

[CONFIDENTIAL COMMITTEE PRINT]

WITHHOLDING TAX

HEARING

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON FINANCE UNITED STATES SENATE

SEVENTY-SEVENTH CONGRESS

SECOND SESSION

ON

DATA RELATIVE TO WITHHOLDING PROVISIONS OF THE 1942 REVENUE ACT

AUGUST 21 AND 22, 1942

Printed for the use of the Committee on Finance



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1942

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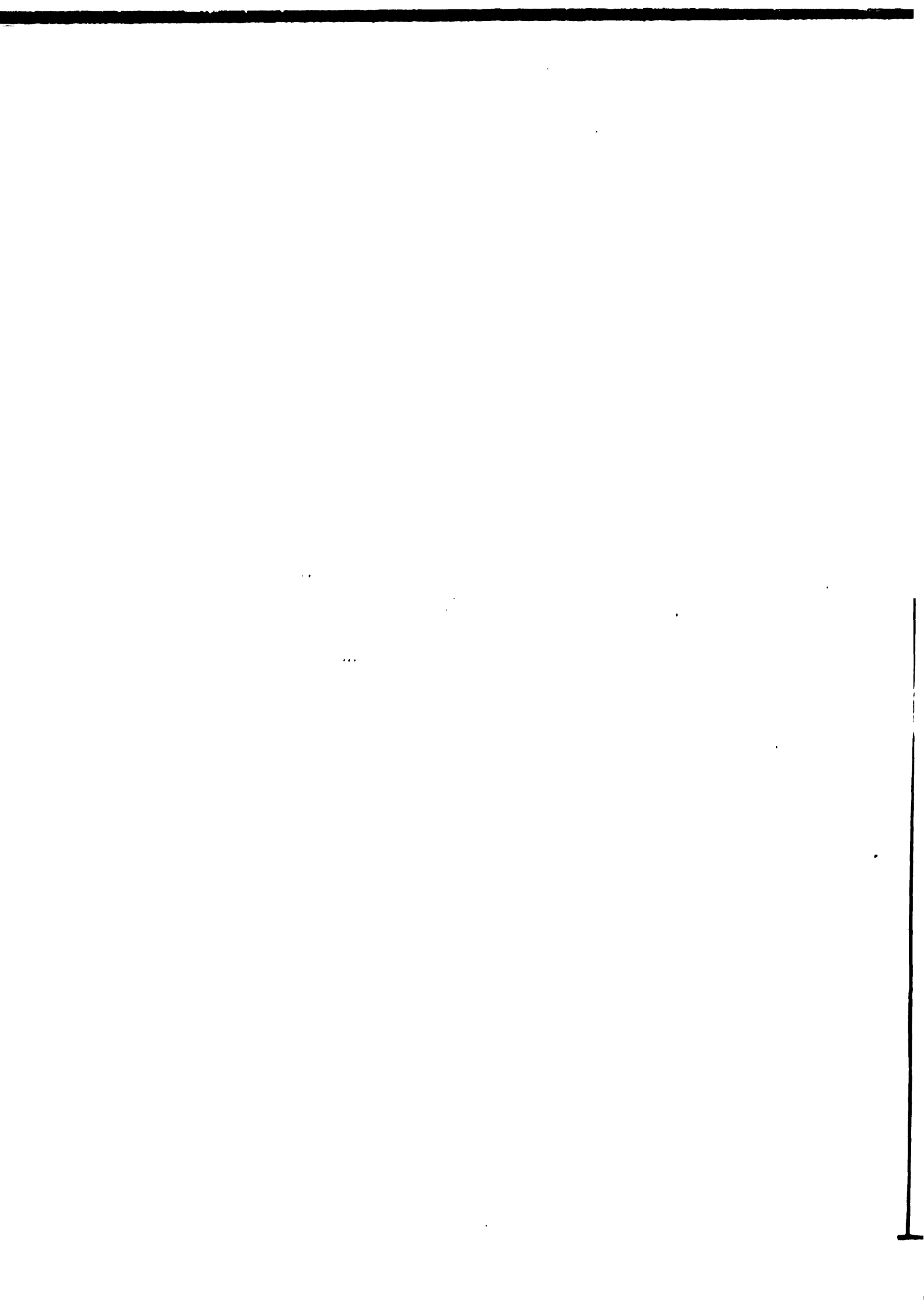
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DATA RELATIVE TO WITHHOLDING PROVISIONS OF 1942 REVENUE ACT

FRIDAY, AUGUST 21, 1942

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON FINANCE,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m., in room 312 Senate Office Building, Senator Bennett Champ Clark presiding.

Present: Senators Clark (presiding) and Danaher.

