt that a tax avoidance device had been created to the extent that partnerships and proprietorships could incorporate and elect Subchapter S status to escape the restrictions imposed on retirement programs for these unincorporated organizations. The Committee rationalized that an organization seeking to be taxed in a manner similar to a partnership should be subject to the same H.R. 10 limitations as a partnership.

While the Committee makes it quite clear that the target of the provision is tax avoidance, no probative evidence of tax abuse or intent to avoid taxes by Subchapter S corporations is offered or even discussed. Indeed, the calculations of the

Committee itself indicate that the Treasury's loss of revenue with respect to this particular device is quite small. Although there are approximately 200,000 Subchapter S corporations today, the Committee notes in chart 6 of its report (H. Rept. 91-413 (Pt. 1)) that this change in the law will produce less than $2.5 million additional revenue by 1979. This is only about four-hundredths of one percent of the additional revenue expected to be raised by H.R. 13270 by that year.

NALU realizes that revenue neutrality is a goal of this bill and that it is not intended as a revenue raising device. However, if tax avoidance is the problem to which section 541 is directed, then surely the problem could not have been great or even significant if less than $2.5 million can be gained by halting this alleged tax avoidance practice.

Even if the tax avoidance allegation were valid, this would form no basis for taxing these corporations like partnerships. Nor can NALU agree that partnerships and Subchapter S corporations are so similar in organization or operation to warrant this change.

This very point is stressed by Professor Boris Z. Bittker of the Yale University Law School in his book Federal Income Taxation of Corporations and Shareholders. Professor Bittker notes, "More important than labels, however, is the fact that

an electing corporation remains a corporation -- not only as a matter of state law, but also for many federal income tax purposes. This point cannot be overemphasized, because it is often erroneously said that Subchapter S permits corporations to be treated as partnerships. In point of fact, there are many differences between a partnership and an 'electing small business corporation.' Even while the election is in effect, corporate redemptions, liquidations, reorganizations, and many other transactions are governed by the tax law applicable to corporations, rather than by the law of partnerships; and if the election is terminated, the corporate income tax will once again become fully applicable. Recognizing these facts, some commentators have sought to sum them up in a label -- 'pseudo-corporation,' 'conduit-corporation,' and 'hybrid corporation,' to say nothing of more barbarous coinages like 'corpnership' and 'pseudo-type corporation.' The author prefers the more neutral terms 'electing corporation' or 'Subchapter S corporation,' however, because they serve as a constant reminder that the corporation does not cease to be a corporaticn by electing to come under Subchapter S."

In making the election, the only significant change from a regular corporation which a small business undergoes is that corporate income and losses are passed directly to the shareholders and cease to have consequence to the corporate

entity itself. To treat the pension plans of Tax Option Corporations differently from those of other corporations would only complicate the operation of small businesses seeking Subchapter S status for other sound business purposes.

If the owners of an established small business decide that in the interest of sound financial operation it is wise to elect Subchapter S status, they will find, if this provision of H.R. 13270 is enacted, that they are confronted with an alarming array of major and very complicated decisions. The retirement program of every shareholder-employee may have to be revised to compensate for the 10%-$2500 limitation. The corporation will also have to determine to what extent any restructuring of the retirement program for shareholder-employees may require or make desirable the restructuring of the retirement program for other employees. Any change of this nature of course must consider the possible consequences to employee-employer relations, particularly if the restructuring results in smaller retirement contributions for long-time employees.

If restructuring of a retirement program is thought desirable, consideration must be given to the disposition of long-term contractual obligations designed to meet the company's obligation under the old plan but which may not be appropriate to the needs of the revised retirement program. If, for example,

the original program is funded by life insurance, it may be necessary to lapse some policies, the premiums for which do not meet the requirements of the new plan, and acquire others at considerable additional cost.

If the small business corporation is capable and willing to surmount these difficulties, the shareholder-employees will discover that the retirement program available to them as shareholder-employees of a tax option corporation is substantially smaller than that of any other corporation. The reitrement programs available to corporate employees, of course, contain none of the H.R. 10 restrictions. The H.R. 10 limitations applicable to owner-employees in a proprietorship or partnership do not limit the retirement program available to owner-employees with less than 10% ownership in the organization. However, the limitations which would be applicable to Subchapter S corporations would include all shareholder-employees with more than 5% ownership in a corporation. This particular discrimination against small business corporations is entirely unexplained in the Ways and Means Committee report on H.R. 17230.

The net result of all this is to inject federal income tax back into the picture as a primary consideration in choosing a form of business operation. This is the very problem Subchapter S was created to prevent.

NALU feels there is no need for new restrictions on small business corporations and urges this Committee to recommend that Section 541 of H.R. 13270 be deleted in the final version of the Tax Reform Act of 1969. As I said earlier, we are joined in this request by the National Small Business Association.

II. Total Distributions from Qualified Pension and Profit-Sharing Plans

Section 515 of H.R. 13270 proposes to revise Secs. 402(a), 403(a) and 72(n) of the Internal Revenue Code to the extent that total distributions of the funds accumulated in qualified pension and profit-sharing plans taking place within one year of the employee's death, separation from the employer's service, or death after retirement shall be eligible for capital gains treatment only as to the net taxable portion of the contribution made by the employer.

The Ways and Means Committee in recommending this element of tax reform notes as its reason for change that the present treatment enables highly compensated employees to convert substantial amounts of deferred compensation from its regular ordinary income treatment to capital gains and that the Committee considers it appropriate to restrict the extent to which lump-sum pension distributions receive more favorable capital gains treatment than pension income received over a period of retirement years.

NALU questions whether the objective here sought by the Ways and Means Committee is most appropriately achieved by this change in tax treatment.

On page 154 of the report accompanying H.R. 13270, the Committee has set forth an example of the treatment afforded lump-sum distributions under present law as compared to the treatment for those same distributions under the proposed law. In the example given, the Committee notes that an effective tax rate of 25% is now paid on lump-sum distributions of qualified pension and profit-sharing plans, whereas under the House proposal an effective rate of 66% would be paid. The report points out that the special capital gains rule of Section 402(a)(2) presently results in a tax differential of 41%. It goes on to say that if the special five-year forward averaging provision of the proposed law is used, the effective tax rate will be 57%, or a tax differential of 32%.

In making these comparisons, however, the report does not discuss the rate differentials produced by this same suggested change if Section 511 of H.R. 13270 also becomes law. Section 511 proposes to repeal the alternate capital gains tax for individuals. In discussing the effects of enactment of Section 511, the Ways and Means Committee indicates that the capital gains tax rate would be increased from 25% to an effective rate of

32.5% after 1971. If we use the same example as cited in the House Report but assume an effective capital gains tax rate of 32.5% rather than 25%, the rate differentials will be 33.5% and 24.5%, rather than 41% and 37%, respectively. Thus, whatever "abuse" or "loophole" the House is concerned with will already be substantially restricted, without changing the tax treatment of lump-sum distributions.

If we add to this the proposed adjustment in the individual tax burden as set forth in Sections 802 and 804 of the bill which sets the maximum income tax rate for individuals at fifty percent, it can readily be seen that whatever objective is sought by the amendments contained in Section 515 are to a large extent achieved by reform measures in other sections of the bill.

The Ways and Means Committee is concerned that present law unduly benefits highly compensated employees. At page 154 of the Report, the Committee states that presently "...the more significant benefits accrue to taxpayers with adjusted gross incomes in excess of $50,000." However, as the bill is written, the adoption of the provision relating to lump-sum distributions would only penalize employees who are not highly compensated and would not have the sweeping effect on highly compensated employees that is visualized by the Ways and Means Committee.

Under Section 802 of the bill, the maximum tax rate would be 50% and this, taken together with the increase in the capital gains tax rate from 25% to 32.5% would mean that the future differential in the tax treatment of lump-sum distributions would be only 17.5%, rather than the 41% suggested in the example given in the House Committee's Report.

Any undue tax advantage a highly compensated employee might have under present law will have been curbed without the necessity of touching this particular and highly desirable provision of the Code. Increasing the tax on lump-sum distributions would adversely affect all employees who need and deserve the present tax treatment of lump-sum distributions from their pension or profit-sharing plans. For example, consider the employee who is retiring because a total and permanent disability and who wants to purchase a joint and last survivor annuity for himself and his wife. The enactment of Section 515 of H.R. 13270 would sharply increase the tax he would have to pay on his distribution and would therefore substantially reduce the annuity available to this individual and thereby his monthly income and that of his wife for the rest of their lives. Also consider the situation of a widow, who because of the untimely death of her husband, is faced with the necessity of receiving his deferred compensation in lump-sum, if she is to keep the children in college, pay the mortgage on the home and still have enough to pay the expenses of her late husband's estate. Unless her independent income is substantial, this provision will

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weigh substantially on her ability to maintain her household.

We think the House has placedtoo much emphasis on "highly compensated employees" in this regard. Consideration should be given to employees as a class. The millions of employees in this class are not highly compensated and they should not be penalized by the enactment of this provision of the bill.

III. Advertising Income

In December 1967, the Internal Revenue Service amended Income Tax Regulations Sections 1.511, 1.512 and 1.513 to permit the taxation of advertising income which tax exempt organizations derive from magazines, journals and similar publications. In Section 121 of H.R. 13270, the House Ways and Means Committee agrees with the Service position. NALU feels that this reorientation of this rule is unnecessary and unduly restricts vital functions of exempt organizations.

As enacted in 1950, the unrelated business tax was to be a tax confined to income from a trade or business regularly carried on by a tax exempt organization, but which was not substantially related to the purpose for which the organization was granted its income tax exemption.

The law did not propose to tax the income from every trade or business regularly carried on by a tax exempt organization. So much of the income from a trade or business regularly carried on by the exempt organization which was related to the organization's exempt function was to continue to be exempt, even though competition between the exempt organization and non-

exempt corporations would result. It was recognized that a trade or business might form an intregal part of the function of a tax exempt organization.

The concept embodied in the Treasury position and approved by the House Ways and Means Committee in effect eliminates from the requirements for taxation that an operation be a trade or business and that it be unrelated.

The amended regulations, in clarifying the term "trade or business," provide that the term includes "any activity" carried on for the production of income from the sale of goods or performance of services. The phrase "substantially related" has been clarified to mean "contribute importantly."

Since every exempt organization has several trade or business activities, by breaking the exempt organization into several activities and requiring each to stand the "contribute importantly" test, the Internal Revenue Service can virtually destroy the tax exempt status of any organization subject to these provisions of the code. Any exempt organization which tries to divorce itself of all business activities which may result in taxation under the amended regulations, as a practical matter, will so divorce itself of activity as to be almost dormant. This is particularly so if we consider that an activity may become taxable without regard to its relationship to the exempt purposes of the organization.

In this instance, the Service ruled and the Ways and Means Committee agreed that all advertising is to be considered unrelated, ergo, that no advertising can in any way be related to any tax exempt purpose of any exempt organization.

But, in fact, the publication of a magazine or other journal, with accompanying advertisements, is an essential function of most exempt organizations. One of the basic reasons individuals or corporations associate in the form of a trade or professional association is to facilitate the free exchange of ideas and products of mutual interest to a particular trade or profession. For this function to be meaningful and useful, the exchange must be frequent, the information disseminated must be comprehensive and the process of dissemination must not be prohibitively expensive. A magazine, circular or similar publication is a perfect tool for this purpose.

A magazine or other similar publication enables an association to collect, at any one point in time, the ideas and products of a variety of experts that would be impossible in any other forum. At the same time, by charging some of the contributors a fee for the use of the publication as a forum

for the presentation of their products and ideas, the expense to the association is kept to a minimum. In many cases, these activities provide the association with extra revenue to apply to the general enhancement of association activities. Some of the ideas and products presented in association publications are presented in the form of commercial advertising, which is a universally accepted and effective method of disseminating this type of information. If this basic tool of communication is to be curtailed by taxing the revenues it produces, a vital function of the association will be imperiled.

Life Association News, the official publication of The National Association of Life Underwriters, is a monthly publication averaging approximately 130 pages of which about 50 percent is advertising. The magazine will accept only advertising which describes a service or a product that is of value to the life insurance agent in his capacity as an agent. This includes advertisements of the availability of newsletters and/or books containing information of concern to the life insurance industry and advertising concerning new insurance products and/or services available to the agent from various sources. This advertising is an extremely valuable and effective tool in any Association's performance of its obligation to keep its membership informed. While it is not our purpose to suggest that all

advertising in a publication of a tax exempt organization is related to the organization's exempt purpose or any other tax exempt purpose, we feel that it is totally arbitrary and illogical to conclude that all advertising is unrelated to tax exempt purposes.