Senator CLARK. Dr. Jacobstein, will you identify yourself for the record, please.

STATEMENT OF MEYER JACOBSTEIN, OF BROOKINGS INSTITUTION

Mr. JACOBSTEIN. Meyer Jacobstein. On the staff of the Brookings Institution.

Senator CLARK. All right, Doctor, you may proceed.

Mr. JACOBSTEIN. Mr. Chairman, neither Dr. Hardy nor I have a written or prepared statement this morning.

Senator CLARK. We would be very glad indeed to have your oral statement.

Mr. JACOBSTEIN. We were called into this situation rather suddenly, as Senator Danaher knows, only yesterday for the first time. As the result of our very informal discussion yesterday it occurred to the Senator that such observations as we have made in connection with our other studies might be helpful to this committee, and I am very glad to be here to present those views. I would rather Dr. Hardy would discuss the technical aspects of the question raised by Senator Danaher, that is, the advisability of using the coupon system as a means of mopping up purchasing power. That is, I think, Senator, a correct statement, the use of the coupon system based upon purchases made by the consuming public. I would like to make a general statement and then turn the matter over to Dr. Hardy who is a tax expert, and I am not. I have studied the question in a general way.

It is obvious that it is necessary to mop up the excess purchasing power of the community, not only because of its effect on the price situation but because the Treasury needs the money and needs it quickly. Obviously if the Treasury can collect from the consumers as the purchases are made the Treasury has the use of those funds long before it would obtain them by the income-tax method.

Now, there are many ways, of course, of mopping up this surplus purchasing power. The income tax, unfortunately, does not reach

large groups of people. It does not reach the farming group, it does not reach the low-income group, and in many instance it does not reach even well-to-do people who live on capital and annuities of various kinds who do not come within certain income brackets.

Then, there is, of course, the sales tax as a method. We will not discuss that this morning, since apparently that is out of the picture for the moment, but that, from my standpoint, is a very effective way of mopping up some of this excess purchasing power.

Then, there is the withholding tax at the source based on pay rolls. Unfortunately, there again there are many people in this country who are not on pay rolls. The farmers are not on pay rolls. There are a great many people who get income from investments that are not on pay rolls, annuities, and what not. So, the pay roll as a means of reaching this excess purchasing power is not all-inclusive, it does not cover everybody.

If you want to mop up purchasing power the thing to do is to go after purchasing power. When a man buys anything that is the time to collect the money. In other words, consumption, as I see it, is a basis of reaching the widest number of people. In the Senator's memorandum, which I saw, consumption is advocated by the Senator as a basis of reaching the widest number of people in all groups, and it reaches everybody alike. That is, it reaches the farmer as well as the workingman who escape the payment of taxes today. That is, they earn too little to be reached by the income brackets, and in the case of the farmer, in most cases they are not reached at all.

Senator CLARK. Doctor, what this plan is, it is essentially a compulsory savings plan based on sales tax methods, is it not?

Mr. JACOBSTEIN. I should say that is a fair description of it, yes. It is the use of a sales tax method without being a tax.

Senator CLARK. So far as the impact on the public is concerned, it is precisely the same as a sales tax, except you give the money back sometimes.

Mr. JACOBSTEIN. That is right. That is a very fair statement, I think. Senator Danaher used the word "self-assessment." If I buy a dollar necktie I pay \$1.10 under his plan.

Senator CLARK. Of course, you do that with the sales tax, too.

Mr. JACOBSTEIN. You do that with the sales tax. I might say now, as I suggested yesterday, this suggested method lends itself to a combination of both, so when I pay 10 cents on the dollar for the necktie, I might get the 10 cents back at some future time by means of a coupon which is redeemable and exchangeable for some Government stamp or bond, or I might get back not the 10 cents but 5 cents, 5 cents being permanently held by the Treasury. So that this coupon method, as I see it, can be used as a withholding tax based on consumption, and may be combined along with a sales tax. You can do both things. The only difference here is that you are using consumption rather than the pay roll as the basis of collecting the tax, as distinguished from the withholding tax as generally and conventionally understood. A withholding tax is usually withheld at the source. Here you withhold it not at the manufacturer's end but at the retailer's end. You are using the retailer instead of the manufacturer to siphon off several billions of dollars, depending upon the rate of the assessment of a tax.

I think this coupon method ought to be discussed not as against any other system. It may be that several systems can be used. Any one of them might be very useful to the Treasury in accomplishing this purpose. But looking at the coupon system by and of itself, it seems to me that it is a workable method of reaching the largest number of people quickly, for siphoning off purchasing power into the Treasury from day to day, or week to week, or month to month; and it has that advantage.