When Congress recognized that certain activities in our society made such important social contributions that their development should be encouraged by exempting them from federal taxation, it recognized to a certain degree a competitive advantage was being afforded these associations over the business operations of other non-exempt organizations. However, it was felt that this was an acceptable price to pay for the promotion of the socially desirable activities involved. Unless Congress is going to retreat from this policy, so much of Section 121 of H.R. 13270 as relates to the taxation of advertising income of exempt organizations should be deleted.

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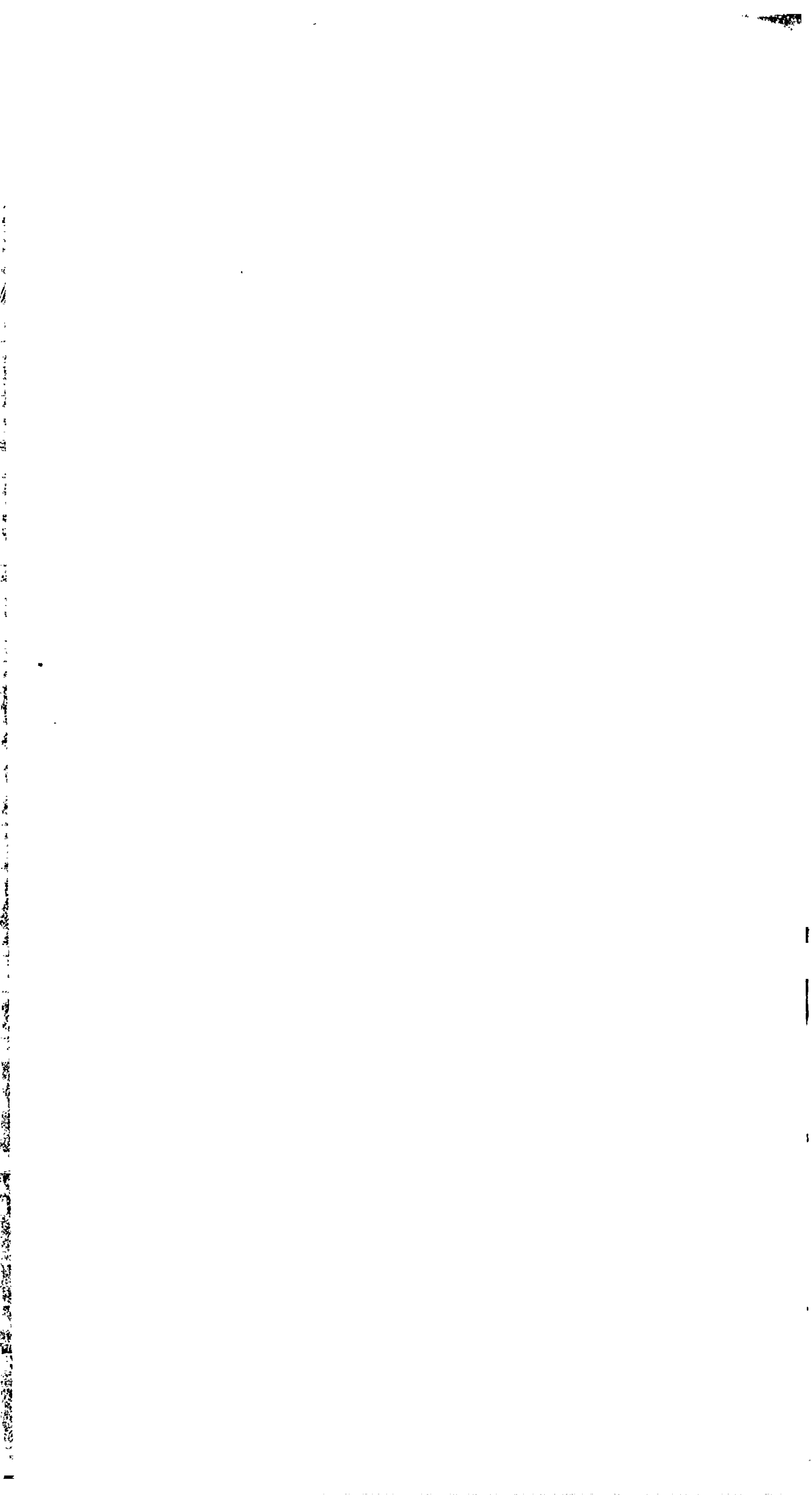
SUMMARY OF
STATEMENT OF LEONARD E. KUST, VICE PRESIDENT AND GENERAL TAX COUNSEL, WESTINGHOUSE ELECTRIC CORPORATION, BEFORE THE COMMITTEE ON FINANCE, UNITED STATES SENATE, SEPTEMBER 8, 1969, RE H.R. 13270

1. Imbalance between business and individual tax burdens. H.R. 13270 reduces individual taxes while increasing corporation taxes. The economic desirability of such a shift in tax burdens is questionable.
2. Moving expenses of employees. The categories of allowable moving expenses should be enlarged to cover all normally incurred expenses. The proposed limitation of $2,500 should be increased to $4,000 where the sale of a house is involved.
3. Depreciation of Real Estate. The proposed amendments go beyond those required to eliminate abuse. Present depreciation methods should be continued for owner occupied industrial and commercial buildings.
4. Restricted stock and other deferred compensation. The proposed changes in the treatment of deferred compensation and restricted stock render such arrangements useless as means of inducing key employees to remain with the employer company and providing such employees with a proprietary interest in the business. Amendments are suggested eliminating tax preference for the employee without destroying the usefulness of restricted stock and deferred compensation measured by stock in serving valid employer purposes.



STATEMENT OF LEONARD E. KUST,
VICE PRESIDENT AND GENERAL TAX COUNSEL,
WESTINGHOUSE ELECTRIC CORPORATION,
BEFORE THE COMMITTEE
ON FINANCE,
UNITED STATES SENATE,
SEPTEMBER 8, 1969,
RE H.R.13270

My name is Leonard E. Kust and I am Vice President and General Tax Counsel of Westinghouse Electric Corporation.

It is my purpose to testify in behalf of Westinghouse on four of the specific areas of tax reform included in H.R.13270: Moving expenses, depreciation of real estate, restricted stock plans, and other deferred compensation. I will cover a fifth item, the capital gains rate applicable to corporations in some general remarks with which I would like to begin.

May I say at the outset that we applaud the effort to reform our federal income tax structure. There is need for reassessing exemptions, deductions and special provisions with the purpose of making the tax system consonant with present needs and priorities, providing equity where inequities have become evident and broadening the base of the tax in order to permit a reduction of rates.

There will, of course, be disagreement over what specific reform proposals serve these purposes best. Moreover, enthusiasm for tax reform should not be permitted to add layers of new complexity to the tax laws or to create new imbalances in the

tax structure.

The momentum for tax reform should not be dissipated through prolonged deliberation but measured consideration of so important a matter as broad-scaled reform of our income tax is certainly necessary.

Imbalance Between Business and Individual Tax Burdens Under H.R.13270

I am concerned that in the overall the structural and rate reform measures of H.R.13270 result in a shift of the total income tax burden between corporate business and individuals. This needs to be carefully evaluated. I do not believe such a shift is wise.

The 1964 Revenue Act reduced individual tax liabilities by 20%. But corporate tax liabilities were reduced by less than 8%. Corporations did have the benefit of the investment credit and new depreciation guidelines of 1962, but these benefits and the 1964 rate reduction were more than offset through 1967 by speed-up of tax payments. Then the surcharge increased corporate taxes by 10% in 1968 while individual taxes were increased by only 5%. The surcharge extension increased both corporate and individual taxes by 10% for 1969 and both will revert to previous levels in 1970, i.e., individuals will again enjoy the 20% rate reduction of 1964 while corporations will receive only

the 8% rate reduction. Yet H.R.13270, when fully effective, would provide additional individual tax reductions of approximately $7.3 billion while the tax burdens of corporations would increase about $4.9 billion.

It is in this context that I question the advisability of increasing the corporate capital gains tax to 30% and repealing the investment credit.

There should be thorough consideration of the economic desirability and justification of the shift in relative tax burdens between corporate business and individuals inherent in H.R.13270. A statement on behalf of Westinghouse, in opposition to repeal, was filed with the Ways and Means Committee and I will not repeat our arguments here. But if the Finance Committee should deem repeal of the investment credit desirable, I urge that some compensatory adjustment be made in corporate tax liabilities, such as more liberal depreciation allowances or a reduction in the corporate tax rate to keep the relative tax burdens of corporate business and individuals from shifting to the disadvantage of corporations. It is always tempting to shift taxes to business but the economic wisdom of submitting to the temptation must be questioned if our long-term national interest is to be served.

I should now like to follow these general comments with

comments on some specific structural changes in H.R.13270 affecting our operations.

Moving Expenses of Employees

The first is moving expenses of employees. The reform bill quite properly addresses itself to the inadequacy and confusion of existing law.

Thus, proposed new section 231 recognizes that the transfer of employees between company locations is a common business practice, and the reimbursement of expenses of relocation a business expense of a non-compensatory character. However, under the provisions of the Bill the expense is non-compensatory only if it falls within certain prescribed classes of expense and certain dollar limits. For practical reasons in order to prevent tax avoidance some limitations are necessary, no doubt, but they should be broad enough to permit recovery of the costs and expenses involved in the average move.

It may be thought that only the more highly paid employees are transferred by an employer. Several years ago in an effort to provide background data for legislation, we analyzed the moves made within our Company. We found 70% of the transferred employees earned under $15,000 and 20% between $15,000 and $20,000. Only 10% had income exceeding $20,000. We do not have a similar breakdown for subsequent years but we know the number of transfers has more than doubled, testifying to the growing urgency of the problem.

I have in mind two classes of expense inadequately covered in this Bill which I submit that this Committee should consider. The first is that miscellaneous group of expenses which are inevitable in every move, such as connecting and disconnecting utility services, disconnecting and installing appliances, altering rugs, re-registering automobiles, etc. Collectively these represent a significant item to the average employee. I suggest that a catch-all category be established to include such common miscellaneous items. An over-all limitation with respect to deductible moving expenses should be adequate protection against abuse.

The other class to which I refer is the costs and expenses incurred in connection with disposition of a house at the old location. While commissions and closing costs incurred are covered by the new section, often there is delay in the sale which involves "carrying charges" such as taxes, insurance, interest, utilities and maintenance being incurred simultaneously on both the old and the new home. In 1968 expenses in connection with the disposition of homes of transferred Westinghouse employees averaged about $3,000 per employee, of which the "carrying charges" described are about $1,000.

The over-all limitation of $2,500 with respect to "indirect" moving expenses is not realistic when the sale of a home is

involved. The costs and expenses in connection with selling a home will generally exceed that amount, leaving nothing for the other expenses incurred. Since a demonstrable inadequacy exists where the sale of a residence is involved, I suggest that the over-all limitation on "indirect" moving expenses be enlarged in such a case to at least $4,000 and the allowable expenses expanded to include all the costs and expenses of home disposition, other than loss on the sale.

Depreciation of Real Estate

The proposed reform of depreciation of real estate to prevent abuses by high income individuals is too sweeping. It not only reaches the abuse but would repeal desirable and needed depreciation allowances for taxpayers who do not utilize investment in real estate for tax avoidance but who must invest in buildings as a necessary adjunct to their manufacturing or commercial pursuits.

For many years prior to the Revenue Act of 1954 the business community had complained persistently about the inflexible and inadequate tax depreciation rules. The Revenue Act of 1954 was the first step toward recognition of the need for relief from those rules and was followed in 1962 by an administrative liberalization, commonly referred to as the new depreciation guidelines. The latter, however, had little or no application to real estate.

Thus, the only depreciation reform with respect to real estate has been the 1954 Act permitting the adoption of the double declining balance and the sum-of-the-years digits methods for new buildings.

Admittedly, the use of the double declining balance and sum-of-the-years digits methods of depreciation by high income individuals investing in real estate ventures has resulted in tax avoidance. The proposed solution is to eliminate the accelerated depreciation methods enacted as part of the 1954 depreciation reform with respect to all buildings, except residential housing.

Owner-occupied industrial or commercial properties tailored to the requirements of specific manufacturing or commercial pursuits do not, however, lend themselves to tax avoidance. Such properties are usually occupied during their full economic life by the operator of the business. There is no established market for such properties and they rarely change ownership. They do not serve to generate losses to offset other income and then yield capital gains on sale when rents begin to exceed the depreciation. Furthermore, investment in new productive facilities should not be discouraged as drastically as does H.R.13270, by eliminating the investment credit on new equipment and the accelerated methods of depreciation on the associated new building.

It is recommended that double declining balance and sum-of-the-years digits methods of depreciation be denied only to real estate held primarily for rent where the income is predominantly from rents, permitting the abuse against which the House legislation is aimed. Present depreciation methods should continue to be applicable to predominantly owner-occupied industrial and commercial buildings. The proposed changes in the recapture provisions are adequate in the case of such property to prevent any abuse of double declining balance or sum-of-the-years digits depreciation.

Restricted Stock and Other Deferred Compensation

H.R.13270 contains three amendments having a direct effect on deferred compensation payments. In industry, these payments typically are awards of money to executives which are to be paid at some future date, either over an immediately succeeding number of years or over some period after retirement. They may be paid in cash or converted into stock which is issued to the executive subject to restrictions, in which case the award is termed "restricted stock", or may be so converted without issuance of the stock, in which case the award is sometimes referred to as "phantom stock". Many variations are possible, but in substantially all cases the awards are initially forfeitable, being contingent upon the continuation of employment for some number of years.

The amendments referred to are new section 85, which taxes as ordinary income the entire market value of restricted stock at the earlier of the time when restrictions lapse or when the stock is no longer subject to a substantial risk of forfeiture; new section 1354, which imposes a throwback rule on the computation of tax applicable to deferred compensation payments; and new section 1348, which excludes deferred compensation payments from the 50% maximum rate limitation on earned income.

The intention behind the restricted stock provision is to end the capital gain benefit available with respect to appreciation in restricted stock under current Treasury regulations, and behind the throwback rule, to prevent the obtention of lower tax rates by deferral of income into lower income post-retirement years of the employee. The intention behind the exclusion of deferred compensation from the 50% limitation is not disclosed by the Ways and Means Committee Report or House debate, but presumably is to induce employees to take current income.

We agree with the Administration that these proposals require further study. We would be happy to work with the Administration and the Congress toward a reasonable solution of the problems involved. The following comments are offered to this end.

In the concern for ending preferences to employees the proposals in the House Bill go too far and impair the valid

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objectives of employers. Deferred compensation, particularly that issued in the form of capital stock, serves two legitimate business purposes of employers. First, through deferral coupled with forfeitures it enables employers to induce employees to remain with the company. Second, deferred compensation in the form of stock awards serves to give the employee a proprietary interest in the company. These business interests predate the income tax and have been accepted as valid by the Congress in the past. They are still valid today. I believe that it should be possible to serve these valid business purposes and prevent any undue tax preference to employees.

Yet, if compensation paid currently is subject to a 50% maximum tax rate and, at the same time, the tax on deferred compensation is not so limited, the result clearly discriminates against the legitimate business purposes involved. If, in addition, it is remembered that the recipient of a deferred compensation payment is, under the throwback provisions, henceforth burdened by the necessity either of recomputing income tax liabilities for all years subsequent to 1970 for as many as perhaps twenty-five years or else paying tax at an even higher rate under the new section 1354, it becomes apparent that deferred compensation simply cannot be used any longer.

Since restricted stock is probably deferred compensation

within the meaning of sections 1348 and 1354, although this is not clear the foregoing comments apply to it as well. In addition, restricted stock is rendered useless by the proposed subjection to tax when no longer forfeitable even though still subject to restrictions on sale. Although most restricted stock issued by employers in the last few years has contained restrictions lapsing only after retirement, generally it has not been subject to forfeiture longer than five years after issuance. If taxation is accelerated to the time when forfeiture terminates, restrictions on sale of the stock cannot really extend beyond that time for then the consequences to the employee would be worse than under the present qualified stock option rules.

But qualified stock options are not an adequate alternative to restricted stock and deferred compensation measured by stock, for purposes of developing a proprietary interest. Although offered by the Treasury and accepted by the Congress as "the appropriate means by which key employees could be provided with a stake in the business," the qualified stock option must be declared at best only a qualified success. It is the failure of the qualified stock option to serve adequately as a means of creating significant key employee proprietary interests that has shifted emphasis to restricted stock and deferred compensation measured by stock. We have not used qualified stock options widely and with good reason. Requiring the employee to pay 100% of the market price at the time

the option is granted and then to hold the stock for three years imposes too much strain on the many people who must borrow in order to exercise the option. Thus, with respect to the Westinghouse qualified stock options which have now expired under the 5-year limit on exercise, 31% of the grantees receiving options in 1964 have already made disqualifying dispositions of their stock. It is clear to us that qualified stock options are unlikely to serve significantly as a device for creating long-term equity participation by key employees. Neither can restricted stock, nor deferred compensation measured by stock, under the proposed rules.

I suggest that qualified stock options, restricted stock and deferred compensation measured by stock should all be viewed as serving a legitimate corporate purpose which should not be destroyed by the tax treatment in the hands of the employee accorded to these compensation-with-a-proprietary-interest devices. Undue tax preference for the employees can be eliminated without frustrating the legitimate desire of the employer company to use compensation devices which will deter key employees from leaving and give such employees a proprietary interest.

Since qualified stock options do not adequately serve these purposes and since restricted stock and deferred compensation, while serving these purposes, are thought to confer an undue benefit on the employees, I suggest a modification of the quali-

fied stock option rules to serve as the controlling statutory framework and to permit:

(1) the issuance to an employee of an option to purchase stock of the employer at 100% of current market value with taxation of the full gain on the sale of stock held for more than 3 years after exercise of the option as capital gain, as at present.

(2) the issuance of a similar option to purchase at a price below the current market price stock subject to restrictions on sale, with taxation of the difference between option price and market price on date of grant as ordinary income when restrictions on sale lapse. Any appreciation above market price at date of grant could be taxed in whole as capital gain upon disposition if the stock is held for more than three years or could be partially taxed as ordinary income, measuring such additional income by the percentage by which the option price was discounted from market value on the date of grant. The first alternative would be simpler but the second would perhaps be more appropriate.

(3) the outright grant to an employee of stock of the employer subject to restrictions on sale or the award of deferred compensation to an employee measured by stock of the employer with taxation in either case of the market value of the stock as ordinary income when the restrictions on sale lapse or the

deferred compensation is distributed.

All other present restrictions on qualified stock options would continue to apply, bringing a desirable unity of applicable rules to the whole area of stock options, restricted stock and deferred compensation measured by stock.

Such provisions would remove any undue preference to employees but permit the employer flexibility in serving his purposes of deterring his employees from leaving and motivating them with a proprietary interest to maximize the performance of the business.

It should be evident that exclusion of deferred income falling within the categories described from the 50% maximum rate limit on earned income is incompatible with the aims sought to be served. While such deferred income will serve the interests of the employer, employees will be reluctant to accept it in place of current income if current income is subject to the 50% maximum rate but deferred income is not. With the safeguards which I have suggested it is unnecessary to exclude deferred compensation from earned income subject to the maximum rate. Indeed, if it is not included in earned income the employer's purposes served by deferred compensation will be frustrated. If the 50% maximum rate is applicable then I submit that the throwback rule is unnecessary, obviating the incredibly complex and burdensome record-keeping rules involved.

As a final suggestion with respect to deferred compensation

it should be clarified that bonuses payable over no more than five years and subject to earn-out should not be considered deferred compensation. Since such bonuses are forfeitable unless earned-out through continuance of employment they are in fact income only as earned out. Moreover, such forfeitable bonuses really serve the employer's purposes of retaining key employees and rarely provide the employee any benefit over current compensation.

In closing, may I again commend the Congress and this Committee for their determination to proceed with the difficult task of tax reform. I appreciate this opportunity to present views on behalf of Westinghouse and I trust that the suggestions made will be viewed not as opposing reform but as an effort to keep reform from having unintended and undesired results.

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SUMMARY

Presentation by

Miss Vivien Kellems

East Haddam, Connecticut

for the

<u>Senate Committee on Finance, regarding S2794</u>

<u>September 8, 1969</u>

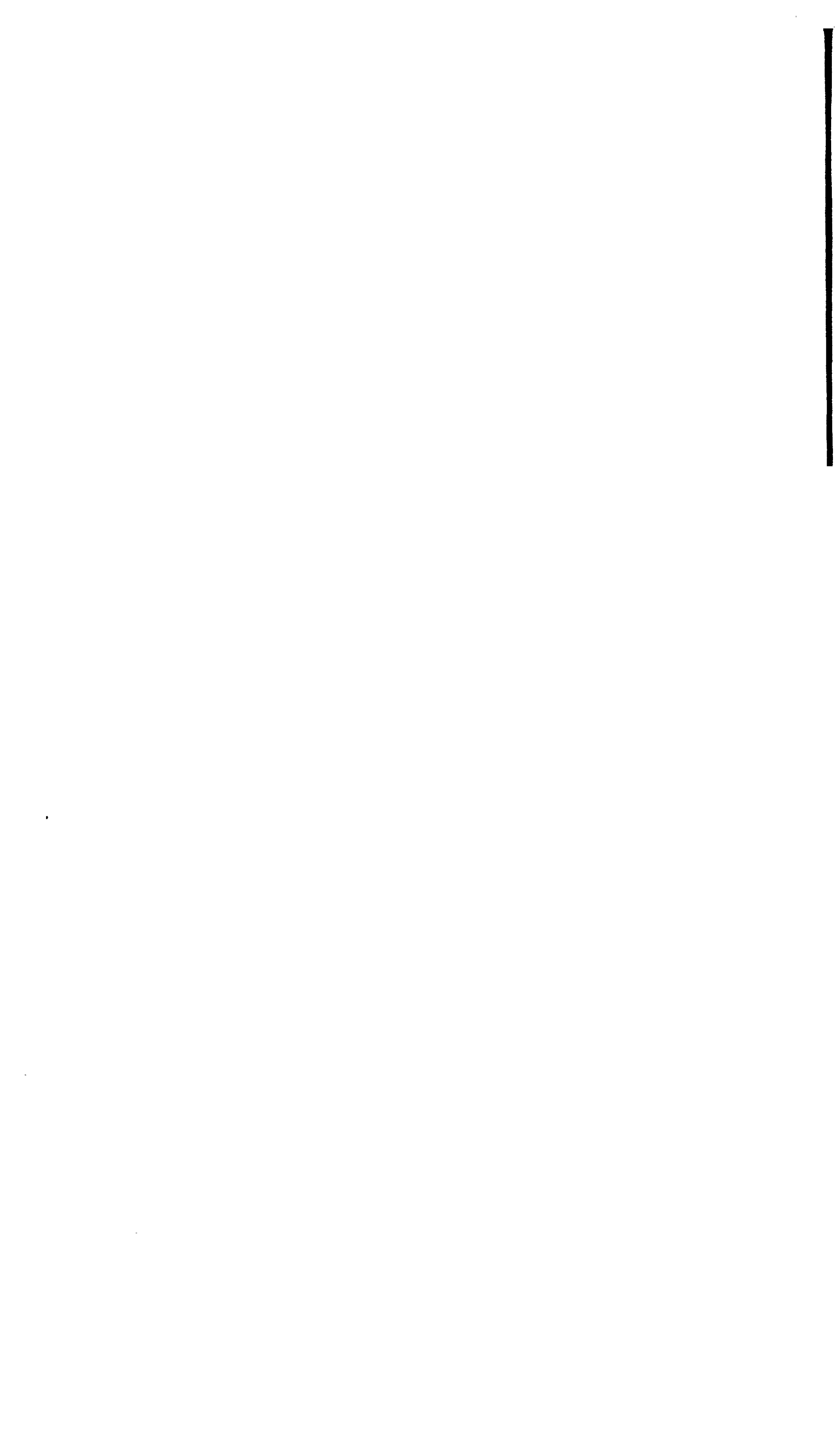
1 - Brief History of the Community Property Law, passed in 1948, which resulted in the penalty tax on single people.

2 - Analysis of this law.

3 - Attempt to test the Constitutionality of the penalty tax.

4 - Bill S2794, Introduced by Senator Eugene McCarthy, August 7, 1969.

5 - Action taken by Miss Kellems to test the constitutionality of the penalty tax.