Now, there is an aspect to this question which was not brought out in the original memorandum which would make the scheme perhaps a little more palatable if certain deductions were made by any method, either by the withholding tax method or direct sales tax method or by Senator Danaher's proposal, and that aspect of the question I will leave to Dr. Hardy to discuss. It is his original contribution.

I think that covers the general statement that I wish to make this morning, Mr. Chairman.

Now, I would like to ask Dr. Hardy to present his views, unless you want to ask some questions, Senator.

Senator DANAHER. Just one. It is a fair summary that as the result of such consideration as you and your colleague have given to the coupon method, it is a workable proposal irrespective of the question of policy involved?

Mr. JACOBSTEIN. That is right.

Senator DANAHER. All right.

Senator CLARK. Dr. Hardy, the committee would be very glad to hear from you.

STATEMENT OF CHARLES O. HARDY, OF BROOKINGS INSTITUTION

Mr. HARDY. First, just to avoid confusion, I notice that Dr. Jacobstein has used the word "coupon" where Senator Danaher has used the word "stamp." I prefer to use the word "stamp," because I am using the word "coupon" for another thing in the plan that I have been working on, namely, for the purpose of providing an exemption from the tax or forced loan, either one.

Now, as has been stated a moment ago, this is a forced loan, using the mechanism of the sales tax both for distributing the burden and for the mechanics of collection. It should be pointed out, I think, that you can do the same thing with the mechanics of any other tax; that is, under the income tax you can give out bonds or coupons redeemable in bonds instead of giving receipts for the income tax. You can do that, as far as I can see, with any tax, for the whole schedule of taxes.

I would like to say just a word on the result of doing it this way as compared with making it a tax and calling it a day. The basic necessity of running this system, either out of taxes or forced loans, one or the other, is simply, in effect, that we have to bring about a readjustment of consumption in the country to the amount of consumers' goods and services that we can spare the resources to produce under war conditions. First, we have got to devote our productive energies to the war. If we do not devote a large part of the purchasing power correspondingly to the war, then we have got the choice of either making the adjustment by an inflationary rise of prices, which is also a form of sales tax only it is paid to the dealer and producer

instead of being paid to the Government, or you can use the mechanism of the sales tax, as far as I can see, by mopping up the increased purchasing power that is created by the rising amount they receive in their pay checks.

If you do not do that, the only other alternative, as far as I can see, is the plan that the O. P. A. is working on now, holding down the prices while the incomes go up, and depending upon people to make a quasi-voluntary saving, because they haven't anything to spend the money on. The thing that bothers me about this program is the objection to carrying this principle too far in your fiscal system, the principle in Senator Danaher's statement. That is, when you do that either by forced savings, by the issue of stamps in lieu of tax receipts, or do it by the O. P. A. method of setting on a price lid and letting the incomes go out of alignment, you are just deferring the problem. You are saying at this time, "We can give our people as much purchasing power as they could spend in the absence of the present fiscal conditions, and although there is nothing to spend it on we are letting them store it up until some future time." If that is done in the right amount the result is, as pointed out a moment ago, either by you or Mr. Jacobstein, the result may be to provide a backlog of purchasing power at a time when, after the war, you might have a deficiency. On the other hand, if the money is stored up, whether it is in the form of these stamps or in the form where people haven't spent it because they have had no way to spend it, in either case if it is too large a proportion you are going to have the problem, whenever you do turn it loose, that you have now in the other case, namely, of having a lot more purchasing power than you have goods and services to make it good with.

That is the answer, I think, to the question that might be raised as to why not carry this principle through and apply it to income tax, corporation tax, and everything else.

The purchasing power that we are trying to mop up now flows out of the current level of production. A lot of that income is generated out of the production of things that we cannot consume. Now, when it comes to that hoped-for period when you are going to be able to allow people to cash in these stamps, or the bonds they get for these stamps, or let them cash in the bank deposits which are piling up now because of the relative success of the O. P. A. program, you have a situation then in which the current production of 1945, let us say, is all of it matched by income which it generates, and in addition to that you have got all the income that is turned loose out of this stored-up category. I hope I have made myself clear on that. It is exactly the same problem whether you do it this way or whether you do it by the O. P. A. program, assuming the O. P. A. program is administratively enforceable over a long period. Obviously this has the advantage that this definitely sews up the purchasing power in such a way that it cannot be released until we discover the proper period to release it; whereas, the O. P. A. program does not sew it up at all, it leaves it to each individual to accumulate it in his bank balance, or his sock, in some way or another, it simply prevents him from spending it by cutting off the outlet. Do I make myself clear?

Senator DANAHER. Yes.