The first income tax law passed under the Sixteenth Amendment in 1913, consisted of 40 pages. The latest, published July 22, 1968, is 1593 pages. Titles, sub-titles, tables, texts, cross-references, special rules, miscellaneous information, all in very fine print, is one vast labyrinth of gobbledy-gook. Can the most brilliant lawyer, the most adroit and versatile accountant, can the Secretary of the Treasury, can anyone of you gentlemen on the Finance Committee, possibly grasp and understand this fantastic monstrosity we call our Income Tax Law? And this does not include volumes of court decisions, regulations, special rulings, and other paraphernalia.

Congress now proposes to "reform" this hydra-headed monster, close a loophole here, put a patch on there, levy more on one hapless taxpayer, give a crumb of benefit to another. When finished, the whole mess is going to be more incomprehensible and hopeless than it is now.

Naturally the whole thing is shot through with favoritism, injustices and inequities. The most blatant and unconstitutional of them all is the penalty tax against single people.

There is no law that says single people must pay higher income taxes just because they are single. Congress never has, nor does it dare to pass such a law; even this Supreme Court would have to declare it unconstitutional. Then how is it possible that for the past 21 years, the Federal Government has sucked into its cavernous maw billions of dollars from American citizens on the pretext that it is legal to penalize people for not being married?

It was done in 1948 with a sleight-of-hand trick called the Community Property Law which wasn't a Community Property Law at all. That was the excuse given for the wholesale robbery of millions of helpless people.

It all began when the Income Tax Amendment to the Constitution was adopted in 1913, and came about because our laws are derived from two different systems, the Spanish Law and the English Common Law. At the end of the Mexican War, Mexico ceded to the United States that territory now comprising New Mexico, Arizona, California, Idaho and Nevada. As each of these states was admitted to the Union, it embraced most of the English Common Law, but retained those Spanish Laws protecting the rights of the wife to one-half of the property acquired after the marriage, also one-half of the income earned by the husband. These laws were inherited from Mexico which in turn, had adopted them from Spain.

Texas came into the Union by treaty, an independent nation, but Texas had already put the community property laws in her Constitution. Louisiana was acquired by purchase from France, but the French community property law was practically the same as the Spanish, so one more community property state came into the Union.

The rest of the states derived their laws from the English Common Law and gave no such rights to wives. As Senator Connally said, women in many of these states were little better than serfs. In some states it was legal for a man to beat his wife, provided the switch was no thicker than his thumb.

When the first income tax law was passed under the Sixteenth Amendment, the Internal Revenue Service recognized these community property laws and permitted married people in these seven states to split their incomes and pay at a lower rate. Since these first income taxes were very low and exemptions relatively high, the rest of the country paid no attention to this special benefit enjoyed by their sister states. However, after the first world war when income taxes reached astronomical heights, the common law states came to with a bang. How come? Why weren't they entitled to the same tax break?

The first bill to equalize these rates was introduced in Congress in 1921, but went down to ignominius defeat. The community property states refused point blank to extend this lucrative loophole to the rest of the country.

They had a good thing going and didn't propose to give it up. Again and again the common law states tried to pass this bill, but each time they lost. As Senator Fulbright said, these bills were "filibustered to death". Due to the lower taxes paid by married people in the community property states they were sitting pretty; the common law states were paying a disproportionate share of the cost of the Federal Government.

By 1947 the battle lines were drawn and feelings ran high!

The very first bill introduced in the 80th Congress was House Resolution No. 1 - to reduce income taxes. The House passed this bill and sent it to the Senate where Senator McClellan immediately proposed an amendment to pass on the blessings of split income taxes to the rest of the country. By this time five more states, Michigan, Nebraska, Oklahoma, Oregon and Washington had passed community property laws, making a total of twelve such states. Senator McClellan's amendment proposed to bring the other thirty-six states under this protective tax umbrella.

It was a lighted match and fireworks exploded on the Floor of the Senate. Senator McClellan charged that the Community Property states were getting away with murder. He claimed the common law states were paying $500,000,000 a year more than the community property states, an advantage to these twelve states of $175,000,000. He was grieved that Arkansas, his home state, paid $5,000,000 more in federal taxes in 1946 than a community property state of comparable population would have paid. To the distinguished Senator this was an unbearable penalty inflicted upon his state and "the rankest and most unjust discrimination that exists anywhere in our tax laws against three-quarters of the states". "Such a monstrosity in our tax structure" was not to be borne and he demanded "righteous and equitable treatment for simple justice to all American citizens alike." But to Senator McClellan and 99% of that august body, such "righteous and simple" justice did not apply to single people.

Throughout the debate the only words used in referring to the taxpayers were the "citizens" or "people of my state" or of the United States. The words "single people" appear only three times in that whole, lengthy debate that stretched out over months. Senator Millikin rather timidly ventured the opinion that there were other people to be considered. He suggested that there might be "important effects on the distribution of taxes among the different income groups between married and single persons". And at another time, "I am emphasizing that we are dealing with a group problem. Under the Senator's amendment a single person living alone would not benefit. Widows with children would not benefit. Children with dependent parents would not benefit."

But the Senator might just as well have saved his breath. Not one member of that "most exclusive club in the world" even heard the word single. Even widow with children failed to register. Senator McClellan tartly replied, "the bill does perpetuate a group benefit which now accrues, and I am trying to quit perpetuating this group benefit to the community property states." And the rest of the Senators went right on prattling about the "citizens of my state," or the "citizens of the United States," or the "people" of the state or nation. To them there were no single people; everyone was married.

Incredible! Suffering poignantly from "blatant injustice" they were utterly oblivious that they were shunting off onto the frail shoulders of those least able to pay, the whole weight of the burden which they were determined to dump from their own. There was no pretense; it was a straight tax gimmick. It unabashedly gave a tax advantage to one class of taxpayers. One member assured Senator McClellan that the Ways and Means Committee would "consider this matter with the greatest sympathy". To which the Senator from Arkansas replied, "I want a reduction in taxes, not sympathy." He then informed Senator Knowland, "On our present salary ($12,000) I pay $646.00 more Federal tax than does the Senator from California. I need that money for my family as much as does the Senator need that amount of money for his family. All I am asking is that justice be done." The saving on the present Congressional salary is over $4500.00.

It was then suggested that Arkansas could pass its own community property law, but this was not easy. The five states that had passed such laws did so in self-defense with the greatest difficulty. Another state, Pennsylvania, had passed such a law only to have the Supreme Court of Pennsylvania declare it unconstitutional. Community property laws created all kinds of problems affecting estates, domestic relations and commercial credit; they could upset court decisions and cause individual and general chaos. Senator McClellan didn't think much of that idea; the only solution to his problem was a Federal Law; he would settle for nothing less.

At this point Senator Connally invited the Senator from Arkansas to move to Texas and this brought up another sore point. While the Senator couldn't very well move to Texas, that was exactly what a number of his constituents were doing. The town of Texarkana was divided right down the middle by the state line between Texas and Arkansas and many wealthy citizens of Arkansas, whose businesses were in that state, found it profitable to move their homes across the state line to Texas where they happily split their incomes and paid Uncle Sam at the lower rate. Other states lamented loudly that the Community Property states were siphoning off the wealth and business of the non-community property states. They did indeed, have a good thing going!

Senator Fulbright termed it "geographical discrimination" and he challenged any Senator to "cite any other case where we make a distinction and a difference in the tax burden because of citizenship in a particular state or states."

I ask Senator Fulbright, show me any other tax law which makes a distinction and a difference in the tax burden because of the marital condition of the taxpayer?

The bill did not pass in 1947. However, it was one of the first bills passed in 1948. One April 1, 1948 President Truman vetoed it, calling it "inequitable". The very next day Congress passed it over his veto.

It should be made quite clear that this was not a community property law. Not one property law, or any other law, was changed one iota. Not one piece of property, or penny of income changed hands under this law. No wife anywhere received one thing except as she benefited by the tax savings. Everything remained precisely as it was and the husband still owned his income. It was a straight tax gimmick, class legislation and discrimination of the most flagrant sort. There was absolutely no pretense. It was a rich, married taxpayer's bill, the higher the income the greater the percentage of saving. Poor married couples, those receiving $5000 or lower, didn't save a dime. The single taxpayers were left holding the bag. They had to pay at the confiscatory rates of World War II without a penny of relief. Never has a law been passed saying they must pay at these exorbitant rates, but under this so-called community property law, the Internal Revenue Service has arrogated to itself the power to illegally collect billions and billions of dollars from these helpless people.

But more than this, the law gave the rich, married people in the community property states something they had not had before. They could now split all income, including that derived from premarital estates. This they could not do before. But under this law rich, married people in all 48 states could split this income, and thereby save themselves billions of dollars. Add to this the estate tax which permits them to pass on one-half their estate with no tax, while the other half is taxed at the lowest rates, and the picture is complete. They had it made! To finish off the single taxpayer, when he dies 100% of his estate is taxed.

But before his sad demise, one more indignity - the Surtax! Since there wasn't one more thing to tax, Congress taxed a tax. This was not a tax on income, this was a tax on the income tax and again the single people had to bear the brunt of it. 10% for married people, but up and up and up for single people because they have to pay 10% on the penalty they are already paying. In thousands of cases it runs over 14%. I make no comment on this action; the facts speak for themselves.

Has there ever been such rank, discriminatory, unjust, unconstitutional legislation against millions of American citizens? Why? Because they are not married.

There has been one attempt to test the constitutionality of this system. The day after Christmas, 1953, one Mr. Faraco died. The very next year, the income tax of his widow was raised 40% because she was now a single person. Mrs. Faraco resented this unjust penalty for having lost her husband, and brought suit to recover this money in the Tax Court of the United States. The Tax Court refused to consider the constitutional issue, and the case, Antoinette M. Faraco, 29 T C 674 (1958), was appealed to the Court of Appeals for the Fourth Circuit and that court held that the law was constitutional (Faraco v Comm., 261 F 2d 387 (4th Cir., 1958)).

The Court of Appeals stated, page 389:

> "Taxpayer seeks to recover the difference in the tax paid upon her 1954 income and the amount of tax which would have been due if a husband and wife reported the same income and deductions upon a joint return. Permitting married taxpayers to use the split income device of #2 of the 1954 Code, 26 USCA #2, while withholding the privilege from single persons, she says is such an arbitrary and unreasonable discrimination that it cannot be allowed under the Constitution. Classification of taxpayers according to marital status is not unreasonable, however, and there was much reason behind the purpose to equalize the tax burden as it falls upon married couples in common law states in comparison with those in community property states. The fact that the change gave a proportionately greater tax reduction to married couples with large incomes is wholly irrelevant; if the rapid acceleration of the progressive tax rates ran afoul of no constitutional guaranty, a slight withdrawal may not be said to have done so. We find no merit in the taxpayer's contentions."

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In plain English, this decision says that because the increased tax of 40% was so "slight" it did not violate the Constitution, and without doubt, is the most idiotic decision in the whole legal history of the United States. Since when does the amount of damage determine the constitutionality of a law?

That decision was rendered by Judge Clement F. Haynsworth, who has recently been nominated for the Supreme Court.

The Supreme Court refused to rule on this question by denying certiorari (359 U S 925 (1959)) and until it does rule, the constitutionality of the penalty tax on single people simply because they are single, has not been established.

In 1962, Senator Eugene McCarthy, of Minnesota, introduced a bill (S35) which would permit certain persons 35 years of age, or over, to qualify as Head of Household, and pay a lower tax, however, not as low as married persons in the same income tax brackets. There was already a rather nebulous classification, Head of Household, which Congress had added in 1951, to partly still the cries of outrage from indignant taxpayers, but the requirements were so strict that very few people could qualify. For all the relief it afforded, it might as well not have been there.

Senator McCarthy sought to amplify this classification to include many more over-burdened single taxpayers. He got exactly nowhere. His was a lone voice crying in the wilderness. In spite of the lack of understanding and co-operation, even ridicule, the Senator persisted and has reintroduced this bill in each succeeding Congress (88th, 89th, 90th). Convinced of the injustice of the penalty tax and also persuaded that it was unconstitutional, Senator McCarthy felt that it was the best bill that could be considered at that time, since there was such opposition to the whole idea of fairness and justice for single people. Later other Senators joined him in sponsoring the bill and several Congressmen have introduced similar bills in the House of Representatives.

And the Ways and Means Committee recently actually included such a measure in its proposed tax reform bill. This action reflects the change in the political "climate" regarding this tax.

Finally, Senator McCarthy stood on the Floor of the Senate on August 7th, this year, and introduced a bill (S 2794) to abolish the whole unsavory, unconstitutional mess. He was heartily commended by Senator Ribicoff, of Connecticut, who pledged his support of the bill. Senator Ribicoff said, "The Senator from Minnesota has been in the forefront of this fight for many, many years. He has been a lone voice, receiving very little support from anyone else in the executive branch or in the legislative branch. I will certainly be pleased, as a member of the Committee on Finance, to support the Senator's efforts to bring justice in this important field."

It is this bill, Gentlemen, which brings me before your Committee today.

On April 15th, I signed a blank income tax form (1040) and sent it to the Director of Internal Revenue, Andover, Massachusetts. I then wrote the Secretary of the Treasury that I would not pay any more taxes until the Federal Government refunded to me the sum of $73,409.03, taxes which have been illegally collected from me for the past twenty years, plus interest.

From that time, letters have poured in from all over the United States. As their numbers increase, my blood pressure rises! They come from all over the country, from all kinds of people, young people working their way through college, elderly widows trying to make ends meet on meager incomes, school teachers, nurses, telephone operators, stenographers, secretaries, factory workers, and thousands of retired people - a cross section of America. All tell one bitter, heart-breaking story, a crushing penalty tax by an all-powerful, greedy, ruthless government for one reason only, these millions of people are not married.

What began as a simple test of the constitutionality of this tax, has now become a flaming, emotion-packed crusade.

We are creating paupers out of decent, self-respecting, self-supporting American citizens. Read these letters and see if you can stay calm; widows with small children, women whose husbands have been killed in Vietnam and who must pay a penalty for the sacrifice they have made, other widows using the capital of the small estate left by a husband to pay current taxes, one woman living on crackers and tea. Thousands terrified at what the future holds; these are proud people who cannot bear to ask for public assistance, and always the cost of living spiraling ever up and up while their standard of living goes down. Is this what this Committee wants? Is this what the Congress of the United States wants?

I have no quarrel with the split income tax provision, and certainly there isn't any intention to take this tax privilege away from married people. More power to them and to anyone else who can legally save on their taxes! All we single people ask is the same tax break. We want simple justice for single people. And millions of married people agree with me.

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PARENTS WITHOUT PARTNERS, INC.
Summary of Testimony
Senate Finance Committee
Monday, Sept. 8, 1969

Parents Without Partners is an international organization of over 50,000 members who are divorced, widowed or separated parents.

Our testimony covers the following points:

(1) Amendment of the "surviving spouse" section of H.R. 13270 to provide joint-rate taxation of all single parents who maintain homes for their children.

(2) Comparable treatment of married persons living apart pursuant to separation agreements with that afforded divorced and legally separated persons.

(3) Deductibility of medical and child care expenses by the parent who pays them without regard to the child's status as that parent's dependent.

(4) Deductibility of child care expenses by divorced or separated fathers comparable to the deduction presently available to widowed fathers.

Mrs. Dorris Palmer
International President
P. O. Box 7293
Kansas City, Mo. 64113

Mrs. Joan Kushnir
Legislative Liaison Comm.

Mrs. Caryl Terry
Witness

PARENTS WITHOUT PARTNERS, INC.
Testimony
Senate Finance Committee
Monday, Sept. 8, 1969

Parents Without Partners is an international organization whose sole criterion for membership is that each member be a single parent. Over 50,000 widowed, divorced, or separated parents belong to more than 400 chapters of our organization throughout the United States. We have requested permission to testify concerning H.R. 13270 because of certain tax inequities and related matters affecting single parents and their children. In March of 1967, 2.4 million widows and 2.9 million divorced and separated women were employed in the United States.[1] Of these 5.3 million employed women, 1.7 million had children 17 years of age or younger.[2] There were 819,000 families headed by employed males which were not husband-wife families.[3] The tables from which the latter figure was obtained unfortunately do not contain data about children in such families. We wish

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1/ United States Dept. of Labor, Bureau of Labor Statistics, Sepcial Labor Force Report No. 94, Marital and Family Characteristics of Workers. March 1967, p. A-5. Table A.

2/ Ibid, p. A-12. Table O.

3/ Ibid. p. A-22. Table T.

to emphasize that none of these figures reflect the total number of single parent homes in the United States. These figures do suggest, however, that millions of children live in single parent homes.

Although we support H.R. 13270's adjustments in the taxation of individuals, such as the increased standard deduction and maximum standard deduction and the provision of intermediate tax status for single individuals over the age of 35, we urge this Committee to amend H.R. 13270 before reporting the Bill to the Senate.

We seek amendments in four basic categories: (1) To equalize the tax treatment of divorced, separated and widowed parents; (2) To supplement this equal treatment by permitting persons living apart pursuant to separation agreements to elect to treat themselves as widowed, divorced or legally separated persons for tax purposes; (3) To permit parents to deduct medical and child care expenses without requiring the children on whose behalf such expenditures are made to be the taxpayer's "dependents" under Section 152 of the Internal Revenue Code of 1954; and (4) To liberalize the child care deduction available to fathers.

Section 803(b) of H.R. 13270 amends Section 2(b)(1)(A) of the Internal Revenue Code of 1954 to tax widows and widowers who maintain homes for dependent children at the joint

rate applicable to married couples, while divorced or separated parents maintaining homes for dependent children continue to be taxed at the higher intermediate rate. The responsibilities and financial problems of all such single parents, regardless of the cause of their single status, are substantially identical. In many cases, divorced or separated parents are confronted with the necessity of supporting two households from the income which previously supported a single household, without the insurance, pension or annuity benefits often available to widowed persons. Most divorced and separated mothers work in order to provide decent homes for their children. In fairness they should not have to contend with a tax burden larger than that placed upon a parent in comparable economic circumstances who has lost a spouse through death. We urge this Committee to amend Section 803(b) to avoid its present discrimination against divorced and separated parents, and to provide joint-rate taxation for all single parents who reside with dependent children. Parents Without Partners urges that all de facto single parents, regardless of the circumstances which cause their single status, should be treated equally for tax purposes, and that single parents who maintain households for dependent children should not be discriminated against vis-a-vis married taxpayers.

We also recommend that Sections 2(b)(1)(A) and 214 of the Internal Revenue Code be amended to equate taxpayers maintaining separate households under a separation agreement, often during a statutory waiting period prior to divorce, with taxpayers who are already divorced. This would, of course, require such separated individuals to forego their current privilege to file tax returns jointly with their separated spouses, as they can under Section 6013. In many cases this privilege is illusory as emotional considerations and other factors make it actually impossible for such persons to file joint returns. There is no distinction between the situation of such separated persons and divorced, legally separated or widowed individuals. However, the law now imposes a higher tax burden on such persons during this difficult waiting period.

We request this Committee to amend Sections 213 and 214 of the Internal Revenue Code of 1954 so as to permit a parent who actually pays for medical or child care for minor children to deduct medical care payments and child care payments made for such children whether or not the children are that parent's "dependents" under Section 152 of the Code.

Section 213 fails to permit a parent who bears the responsibility for a child's medical expenses but does not claim the child as a dependent for tax purposes to deduct

medical expenses paid on behalf of the child. We believe that a parent who spends more than three percent of his adjusted gross income on medical expenses for himself and his children should be permitted to deduct the excess expenses whether or not his children are his "dependents" pursuant to Section 152.

Similarly, Section 214 provides a deduction of up to $900 for child care expenses incurred so that a woman, widowed father or certain married persons can be gainfully employed only if such expenses are paid for children who are the taxpayer's "dependents." This deduction is not available to divorced or separated fathers who have custody of their young children, nor is it available to the many women who must work and must pay out substantial sums of after-tax dollars for child care who do not claim their children as dependents for income tax purposes. We recommend that Section 214 permit any single-parent taxpayer having custody of children under 13 to obtain the benefit of the child care deduction without regard to the child's status as his "dependent" under Section 152. Incidentally, we suggest that the Committee consider raising this age limitation.

In addition, we urge this Committee to amend Section 214 to permit parents who are separated but who have not yet

received a decree of final divorce or legal separation to benefit from the deduction for child care if such parents maintain separate households and do not file joint income tax returns.

Unfortunately, we are unable to estimate the revenue impact of our suggestions. However, there is no reason to anticipate a very large revenue decrease from these suggested amendments. Whatever are the relevant revenue considerations, inequality of treatment among taxpayers who are similarly situated is undesirable. Single parents should not bear a disparate tax burden, a tax burden which inevitable affects their children.

George Eliot wrote that ". . . . children are still the symbol of the eternal marriage between love and duty." Members of Parents Without Partners love their children and want to do their duty. With your help we will!

Office of Dorothy Shinder,
Volunteer Tax Reform Advocate,
Director, "WAR SINGLES (Not War Widows)";
President, "SINGLE PERSONS TAX REFORM;
Volunteer National Service Organizations
1692A Green Street
San Francisco, California 94123

For Immediate Release

The following is a Statement by DOROTHY SHINDER, Director of "WAR SINGLES (Not War Widows)" and President of SINGLE PERSONS TAX REFORM, of which only the Summary is being presented orally, and the remainder submitted in its entirety, on Tax Reform for WAR SINGLES and other unmarried persons, per se, to the SENATE FINANCE COMMITTEE, Washington, D.C. on Monday, September 8, 1969:

* * *

Mr. Chairman and Members of the Senate Finance Committee:
You honor me by permitting me to speak before you. My appearance is in the interests of Human Rights, Social Justice and Equity of the Law. It is for a cause which is very dear to the hearts of every American -- Taxation without Representation. "WAR SINGLES (not War Widows)" have never been recognized or acknowledged by our government, and are now asking for War Reparations, comparable to what War Widows receive, and for other benefits; other single, widowed and divorced persons also should be included in the tax laws.

S U M M A R Y (Statement attached)

WAR SINGLES are over-35 heterosexual single, or briefly married women, whose chances of marriage or remarriage were spoiled by the wars. War Singles have worked in respectable jobs for 20 years or more, all the while paying the highest rate of income tax with very little, if any exemptions. They have provided for themselves, been their own wage-earners and have assumed the entire economic responsibility and burden of maintaining their own households, where they live.

WAR SINGLES are as much an after effect of war as are War Widows, who receive compensation.

→ from the Billions more than necessary for Defense!
WAR SINGLES deserve War Reparations in the amount of $35,000 plus interest. This would be barely comparable to what War Widows have received. The Government took the men, sent them to wars, then actually punished the War Singles for not having husbands; humiliated them, took everything from them, and not only gave them nothing in return but made them pay, and pay more than their share, at that, draining their incomes and violating their Human Rights.

To make further amends to WAR SINGLES, additional benefits should include:

Retirement at age 50 with full widow's social security benefits, including the provision to work whenever they wish for additional unlimited income.

Medicaire.

Tax Deductible rents on their living quarters.

Two $600 exemptions.

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When Senator Eugene McCarthy introduced Head of Household legislation for over 35's, TIME Magazine (Feb. 14, 1964) referred to it as the "Working Girls" Bill. It was intended to aid and assist unmarried women, be they single, widowed or divorced, because there were 13,000,000 unmarried women as compared to 5,000,000 unmarried men who were alone, working and supporting themselves, and had extra expense, and were deprived of their HUMAN RIGHTS.

This was why, Senator Long, it was so cruel and unchivalrous of you to poke fun at so many deserving, respectable unmarried women by saying "In my state, that kind of relationship is recognized as a situation in which two people have 'took up'. The amendment would give better tax treatment for those who have just 'took up' than married people would receive under the law." (TIME Magazine, Feb. 14, 1964).

Split Income for married persons serves as an incentive for marriage. Heterosexual unmarried women desire marriage, love and companionship with heterosexual unmarried men. They would gladly forego any tax break as an unmarried person. But the odds are against these women who are now over 35 years. WHY? Because of the 15,000,000 casualties in WW II and the foreign marriages, right and left, to our American men stationed in other countries. In Australia, alone, there has been an estimated 30,000 war brides, leaving 30,000 American women without husbands NOT TO MENTION THE OTHER COUNTRIES! And also because of the increased number of male homosexuals which further depletes the supply of available men.

This is why it is so shocking to see that the gracious Senator from Minnesota has introduced S. 2794, which would allow income-splitting for single people.

In the name of God, this must not be. This is destructive legislation. It tends to further ruin the chances of marriage for heterosexual women; it will condone and accept homosexuality, it will induce a greater degree of permissiveness. This is truly legislation without a conscience and is not in the best interests of a heterosexual society.

CERTAINLY, all unmarried persons deserve a tax break for fairness and equity of the law. This can be accomplished in the form of two $600 exemptions for those who maintain their own households, or even Head of Household legislation. It could also be accomplished by the tax rate changes for all unmarried persons. But surely, not split income!