Mr. HARDY. Coming to the other question, it seems, as Dr. Jacobstein has said, perfectly feasible to make these stamps which a person

gets in exchange for a surcharge on his retail purchases, and make them redeemable 100 percent in Government bonds, or make them redeemable 50 percent in Government bonds if you want to store up half the purchasing power and wipe out half of it, or make it 2 percent redeemable and 98 percent held, so the 2 percent will be enough for the person as an incentive to see to it that the dealer gives him the stamps. That was the line we were working on, giving very small redemption values, simply as an aid in enforcement. But the administrative problem is just the same whether it is 5 percent redemption or 100 percent redemption in the matter of these coupons or in Government bonds. Of course, as I said a moment ago, obviously if there comes a period when purchasing power seems to be deficient in the market you have got the possibility then where a redemption of these things is putting a lot of money into circulation instead of doing it through the W. P. A. or deficient spending of any other sort.

I think it has a great advantage over the usual deficient spending program. This program just postpones the problem of administration, in deciding how much purchasing power is available to release and to what extent it will create the old wartime inflation over again.

Senator DANAHER. Let me ask you this question: Considering the withholding tax, regardless of the rate, whether it is 5 percent or 10 percent is immaterial, simply the Treasury withholds it currently and applies the proceeds against the tax due in a given year, under the proposed withholding tax plan that came from the House-----

Mr. HARDY. The deduction from salaries and interest, and so on, at the source?

Senator DANAHER. Yes.

Mr. HARDY. Yes.

Senator DANAHER. That is a currently applied method of withdrawing so much of the consumer purchasing power as is represented by the tax collected or withheld.

Mr. HARDY. That is right.

Senator DANAHER. And then applied as against the tax due.

Mr. HARDY. Yes.

Senator DANAHER. Whereas, under this proposal which I had asked Dr. Jacobstein to canvass with you gentlemen, you not only are accumulating for the Treasury currently perhaps \$5,000,000,000 a year, but you are accumulating it year after year, that is, you are still withholding constantly from the market so much of the amount withheld as is not necessary to be applied in reduction of taxes currently due. Do you follow me there in that contrast?

Mr. HARDY. I do not believe I do, Senator Danaher.

Senator DANAHER. I might restate it. We are agreed on my definition of the essence of the application of the withholding tax provisions, are we not?

Mr. HARDY. The withholding tax provision has the effect of withholding purchasing power at the time the income is realized rather than a year hence through the income tax structure.

Senator DANAHER. And if it were in effect only 1 year it would apply only 1 year?

Mr. HARDY. I assume so.

Senator DANAHER. Yes. Whereas this proposal is a continuing thing.

Mr. HARDY. Well, if it were in effect only 1 year it would still apply in only 1 year.

Senator DANAHER. I was just trying to draw the curtain there.

Mr. HARDY. It seems to me the essential difference is that the withholding tax plan applies at the point of receipt of income, and this applies at the point of expenditure of income.

Senator CLARK. Of course, you withhold not only from taxpayers but nontaxpayers.

Mr. HARDY. Yes. To my mind that is the great argument in favor either of this plan or of a straight sales tax, that the income tax misses, and particularly the withholding feature misses a considerable fraction of consuming power in the country. I think this point is frequently overlooked and greatly underestimated, and that is the people who are living off capital rather than off current income. It is often assumed that that consists of just a few very rich people. It is not just a few very rich people. If you are very rich you can live off the income of your capital, but then there are people who have retired, who are living off of their lifetime savings, who may show an income of \$5,000 but who are spending several hundred thousands of dollars a year because they have saved a good many years to provide for their expenditures.

Then you have the people who are living off the proceeds of insurance policies, people who are unemployed but who are well enough fixed so they do not worry about it, about being unemployed, and that group is totally exempt under any such income-tax scheme, whether it is levied at the source or levied in the usual way. That does not make a great deal of difference under ordinary peacetime conditions, but it makes a great deal of difference when we consider groups that receive half the national income, because we are reaching the point where the curtailment of somebody's consumption has to be very marked. Whether we do it by taxation, or whether we postpone the power to consume is much less important than the importance of spreading it so that no considerable group is exempt from it. I think the great advantage of this plan and the ordinary sales-tax plan over the plan we use today is that there is nobody of consumptive ability that is exempt from it. Maybe you do want to exempt a certain amount of consumptive ability, namely, that at the very bottom. That is where my coupon plan was intended to meet the objection to the sales tax.

Senator DANAHER. Will you suspend for just a minute?

I want to hear this. Senator Barkley is calling me. I will be right back.

Mr. HARDY. Yes.

(Short intermission.)

Senator CLARK. All right, Doctor, you may proceed.