1963 My income tax statement was filed IN PROTEST as Head of Household and then amended to include my apartment rent as a tax deduction because I discovered that I was taxed without being represented.

1964 November: a refund check in the amount of $238.39 was mailed to me in error by the Internal Revenue Service.

1965 January: Single Persons Tax Reform, a volunteer national service organization, was organized, duly registered in Washington, D.C. under Federal Regulation.

1966 February 14: 20,000 signatures from all parts of the country on PETITIONS for Head of Household, were compiled in San Francisco and forwarded to President Johnson.

1966 November: Dorothy Shinder vs. Commissioner of Internal Revenue, No. 21942 was heard and the Tax Court said "Congress was the proper forum."

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1967 April 19: The San Francisco Tea Party (reenacting the Boston Tea Party) was staged in the San Francisco Bay by "Single Persons Tax Reform" and "Our Homes are Rented Apartments" because of taxation without representation, and denial of the Right to be Heard.

1968 April: I went to Washington asking for tax reform hearings and had as many as 9 conferences a day with legislators and/or their representatives.

1968 U.S.Court of Appeals ignored its own Rule 39, 28 U.S.C. 455, which is "Substantial Interest", which indicated the opinion was with bias and prejudice, and denying me my due process of law.

1969 March 3: delivered statement on tax reform before Committee on Ways and Means, U.S. House of Representatives on "The Rape of Single Women by our Government" and pointed out the existence of WAR SINGLES (not War Widows) and on Single Persons Tax Reform.

1969 May: "WAR SINGLES (not War Widows)" organized, a national volunteer service organization, affiliated with Single Persons Tax Reform.

This is my third appearance in Washington, D.C. for tax reform. We have worked for 7 long years to get positive corrective action for tax reform. What does it take to get this through to you? We have conducted ourselves in an orderly and lawful manner despite suffering injustice upon injustice. Injustice breeds hate, hate erupts into violence. Must we, as so many others have done, resort to violence to be recognized?

It is a well known fact that there has been much conflict of interest (serving themselves) among public officials. The President of the United States has seen fit to disclose his financial statement. The Judges through the Federal Courts have been asked for this same disclosure.

The time has now come to invoke the 9th and 10th amendments to the Constitution of the United States, which when properly interpreted, mean, when those in public office indulge in questionable practices, we, the people, have the "Right to Know". Therefore with due regard and complete respect for the individuals and offices concerned, it is respectfully requested that all Senators and Congressmen and Cabinet Members of the United States make known their financial statements, thereby disclosing their wealth, and the amount of tax they pay thereon. This must be done to preserve the national security of our country, revive the faith and confidence in our government, and put our public officials back on the right track.

In addition, before our country becomes a church state, which can ultimately destroy the principles of our government, the financial statements of all establishments of religion (some of which are corporations) and the amount of tax paid thereon, should also be made known to the general public. (XVI Amend)

Gracious Senators, the time is now past for recriminations. Is it not time to make amends? To make it up to us? You have the glorious opportunity of setting a precedent for the entire world by recognizing the plight of WAR SINGLES and other unmarried persons.

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S T A T E M E N T

WAR SINGLES are over-35 heterosexual single, or briefly married women, whose chances of marriage or remarriage were spoiled by the wars. War Singles have worked in respectable jobs for 20 years or more, all the while paying the highest rate of income tax with very little, if any, exemptions. They have provided for themselves, been their own wage-earners and have assumed the entire economic burden and responsibility of maintaining their own households, where they live.

WAR SINGLES are as much an after effect of war as are War Widows, who receive compensation.

WAR SINGLES deserve War Reparations in the amount of $35,000 plus interest. This would be barely comparable to what War Widows have received. The Government took the men, sent them to wars, then actually punished the War Singles for not having husbands; humiliated them, took everything from them, and not only did it give them nothing in return, but made them pay, and pay more than their share, at that, draining their incomes and their Human Rights.

FAVORITISM GIVEN WOMEN WHO SERVE HUSBANDS -- Because we are in a male-dominated, family-oriented society, there is far too much favoritism given the women who serve husbands--this cruelly discriminates against War Singles. Though all benefits are based on the wife depending upon the husband for support, no thought has ever been given to the War Single who depends upon herself for her own support.

WAR SINGLES WORK AS LONG AS MEN -- Our laws- the social security and the tax laws are based on the erroneous assumption that women do not work as long as men, and that only the men are the providers--the wage-earners. This is a fallacy. War Singles living alone have been self-supporting and their own wage-earner-providers for as many as 20-30-40-50 years. Thus, if the government has assumed this premise, and it is false, then it is up to these men (the majority of legislators are male) to make amends and correct the wrongs.

MILLIONS MORE UNMARRIED WOMEN THAN MEN - AND WHY? In 1940 these women were full of promise. Suddenly, World War II. The men had gone off to war. 15,000,000 men were battle casualties; this meant 15,000,000 women were bereft of mates. In the United States alone, there were 300,000 casualties. It was only natural that foreign marriages became commonplace. The women were there - the men were ready. The women here too were ready -- the best years of their lives -- but to marry ghosts was not an "in" thing. Australia alone supplied an estimated 30,000 wives to our American GIs. Thus, there are now approximately 13,000,000 unmarried women as compared to 6,000,000 unmarried men over 35 years of age. An aftermath of War! In addition, the ever-increasing number of male homosexuals has further depleted the supply of available husbands. In San Francisco alone they are a reputed 80,000 strong. And more's the pity, when so many are so handsome - what a waste. For every two men who "go together" there are two of us heterosexual women who are left without husbands. This has a devastating, frustrating and demoralizing effect on the unmarried heterosexual women.

WAR WIDOWS -- As far back as the Spanish American War, the widows of veterans received a Dependency Indemnity Compensation, wherein the government pays them for the loss of their providers. This was an effort to "make it up to them." An estimated 117,891 widows received this benefit, but as of 1966, 87,000 were discontinued because of remarriages and the figure dropped to 30,891. The monthly compensation is $4,854,000; or averaging $157.00 per month, each. Since

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1963, the benefits were increased to a minimum of $131 and upwards, per month, depending upon the rank of the deceased husband, and are PAID REGARDLESS OF THE INCOME OF THE WIDOW! Since 1945, each has received approximately between $31,200 and $37,000. All Tax Exempt!

WAR SINGLES DEPRIVED -- But what about the War Singles? Haven't they suffered an even greater loss? As of 1967, there were 2,721,000 single women over the age of 35. Their "would be" husbands were taken from them before they even had a chance to marry and derive a little happiness. Yes, these women were deprived of the love, security, companionship and family which marriage would have brought to them. They will never have the aid and comfort of children in their old age and have suffered emotionally, socially, economically, physically, biologically and financially. Nothing can ever really replace these losses. To add insult to injury, these American women were not only left without husbands to depend on for love and companionship as well as support, but were forced to pay higher taxes - which frequently went for the benefits paid to foreign born widows who had married their American men.

HUMAN RIGHTS -- Despite all this deprivation, the government actually punished these women for remaining single. Our government and society sits in judgment of War Singles when it was the government itself which was responsible for cutting off the male supply. Their equal opportunity for marriage and leading a normal life, their HUMAN RIGHT was taken from them. Yet the Human Rights Commission has failed to include them. In San Francisco there is not a War Single on its Commission. The possibility of marriage decreases as a person grows older - especially for women. Medical authorities claim it is dangerous for a woman to bear a first child after the age of 35; and an older woman is not as flexible as a younger woman and requires more privacy.

THE GOVERNMENT LOOKED THE OTHER WAY -- And what did the government do about it? NOTHING! The statistics were available. These War Singles have been punished unjustly for a situation over which they had no control. They were forced to get out and support themselves. The jobs available to women were low salaried and the income was needed to live on with very little, if any, left for investment, which in turn would have provided tax deductions, which in turn would have lowered their income taxes, which in turn would have made it possible to make adequate provisions for old age as do the men with higher salaries. Thus, without deductions, a straight high tax was paid. Example: In the year 1962 on a salary of $4548., the income tax was $703 leaving $320 per month to live on. (A working WAR WIDOW receiving approximately $157 tax exempt would have $477). In the year 1963 on a salary of $4,868 the tax was $939.12, or $327 per month (a working WAR WIDOW would receive approximately $484) per month to provide for rent, food, clothes, insurance, recreation, upkeep, dental and medical expense, utilities, vacation, miscellaneous. While the married woman's husband was in the enviable position of receiving great benefits for deductions, it was primarily the unmarried women, because of their sheer numbers, who were paying for the rearing of families. The income of War Singles have been drained over the years because they had no deductions or benefits, thus they suffered a wage loss, which when multiplied over a period of 20 years or more, amounts to many thousands of dollars plus interest, which is pure plunder-- yes, indeed, they do have a justifiable grievance against the government! They have a rightful claim and deserve every consideration. While these trusting women relied with faith and confidence on the men in government, these same men manouvered it so that the tax money extracted from them was being used against them. Instead of giving them the benefits which they so richly deserve, and for which they have paid manyfold. The War Single has been forsaken long enough. If society is working towards a goal of permitting each woman to find herself, then society and the government must turn back the clock and return the men taken from these women. If this cannot be done, then it must make amends to those who have suffered great loss.

2.

RECOMMENDATION -- It is recommended that these War Singles receive the sum of $35,000, plus interest, IN REPARATIONS for having been deprived of their HUMAN RIGHTS, for mental cruelty and the grievous suffering emotionally, socially, economically, physically, biologically and financially, because they also had no provider - lost a provider and husband, and were in a SIMILAR SITUATION as a War Widow. This is a glorious opportunity for you gracious gentlemen to set a precedent for the entire world. (The Doctrine of Equality of Treatment to Taxpayers Similarly Situated).

DISCRIMINATION AGAINST WAR SINGLES NON-PROPERTY OWNERS -- Thus, these War Singles migrating to the bit cities for their jobs, working for years on low salaried jobs, while paying the highest rates of taxes, could not even afford to purchase a home because of discriminatory stringent loan relations, or because there was no need for this, and ended up living in apartments which were THEIR HOMES. Yet the government, without compunction, used War Singles' tax money for redevelopment and then turned around and said because you don't own property, you don't count.. and these helpless women were forced to clean their apartment-homes at their own expense without being able to deduct for these expenses. Because there were no guidelines to protect these apartment HOMERENTERS, they were constantly hounded with unjustified rent increases and evictions through unfair practices, at great expense which affected their health and welfare, all due to CONFLICT OF INTEREST OF GOVERNMENT OFFICIALS who owned apartment buildings. Conflict of interest means the men in government cannot serve two masters; they are supposed to serve the people and not make laws to use the people's income tax money or their influence for themselves.

RECOMMENDATION -- a. TAX DEDUCTIBLE RENTS because their apartments are their homes and their property taxes are paid through their rents, which they have never been allowed to deduct because our country still has the Old English Property Laws (which England itself no longer has) and which is UNAmerican and UNconstitutional. Their situation would then be similar to homeowners who can deduct their interest and taxes while enjoying the developing of an equity, which a renter cannot do. Landlords have been receiving far too much favoritism -- example an owner of both an office building and an apartment building can deduct depreciation and expenses, but it is only THE OFFICE RENTERS and not the HOME RENTERS who can deduct expenses. It was never the intent of the 1913 16th Amendment to the Constitution to permit "lording" it over a Homerenter. b. For War Single Homeowners: Tax deductible depreciation and expenses yearly because THEY PAY THE SAME RATE OF PROPERTY TAX as do income property owners.

MEDI-CAL DISCRIMINATES AGAINST WAR SINGLES -- Yet, if these respectable, deserving taxpayers of long standing, these war singles working women become ill in the State of California, Medi-Cal discriminates against them because they do not OWN but pay rent for their home. A widow, who has been sheltered and provided for by a husband, or an individual with a private home valued at $25,000, plus $5,000 in real property, plus $1,500 in fluid cash, or a wealth of $31,500, would be eligible. However, a War Single through aforementioned circumstances, with no wealth except possibly a couple of thousand dollars scraped together from her meager earnings intended for her old age, whose apartment has not been recognized as her home, must first be reduced to a minimum of $1,500 IN CASH WEALTH, as compared to a property owner widow or other individual with <u>$31,500 in wealth</u>. This, despite the fact that these single women have been paying the highest rate of income tax for 10-20-30-40 years.

3.

RECOMMENDATION -- It is recommended that apartments be recognized as homes for these War Singles, which they are; therefore a Homerenter would be in the SIMILAR SITUATION as a Homeowner. It is further recommended that the actual WEALTH of both a property owner and a non-property owner be taken into consideration before allowing this discriminating practice to continue.

SOCIAL SECURITY AS AFFECTING WAR SINGLES -- Social Security is an insurance policy which when paid up in full, that is, the necessary quarters, is supposed to give FULL BENEFITS. Congress thought that the monthly benefit built up over a woman worker's lifetime would be enough to provide security for her. This assumption was based on the theory that she lived with relatives or shared. But she didn't, as pointed out in previous paragraphs, but instead maintained her own dwelling - household for years, thus incurring the same initial expense as does a widow in the same kind of household. The basic purpose of social security is to provide protection for the individual and the home. SINCE THIS PROGRAM IS DETERMINED ON NEED AND NOT BASED ON ACTUAL CONTRIBUTIONS TO THE SYSTEM, why should a widow receive more than a War Single, when they both have the same basic household expenses? Or the average monthly retirement benefits be lower than that of a widow? Or why should widows be eligible for social security benefits at age 60 and not the War Single working woman? Especially since the War Single has DONE HER OWN CONTRIBUTING??? Fair? Absolutely not! It is the War Single who has the least protection under public programs; it is the widow who receives protection under group life insurance or other types of husband's insurance.

INTENSIFICATION OF DISCRIMINATION AGAINST WAR SINGLES -- It is intensified for a War Single who out of her meager salary, pays the same rate of tax, receiving only the basic retirement benefits, while married workers not only receive this benefit but also dependents receive additional benefits. These benefits were designed to prevent workers from becoming dependent when the breadwinner retires, thus an individual's security grows out of their own work. WHAT ABOUT THE WAR SINGLES SECURITY when she has been her own breadwinner all of her working adult life???

RECOMMENDATION -- If the original intent and purpose of the social security laws is to be adhered to, then social security benefits should be immediately provided to a self-supporting wage-earner-provider War Single in LIKE AMOUNT AS TO A WIDOW -- their costs OF LIVING ARE THE SAME -- their situations are the same.

SOCIAL SECURITY DISABILITY DISCRIMINATION AGAINST WAR SINGLES -- War Singles work for 20-30 and more years and are their own wage-earner providers. They acquire their own necessary quarters to qualify for Social Security benefits. However the 1967 Amendment grossly discriminates against them! This amendment is based on the false assumption that only widows and certain divorcees depend on a wage-earner-provider, i.e., their husbands. War Singles have no husbands and when they cannot work as a result of a disability, they lose their wage-earner-provider, (themselves). Whe a spouse with the necessary quarters, REGARDLESS OF WHEN THEY WERE ACQUIRED, becomes deceased, the disabled widow and certain divorcees automatically become eligible for disability benefits, yet the provisions of necessary quarters REGARDLESS OF WHEN THEY WERE ACQUIRED, do not apply to War Singles.

RECOMMENDATION -- Social Security laws should be amended so that qualified self-supporting wage-earner providers, the War Singles, can also RECEIVE disability benefits REGARDLESS OF WHEN THE NECESSARY QUARTERS HAVE BEEN ACQUIRED, and receive the same treatment as women who have served husbands, under the DOCTRINE OF EQUALITY OF TREATMENT TO TAXPAYERS SIMILARLY SITUATED.

4.

SURVIVOR BENEFITS -- 4,544,785 receive survivors benefits, but even though War Singles have the necessary quarters for Social Security, they are never eligible for this benefit. And, if they become deceased before retirement, they receive nothing except $255 burial expense and LOSE EVERYTHING ELSE, plus interest. When women come to work for the State of California, after having completed their necessary 88 quarters in private industry, WHICH ALREADY INCLUDES ONE SURVIVOR BENEFIT PLAY, they are again FORCED to pay for another survivor benefit EVEN THOUGH THEY WILL NEVER USE EITHER ONE.

RECOMMENDATION --It is recommended that War Singles be given comparable benefits to compensate for not having any survivors -- a bequest to a beneficiary, for the sake of justice and equality.

THE ADVISORY COMMISSION ON THE STATUS OF WOMEN -- When the President's Commission on the Status of Women was formed in 1961, it was with the intention of doing away with the "prejudices and outmoded customs which act as barriers to the full realization of women's basic rights which should be respected and fostered as part of our nation's commitment to human dignity, freedom and democracy." To this effect, the California Advisory Commission on the Status of Women was created in 1965, to look into "The effect of social attitudes and pressures and economic considerations in shaping the roles to be assumed by women inthe society." There was not a one War Single on it! It is absolutely shocking, that by their many omissions, the reports rendered have themselves discriminated against and excluded the War Singles. Instead the reports were completely enamored with wives, dependents, widows, survivors. The needs, the pressures and emotional voids of War Singles were completely overlooked.

WHY A WAR SINGLE WORKS -- What with 57% of married women in the working field, we have drifted into a double and triple income economy. With an oversupply of employable women over 40, this has a disastrous effect on the War Single by holding the salaries down. The War Single works because she is forced to be her own provider and needs the income to LIVE ON, not because she wants to get out of the house, or for a change of scenery, or a lark, or something different to do. She is not as fortunate as the married woman entering into the business world for what is called a "second career" opportunity. It is a new life for the married woman, but for the War Single it is a continuation of the old life, thus there has been no equal opportunity.

Doctors prescribe a change for married women when they go through menopause. What about a change for the War Singles who also go through this period, and alone at that. They do not have the warmth and security and love of a husband and a family to help tide them through the rough spots. If there is a new life for the married woman, there should also be one for the War Single. She should also have a change. If the married women have two incomes, that is, the support of a working husband, and can work whenever they wish, then shouldn't these War Singles receive relief in kind? They deserve it after having paid more than their share of taxes for so many years.

RECOMMENDATION -- It is recommended that War Singles, that is, women who have worked for 20 years or more, acquired the necessary quarters in social security, regardless of when acquired, have been their sole provider-wage-earner, have assumed the entire responsibility of maintaining their own household, their dwelling where they live, and have reached the age of 50 years be permitted: Full retirement, Social Security benefits, and in addition, be permitted to work whenever they wish and for unlimited income.

5.

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Not only would this partially make amends for all the past sufferings and multiple injustices inflicted on these innocent, helpless women - and give them some semblance of security and peace of mind, but would also create openings in the labor market for the unemployed and evergrowing youth.

TAX INEQUITY FOR UNMARRIED PERSONS WHO HEAD THEIR OWN HOUSEHOLDS:

SPLIT INCOME -- The 1948 Amendment to the Internal Revenue Code gave a benefit to married persons by allowing the "split income". It was designed to EQUALIZE the tax treatment of married couples residing in community property states and in non-community property states. Also, at this time, two $600 exemptions were allowed for over 65 years, REGARDLESS OF INCOME. The rationale being that those over 65 have a DECREASED earning power, but greater expenses, such as medical expenses.

MEDI-CARE -- Medi-Care now takes care of medical expenses for over 65s. Still, millionaires and other wealthy persons are presently benefiting not only from the double exemption, but ALSO QUALIFY for Medicare which defeats the original intent and purpose of this legislation.

RECOMMENDATION -- If the rationale is based on a decreased earning power, there should be a "means" gauge to be eligible for this benefit, and the tax saving could be applied towards a more equitable tax for the unmarried persons.

HEAD OF HOUSEHOLD -- In 1951, special "Head of Household" rates were added to the Internal Revenue Code as an extension of the split-income benefit...the rationale being to give a portion of the split income benefit to taxpayers who maintain households for dependents, because, in effect, they SHARE INCOME with the person for whom the household is maintained, in a manner SIMILAR to the way a husband shares his income with his wife. The Internal Revenue Code, Sec. 1, reads in part "an individual shall be considered as maintaining a household only if OVER HALF of the cost of maintaining the household during the taxable year is furnished by such individuals." (emphasis added)

It was believed that TAXPAYERS NOT HAVING SPOUSES BUT NEVERTHELESS REQUIRED TO MAINTAIN A HOUSEHOLD (HOME,DWELLING) ARE IN A SOMEWHAT SIMILAR POSITION TO MARRIED COUPLES who share their incomes, thus INCURRING EXTRA EXPENSE. It should be noted that these benefit provisions are because the recipients MAINTAIN AHOME (DWELLING) AND INCUR EXTRA EXPENSE (plus two $600 exemptions).

UNMARRIED PERSONS IGNORED -- However the Code NEVER MENTIONS an individual whose <u>entire</u> cost of maintaining the household during the taxable year is furnished by <u>ONE</u> individual. No thought was given to EQUALIZING the benefits for unmarried persons. The assumption here being that these persons either lived with parents or other persons and SHARED THE EXPENSES of a household. THIS IS NOT TRUE. It has become the custom for millions of Americans to live alone.

HEAD OF HOUSEHOLD PROPERLY DEFINED -- As applied by the IRS, the term "Head of Household" is a misnomer. A household is a dwelling, regardless of the number of people who LIVE IN IT. At issue here is a HOUSEHOLD, a dwelling and the cost involved in maintaining it regardless of the number of occupants. A married couple live only 1-1/3rd times as expensively as one person, and a family of four generally lives <u>on only twice</u> the average budget of a single person.

6.

An individual living alone bears the complete responsibility, the financial burden, visually and socially. This consists of rent, property taxes, food, utilities, taxes, clothes, insurance, medical bills, car expenses, gasoline, laundry, recreation; the very same basic items as a married couple. Thus the FIXED COSTS for an unmarried householder and a married couple or a family of four are known to be comparable, even identical.

Surely, this gracious Committee and the Congress can recognize the difference between one type of unmarried person who DOES NOT MAINTAIN A HOME but lives with parents or others, and thus DOES NOT INCUR EXTRA EXPENSE, and the other type of unmarried person WHO IS REQUIRED TO MAINTAIN A HOME AND DOES INCUR EXTRA EXPENSE.

THE DOCTRINE OF EQUALITY OF TREATMENT TO TAXPAYERS SIMILARLY SITUATED -- Under this doctrine, unmarried head of householders should receive equal tax treatment accorded others in similar situations, under the equal protection of the tax laws, under the XIVth Amendment.

The Congress has made adjustments for married persons and head of households (as defined by the IRS) because they were both in SIMILAR SITUATIONS, that is, HAD EXTRA EXPENSE. Unmarried Heads of Households also HAVE EXTRA EXPENSE as compared to unmarried persons who share, thus this is a SIMILAR SITUATION to the married persons and the present IRS Head of Householders.

The following is an equal Tax exemption (without the Unmarried Person)

UNMARRIED w/DEPENDENT	HUSBAND,WIFE	UNMARRIED,FATHER,MOTHER	UNMARRIED, LVG.ALONE
$600 $600	$600 $600	$600 $600 $600	$600
Exemptions PLUS Head of Household	Exemptions PLUS Split Income	Exemptions PLUS Sharing Expense	Exemption PLUS N O T H I N G!

RECOMMENDATION -- It is recommended that two $600 exemptions as is allowed in the above cases also be enjoyed by the unmarried householders over 35 years of age. It would be a matter of equity for all. It would be a tax exemption benefit equitable to what the others receive in similar situations, regardless of income. Not only would it cost the government less, but those who need it the most would receive a greater benefit and more spending power, which they need so badly. The saving is substantial for those with high incomes, who are also in a position TO INVEST FOR TAX DEDUCTIONS but the lower income person needs all his money, all his income to LIVE ON.

INCOME	PRESENT TAX One $600 Exemption	PROPOSED TAX Two $600 + Exemption	SAVING
$ 5,000	$ 667	$ 553	$ 114
$ 50,000	$ 21,630	$ 21,270	$ 360

Note two $600 exemptions would make it an EQUAL TAX EXEMPTION BENEFIT for all incomes, which actually lowers the cost to government and gives a substantial benefit to the lower and also higher income.

Straight "Head of Household" legislation benefits the rich-higher incomes! It would allow the $5,000 income only approximately $55 as compared to $114 through two $600 exemptions. It must be kept in mind that the lower salary CANNOT AFFORD tax exemptions, while higher incomes can invest.

7.