Mr. HARDY. To close the point I was making in regard to the advantage of assessing the tax or loan, whatever you use, assessing it on the basis of consumption, I point out that there are certain people living off of capital. You also have to account for the fact that there are a good many people who, in a given year, show losses, capital losses that wipe out their tax liability and who, nevertheless, may be maintaining their ordinary standards of living out of capital. I made some study of the incomes of people who report losses, and it would appear that on the average people who have negative in-

come for tax purposes but have to report, with gross incomes large enough so they have to report, probably have \$20,000 or \$30,000 normal income just on the basis of the proportion of rent and dividends, and other types of income in the gross.

You also have got the case of farmers whom it is notoriously difficult to reach on income taxes, unless they are very well-to-do farmers, or the small businessman whose bookkeeping methods and the difficulties of auditing them on the part of the Treasury are such that he may be paying very much less than his income justifies, along with the notorious difficulty of reaching skilled labor if it changes jobs often enough so as not to appear in forms reported to the Treasury. You have got a big class of consumption here, I should say half of the consumption of a normal year that is not reached by income tax with an exemption of \$1,500.

The thing may be summed up in saying the purpose of your fiscal system is directly to regulate, curtail, or restrict consumption. The logic that is in favor of it relates directly to the consumers' expenditures rather than indirectly to the income which throws light on his ability to consume and not on his actual consumption. I think it is all in favor of the retail sales as a basis of assessment, whether you use it in your form or the tax form.

I will come to the objection to it, and that is that it tends to fall most heavily on very low incomes, because a higher proportion of those incomes is spent for consumption, which is the thing that I think has stood in the way of a broad use of this method of assessment in Federal taxes. That, I think, can be met by the use of coupons. This is not cashed in the sense of a stamp that you have used up, but an exemption coupon, or it could be done alternatively by a food exemption. I have made some estimates. These are based on 1941 prices, and they would be a little higher in the case of present prices. I have made some estimates on how you come out when you make an attempt on an assessment of consumptive expenditures designed to raise \$5,000,000,000 with different ways of taking care of the very low income.

If you ignore the problem entirely, just make it on all sales, exempting medical expenditures and rent and practically nothing else, housing and medical care, education—to raise \$5,000,000,000 without any exemption you get a rate of 9.4 percent. To do it with an exemption of \$200 for each single consumer and \$350 for each family—that does not mean an exemption of that amount of tax but an exemption of that amount of income, then the rate would be 12.2 percent.

Senator CLARK. How much, Doctor?

Mr. HARDY. 12.2 percent. To do it with an exemption of all food sales, in addition to all the other exemptions, you would need 15.4 percent on the rest of the expenditures.

Senator CLARK. Your first suggestion was to have a flat exemption of \$200 on all purchases?

Mr. HARDY. That was the second. That is the one that gets 12.2 percent. If you have no exemption whatever you would require 9.4 percent.

Senator DANAHER. That is on 1941 prices?

Mr. HARDY. Yes.

Senator DANAHER. Thank you.

Mr. HARDY. The mechanics of giving that exemption I will come back to in just a moment. The principal difference it makes is to the

incomes under \$500, out of which we estimated that the current consumption in 1941 amounted to between a billion and a quarter and a billion and a half dollars. Without any exemption and with a 9.4 rate that group would pay \$123,000,000, or 9.1 percent of its income. The difference between 9.4 and 9.1 is the housing expenditure chiefly.

Of course, we have to assume that these people spend more than their incomes on the average. It assumes that a lot of people are living off of capital and living off of creditors.

With the exemption of \$350 for each family you would only throw a burden of \$21,000,000 instead of \$123,000,000 on the group below \$500, and you would really make very little difference to the rest of the groups. The rise in the rate about offsets the reduction in the expenditure. For certain groups it works out a little bit one way and other groups if works out a little bit the other way.

For the people with over \$10,000, it is the difference between \$655,000,000 and \$663,000,000. That is all the difference it makes, but it does make a considerable saving in relative terms below \$500, and that spreads the saving over the rest of the community as a slight addition.

The third method, the exemption of food, works out as an intermediate, \$81,000,000 as compared to \$123,000,000 on the very low-income group. As a matter of fact when you come above the \$500 income it does not make very much difference. For instance, \$500 to \$1,000 income, as we estimate it, would pay, without any exemption, \$494,000,000, and with the \$350 exemption it would pay \$398,000,000, and with the food exemption it would pay \$383,000,000. That is not a very big difference when it is spread over the number of incomes that there are in that group from \$500 to \$1,000. It is a difference between the 4.8 income tax, 5.6 income tax and 7.2 income tax. As you get up further in the scale it makes less and less difference.

The mechanics of the food exemption, of course, is obvious enough. It does create a problem for stores that handle both food and other things, the problem of having to classify sales. It makes more of a problem for auditing than you get where all the retail sales are subject to it. You cannot get away entirely from it. You are bound to have some expenditures made at stores that would not be classified as being retail, and you have difficulty where concerns do both wholesale and retail business, and so on.

The mechanics of the thing, as I visualize it, to give the flat exemption is simply to have issued to everybody coupons representing the tax on \$350 for the family or \$200 for an unattached individual, which he would have to get by applying for it, just as he would have to get by applying for it, just as he would have to get in the matter of the ration card on gasoline, sugar, and anything else. It would give an opportunity for complete registration of the population, which could be used for a great many purposes. The plan here attempted to be worked out did not involve asking a man to relate it to his income at all. It is just like the basic exemption on the income tax, it is irrespective of income. Give him these coupons and let him use them in payment for the stamps at the retail store, and use the stamps just the same, whether he pays for them with coupons or with cash. It really amounts to giving him a very small amount of cash. If you have a \$200 exemption the 12 percent rate is about \$24 for the single individual and with the \$350 exemption it is about \$42

per family. I think it is just as well to let people have coupons to pay the income tax. If you pay an income tax you can turn the whole batch of coupons in rather than bother with them at the store.

Some people that I talked to about this plan, Federal Reserve people, have been rather favorable to the idea. They thought it was necessary to make them nontransferable. It seems to me that the labor involved in trying to enforce the nontransfer requirement would be beyond all proportion to the benefits. If a southern sharecropper had such small expenditures that he could not use that amount of coupons and sold them to somebody at 50 cents on the dollar, he is ahead that much. It is only a \$10 or \$12 subsidy. I would say it is not worth bothering about trying to prevent transfers of that sort. If you do not give a bigger subsidy at the expense of the higher income group than that amounts to you get off pretty well. That, you see, could be applied just as well to Senator Danaher's plan as it could to any professor's plan, or the sales-tax plan. It is totally irrespective of whether you give receipts that are not worth anything or receipts that some day may be worth something if you have the national production that would validate it. It is really what a savings certificate or a Government bond is based on.

That is as far as I want to go, unless you have some questions.

Senator DANAHER. Yes, please. I would like to take an individual family of five people, a husband, a wife, one adult child, and two minors. I am assuming they have a reasonable family income of \$3,000 or \$4,000. Does each one of the five, under this plan, get the \$200 worth of coupons?

Mr. HARDY. No. Under this plan, the one adult child, if independent, would get the \$200, and the family would get the \$350.

I might say these figures do not rest on any very careful analysis of what the figure ought to be. Obviously that is a detail that would need a good deal of careful work if the plan was made public and advocated. That is the reason it is still in the confidential stage. I would not want to defend those figures. I think we could reach figures that we could defend, and that would be the idea that the people who are independent economic units, who presumably would file separate income-tax returns, would be the people who would be entitled to a separate coupon. The people who are part of the family group, on a single income, we would put them at \$350. You could, of course, readily say that for a family with more than four you would give \$50 additional for each additional member. That might be justified. I would want to canvass that certainly with the Treasury people.

Mr. JACOBSTEIN. But if the children were all minors the family is the unit.

Mr. HARDY. The family is the unit just as it is for income-tax purposes.

Senator DANAHER. So that whatever the income-tax status is, that would determine the actual people who got the allowances?

Mr. HARDY. Well, it would be based in the same way as the income tax. Take the case of a person who has no income, for instance, a retired person, you see you would have handled the consumptive expenditure on whether they were in fact a family or were in fact separate individuals. I suspect you would have to make some special provision, for example, for people in institutions. It would be rather absurd to give each individual in the poorhouse the same amount of

coupons as an individual supporting himself independently. Each individual in a prison would hardly be taken care of in the same way. There are a lot of things of that sort that would need to be ironed out before the stage of writing a bill.

Senator DANAHER. But the mechanics of making some exemption for low income groups would practically be automatic?

Mr. HARDY. I do now see where it is any more difficult than rationing sugar.

Senator DANAHER. It is a most interesting suggestion.

Senator CLARK. Doctor, have you made any examination of the point that was raised here by the Treasury the other day as to the question of administrative difficulty in counting these multitudinous stamps or coupons, from the purely administrative standpoint?

Mr. HARDY. I did not see these points raised.

Senator CLARK. They were raised during some discussion the other day.

Mr. HARDY. I do not know that I can speak about it, but in general that objection--this is perhaps not very nice to say, but, as far as I have heard, that objection is raised to every new fiscal device that is ever suggested. That does not say it is not valid in this case and is valid in some other cases.