Corothy Shinder vs. Commissioner of Internal Revenue No 21, 942

In the case of DOROTHY SHINDER vs COMMISSIONER OF INTERNAL REVENUE, No. 21942, APPEARED AS COUNSEL FOR HERSELF. Although she was well aware of the existing laws, the purpose and intent of her action before the U.S. Court of Appeals for the 9th Circuit was to obtain a JUDICIAL OPINION. Petitioner respectfully suggests that a just opinion has not been rendered and that the opinion and decision does not follow the Court's own Federal Rule of Civil Procedure Rule 39, 28 U.S.C. 455, "substantial interest", and that the District Court's WITHHOLCING OF INFORMATION CONSTITUTES A DENIAL of her constitutional rights and power.

Petitioner states in her petition for a rehearing: "When there is cause to believe that there is no check and balance between the legislative, executive and judicial departments of our government, then it is incumbent on the people to check and balance those in government who are suspect. Petitioner, a citizen and taxpayer, is one of the people, and has retained the 'Right to Know' and the power reserved to her, to be informed of any questionable 'Substantial interest' of any one in public office. (The enumeration in the Constitution, of certain rights, shall not be construed to deny...others (rights) retained by the people.' U.S. Const., IX Amend.) ('The powers not delegated to the United States by the Constitution...are reserved...to the people.' U.S. Const., X Amend.) (emphasis added).

"Thus, when those who preside over the Court, place themselves above and beyond the law, this, in effect, deprives Petitioner of her liberty, of her right to effectually share and conduct her government and in her equality before the court. In essense Petitioner is deprived of her due process of law. (U.S. Const. V and XIV Amend.)

The Court's opinion states, in part, 'The classifications of the law that adversely affect petitioner are within the range of classification that traditionally have been held constitutional.' The Court's use of the word "traditionall" perpetuates the oral transmission of beliefs from ancestors who had no written memorials and harks back to biblical times and the dark ages. While we live in the present the Courts cling to the past.

"And the Court's ruling on 'constitutional' is purely a matter of interpretation, which can be influenced by "substantial interest" reasoning. It appears a matter of bias and prejudice that the Court, in rendering its opinion, has not used an open mind, and has totally ignored the original intent and purpose of our Constitution which is a WRITTEN MEMORIAL (replacing any non-written memorials) with built-in guidelines, when interpreted with an open mind, to serve and protect Petitioner, as well as members of the Court.

THE OPINION OF THE COURT WITH REGARD TO THE NEED OF MONEY FOR GOVERNMENT DISREGARDS THE WANTON WASTE, SQUANDERING, AND ABUSE OF PETITIONER'S TAX PAYMENTS, AND THE CORRUPTION OF MEMBERS OF OUR GOVERNMENT.

"In its opinion, the Court states 'As the tax court said, and we must say, this unfortunate woman can only hope for relief from the legislative branch of the government. And, on her facts, it may be a slim hope, given today the government's ever increasing need for money.'

NEED FOR MONEY FOR WHOM?? Petitioner at this time would like to point out and query how many Senators like Senator Eastland are ACTUALLY RECEIVING Petitioner's tax money and approximately $167,000 per year for farm subsidy when the intent and purpose of that legislation was to aid the small farmers? Or, how many judges like Judge Fitzgerald Ames of San Francisco ACTUALLY RECEIVED nearly

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$50,000 of petitioner's tax money, on speculation on redevelopment property in San Francisco when there should have been REGULATION. Or, Federal Judge Alphonse Zirpoli, and perhaps others, merrily profiteering with Petitioner's tax money? Or how many Senators like Senator Allen Ellender actually receiving Petitioner's tax money for his personal hobby of movie-making. And why did the House of Representatives actually authorize MORE BILLIONS OF DOLLARS THAN WAS NECESSARY FOR DEFENSE?

"Surely the Court can readily see that actions of these and other public officials reflect on the integrity of all, which is destructive to our government, and tears down OTHER KINDS OF LAW AND ORDER." Witness the rioting!

AND WHERE WILL THE MONEY COME FROM -- The answer is easy. Plugging up the existing loopholes.

1. War Singles REPARATIONS can come out of the Billions appropriated for Defense.
2. Tax Exempt Foundations which have become distorted into loopholes for tax avoidance, so that others have to pick up the tab.
3. 27½% Oil Depletion allowances could be permitted to recover the original cost of risk.
4. Real Estate Loopholes.
5. Church Businesses. Why does Congress constantly veer from the subject of taxing wealthy churches? The First Amendment to our Constitution states in part: "The Congress shall make no law regarding an establishment of religion." There is NOTHING, however, which states that Congress shall make no law regarding an establishment of business.

It is a well known fact that the establishments of religion are now in businesses, even corporations, yet escape the 52% Corporation Tax - Corporations reveal their financial statements, shouldn't religious establishments do the same?

It has been said that if one church alone paid its share of tax, it would amount to approximately $300,000,000 in revenue to our treasury. Coincidentally, that is the same amount that Senator Anderson of New Mexico stated it would take to give Unmarried Persons a FAIR TAX.

THERE IS A GREAT DANGER that if present practices continue, with land and properties being bequeathed to Churches, our country in a matter of 50 or 75 years could become a Church State.

Will history repeat itself, as in the French Refolution, wherein the Church owned 3/4ths of the land; the Nobles 1/4th, and the people were heavily taxed, as they are today in this country.

NOW IS THE TIME for men of vision to take action to prevent any future holocaust.

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STATEMENT OF RICHARD W. EDWARDS, JR. ON
THE TAX REFORM ACT OF 1969 (H.R. 13270)

(Statement before the Committee on Finance,
United States Senate, September 8, 1969)

My name is Richard W. Edwards, Jr. I am a resident of the District of Columbia. I wish to express my appreciation for the opportunity to testify. I speak as an individual citizen. I represent no organization. I have been permitted to testify on two points: (1) the low-income allowance, and (2) the establishment of a class of "intermediate tax rate individuals." I shall speak on the latter point first.

Intermediate Tax Rate Individuals

Sections 803 and 804 of H.R. 13270 establish special lower tax rates for single persons over the age of thirty-five and widows and widowers. *If* special rates are to be given to "intermediate tax rate individuals," the rates should also be made available to married persons over age 35 who elect to file separate returns. One way to accomplish this purpose would be to draft the definition in amended Section 1(b)(2) of the Internal Revenue Code to read as follows (changes from H.R. 13270 in italics):

"(2) DEFINITION OF INTERMEDIATE TAX RATE INDIVIDUAL. - For purposes of this subtitle, an individual is an inter-

mediate tax rate individual if, and only if, such individual is not married at the close of his taxable year, *or if married does not file a joint return with his spouse;* is not a surviving spouse (as defined in section 2(b))*;* and - . . . ."

The purpose of the proposed change is to alleviate the discrimination against married persons that would otherwise result. Let me demonstrate. [A blackboard will be used if available.]

Example No. 1:

Suppose a single man over age 35 has a net taxable income of $8,000 and a single woman has a net taxable income of $4,000. The man's tax for 1971, using the 1971 rates in the bill, would be $1,460. The woman's tax would be $640. The total is $2,100.

Now suppose these same persons were married. Their total taxable income would be $12,000. Applying 1971 regular rates to a joint return, their tax would be calculated as follows: They would divide the $12,000 by 2. The tax on $6,000 would be $1,100 which in turn would be multiplied by 2 giving $2,200. Their tax if married would thus be $100 more than if they were single.

I have used proposed 1971 rates in this and the following examples because they are easier to use in making calculations. The discrimination would actually be more striking if the higher 1970 rates together with a surtax were used.

Example No. 2:

The discrimination is greatest when the incomes of the man and the woman are equal, and applies even in relatively low brackets. Suppose the man and woman each have a taxable in-

come of $6,000. For 1971 they would each pay a tax of $1,030, or a total of $2,060, if single. If they were married and filed a joint return the tax would be $2,200; or $140 more.

Example No. 3:

The "price for wearing a ring" gets higher as the incomes go up. Suppose the man has a taxable income of $16,000 and the woman a taxable income of $12,000. As single individuals the total tax would be $6,170 ($3,690 plus $2,480). As a married couple the tax would be $6,900; $730 more.

Example No. 4:

One final example: A man and a woman with high taxable incomes of $20,000 a year each. The "cost of the ring" to them is $1,640 a year at 1971 tax rates. (If they were single their total tax would be $10,160; if married and filing a joint return it would be $11,800.)

Discussion:

As demonstrated by the examples, Sections 803 and 804 of H.R. 13270, as presently drafted, discriminate against married persons where both have income. Only in cases where one marriage partner has no income or the taxable income is less than one-fourth of the taxable income of the other partner (the exact proportion may vary slightly) is there no discrimination.

The amendment which I suggested at the beginning of my statement will alleviate the discrimination by permitting married persons over 35 years of age to file separate returns as "intermediate tax rate individuals."

Alternate Proposal:

Another alternative, and in my view a better one, would be to delete Section 803 from the bill and make corresponding changes in Section 804(b) to make those rates only applicable to heads of households. The novel provisions for "intermediate tax rate individuals" have no solid rationale.

The present provisions of the Internal Revenue Code permitting married persons to share their income and deductions on a fifty-fifty basis make sense. The theory is that in the maritial partnership income and expenditures may be so comingled that it does not make sense to require that they be segregated between marriage partners. The provisions for sharing income and expenditures, the so-called "split income" provisions, do not represent any special concession at least for families where both marriage partners work or have income -- a common, not a rare, occurrence. (Department of Labor statistics show that in March 1967 12,278,000 married women in the age range 35 through 64 were in the labor force. This was 39.8% of married women in that age range.*) Even if one of the marriage partners has no income, at least the *couple's income is "split" between two real human beings*.

In 1951 a fiction was introduced into the Internal Revenue Code. Special rates were established for "heads of households." The idea was that a widow with children to support was entitled to a fictional "half a husband." This was based on the premise that the same or less income must support almost the same family.

* The figures were calculated from the statistics in Table B on page A-6 of "Marital and Family Characteristics of Workers, March 1967", Special Labor Force Report No. 94, United States Department of Labor.

Now with the terms of H.R. 13270 establishing "intermediate tax rate individuals", we are completely in the realm of fiction; the original principle of income and expense sharing between husband and wife has been lost. The effect of the new rules, as demonstrated above, is to penalize married couples where each partner has income. They would be far better off to pretend that they were single.

Finally, why favor persons over 35? My personal observation is that persons under 35 have a harder time living on their incomes. The only thing that I can see is that persons over 35 earn more and the progressive tax rates "bite" harder. If this is the problem, it should be corrected by reducing the steepness of the progression of the basic rates (which the bill also does), not by creating a class of privileged persons.

Low Income Allowance -- Proposal for Minimum Tax

Section 801 of H.R. 13270 provides for a low-income allowance which is in effect a larger standard deduction for persons with low incomes. The Committee on Ways and Means of the House of Representatives estimated that the provisions of Section 801 will remove 5.2 million taxpayers from the tax rolls in 1970 and an additional 600,000 taxpayers will become non-taxable in 1971. The Committee estimated that in 1971 38.1 million taxpayers will benefit to some degree from the low-income allowance.*

I have no quarrel with sharply reducing the taxes of low-income persons, particularly those who really live in or on the edge of poverty. I am not in a position to pass judgment on the

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* House Report No. 91-413 (Part 1), page 207.

exact formula incorporated into Section 801 and how effective it will be to "screen out" persons living at poverty levels. I do not question the formula.

My concern is a broad, indeed a philosophical, concern. Is not the obligation to pay taxes about as basic as the right to vote? Should not every adult citizen of our country have a responsibility to pay at least something toward the cost of the government from which he benefits? I believe it is unwise to say to millions of persons that they have no responsibility to financially support their government while they continue to have the right to receive government services. The removal of over five million persons from the tax rolls may increase the potential size of groups pressuring for larger government spending programs which they have no responsibility to finance.

If Section 801 is enacted in approximately its present form, I wish to suggest that a minimum tax be established which all adult citizens would be required to pay. The level might be set at $50 a year (less than $1 a week). The tax would be intended to preserve a principle, not to raise large amounts of revenue, although the revenue should be substantial since the number of taxpayers will be large.

The addition of a new subsection to Section 1 of the Internal Revenue Code would, I believe, accomplish the result. Its language might be as follows:

> "In the case of a taxable year beginning after December 31, 1969, there is hereby imposed on every individual who is a citizen of the United States of America, is over twenty-one years of age, and whose tax as determined in accordance with subsections (a), (b), and (c) is less than $50, an additional tax

which when combined with the tax as determined in accordance with subsections (a), (b), and (c) equals $50."*

I wish to thank you for the privilege of testifying here today.

* A provision to accomplish the same result would also be added to Section 3 of the Internal Revenue Code.