I have been influenced, frankly, on the administrative side, very heavily by one of my colleagues who worked with me on this, who has much more expert knowledge and is much more of an expert in this field than I, but unfortunately, or fortunately, he is in the armed services of the country and I cannot refer the question to him. I think basically the answer is that more than half of the States in the Union are doing it, and apparently are doing it pretty successfully. Mr. Dan Selko, through the Brookings Institution, has made a considerable study of the thing.

Mr. JACOBSTEIN. Don't you want to add that Mr. Selko pointed out that such difficulties as are encountered in the States are, partially at least, overcome when you have a uniform Federal tax? Within a State, for instance, if you have a stamp tax you have to exempt interstate commerce. There are a lot of problems that arise where you have a State sales tax or a State stamp tax. Where you have a uniform tax all over the country by one administration, the Federal Government, it is easier to administer than a sum total of 48 States. Now, that was Mr. Selko's conclusion.

Senator CLARK. How many States have stamp taxes?

Mr. JACOBSTEIN. I think he mentioned 25.

Senator CLARK. In our State we have these little tokens.

Mr. JACOBSTEIN. I think he said there were 26.

Mr. HARDY. How many of them use stamps sold to the consumer and how many of them report the direct returns I cannot say offhand.

Senator CLARK. It is not important.

Mr. HARDY. I think I have an answer to it.

Senator CLARK. In Missouri we have these little metal tokens.

Mr. HARDY. Mr. Selko is very much impressed by the Ohio plan in which they made a step toward what you are suggesting in that they gave these stamps and made them redeemable if they were contributed to churches, hospitals, or charitable organizations for a percentage of their value, enough so that people would ask for them. I am afraid I do not have the figures here, but there is a considerable number.

Mr. JACOBSTEIN. May I interject here in order to give you just one more item?

Senator CLARK. Certainly.

Mr. JACOBSTEIN. I assume, Senator Danaher, if the stamp plan that you are advocating were in use the stamps would be affixed by the retailer in a stamp book, so that the stamps could not be resold in the market, or to the retailer and used over again.

Senator CLARK. That is the next thing I was going to ask about, the problem of lost coupons, or the possibility of people selling them at a discount to sharpers.

Mr. JACOBSTEIN. That is right. As you purchase an item you would have to submit your book and affix the stamp in that book, so it would be impossible to tear it out and sell it again or use it over again by the retailer.

Mr. HARDY. The stamp is perforated across, so the retailer tears the stamp across and gives half of it to the purchaser and turns in the other half with the report, so the half is not usable again.

Senator DANAHER. There are several ways in which that non-negotiability of the stamps can be guarded. For example, as to all income earners who have a social security status the album could carry not only their signature but their social security number, and it would be useless unless the album thus identified would be turned back.

Mr. HARDY. My only feeling is that if a fellow spends less than that amount he can only invest it in a bond or savings stamps, and even if he does sell it to somebody else, he has to invest it in a savings stamp, so it is not worth while worrying about anyway.

Senator DANAHER. That is the point that I think most worried the Treasury. They feared there would be created a black market, as they described it, in stamps being negotiated. I share your judgment that if you negotiated all the stamps that could be obtained at any one time it would be infinitesimal in comparison with the gain of getting, say, \$5,000,000,000 a year into the Treasury currently.

Mr. HARDY. That does not defeat the purpose. If the fellow who buys it cannot do anything but buy bonds anyway, the saving is made by somebody, and there is a greater saving and the Treasury is making a profit that is far more to the benefit of the Treasury than the harm that it does.

Mr. JACOBSTEIN. You are mopping up the purchasing power whether it is sold again or not.

Senator DANAHER. Precisely.

Mr. JACOBSTEIN. Don't you think, however, for the record we ought to add here—and maybe the Senator will accept this thought—that if the stamp tax were made universal and compulsory, to that extent a great number of employees who are now buying on a voluntary plan would surrender the voluntary plan; that is, they would not carry both. If I am earning \$2,000 a year and paying 10 percent of my earnings for war bonds, that is \$200. Now, I am compelled to save 10 percent again, and I will go to my employer and say, "I cannot carry both."

Senator CLARK. That, of course, applies to the withholding tax and any other tax. We have been considering the effect of a withholding tax on voluntary sales.

Mr. JACOBSTEIN. The point I make is in computing what you would mop up you cannot add the total \$5,000,000,000 to what the Treasury now takes in.

Senator CLARK. You would have to deduct the amount in voluntary savings.

Mr. JACOBSTEIN. That is right.

Mr. HARDY. That is true in the other scales. As you raise your corporate taxes, you are going to reduce the amount of subscriptions to the other unit bonds. In other words, if you have got a compulsory and voluntary system side by side, as you increase the scope of the compulsory system you are going to narrow the field of the voluntary system.

Senator DANAHER. Do you feel, sir, that we may properly conclude that you believe this proposal to be workable?

Mr. HARDY. Oh, yes; I think it is perfectly workable.

Mr. JACOBSTEIN. That is not saying that something else is not also workable.

Senator DANAHER. I understand. The question of policy is not involved; it is just the feasibility and practicability of it.

Mr. HARDY. Yes. I never regarded one tax plan to be properly appraised by comparing it with another, unless there is some reason for it. You cannot have both, anyway.

Senator DANAHER. It is a substantial problem that the committee has dropped in our laps, and whatever help we can get from any source is most welcome.

Senator CLARK. We are very thankful to you gentlemen for coming up here and giving us your views.

Senator DANAHER. If any additional thoughts occur to either of you that you would like to submit we would most happily receive them.

Mr. HARDY. The only thing I want to say, it might be worth while to send you these tables containing the estimates.

Senator CLARK. Will you give me those figures again, Doctor? That is the figures to raise the \$5,000,000,000?

Mr. HARDY. Yes, sir. I can send you the whole tabulation. That gives the figures for every income group.

Senator CLARK. I would like to have it.

Senator DANAHER. Thank you, gentlemen.

Senator CLARK. The committee will recess until 10:30 tomorrow morning.

(Whereupon, at the hour of 11:15 a. m., a recess was taken until 10 a. m. of the following day, Saturday, August 22, 1942.)

**DATA RELATIVE TO WITHHOLDING PROVISIONS OF
1942 REVENUE ACT**

SATURDAY, AUGUST 22, 1942

UNITED STATES SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON FINANCE,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in room 312 Senate Office Building, Senator Bennett Champ Clark presiding.

Present: Senators Clark (presiding), Gerry, and Danaher.
Senator CLARK. I guess we are ready to proceed, Mr. Paul.

STATEMENT OF RANDOLPH E. PAUL, TREASURY DEPARTMENT

Mr. PAUL. I have handed you a statement. I would like to run through that statement.

Senator CLARK. All right.

Mr. PAUL. You will notice that we state that the Treasury has carefully reexamined this whole collection-at-the-source program since the House bill was enacted, with the idea of making improvements. I think we have accomplished that objective very definitely. It will be noted that much of the criticism of the withholding provisions is made in the light of the unimproved system.

In making that attempt to improve the mechanism, we went to the field and interviewed both employers and employees. We received every cooperation and help from the employers. They were very generous in their attitude, and from their practical experience they made a great many suggestions which we have adopted, so far as we were concerned.

Now, the modifications that we have suggested, or are about to suggest, are listed beginning at the middle of page 1. You will notice that for wages and salaries we suggest the adoption of the type of plan suggested by Mr. Gretz of the American Telephone & Telegraph Co., which involves the use of a simple table to determine the amount of tax to be withheld, and attached to this memorandum is such table. You will notice that we have graded the table in brackets of \$5.

It is possible, from the use of this table, to tell instantly how much to withhold. The table is designed in four blocks: Single persons, not heads of families; married persons with employed spouse; married persons with spouse not employed, and head of family. We have to have a separate table for married persons with employed spouse and married persons with spouse not employed, because of the awkwardness of having the \$500 exemption for single persons which is not half the \$1,200 for married persons.

Now, by means of this table, you can determine the tax direct from the gross wage without any computations.

Under our original scheme you would take a person, say a single person who was making, let us say, \$30 a week, and you would take the table we had then, showing \$11 as the amount exempt from withholding in such case, and you would subtract the \$11 from the \$30, which would leave \$19, and then you would have to multiply the \$19 by the rate of withholding. This makes that same complicated computation unnecessary.

Out of 454 employers interviewed on this field trip I spoke of, almost two-thirds express a preference for the use of such a table as I have just described, and in many cases the use of such a table will entirely eliminate the need for an additional machine, which is one of the problems I will discuss later.

Now, we have made a number of minor changes at the suggestions for changes with respect to wages and salaries, which are listed here.

First, the employer would not be required to get withholding deduction certificates from employees hired and employed for less than a week and paid less than \$11. You can easily see how that would simplify the situation.

Next, the employer will be permitted, if he wishes, to get information on the employee's marital and dependency status on a different form from the one he will have to file at the end of the year giving total wages and total tax withheld, instead of, as in the original procedure, using the same form for both purposes.

Next, the employer would be given 30 days' time to prepare a receipt for an employee terminating employment instead of having to give the receipt along with the last pay check. That improvement is designed to take care of the situation where the records are at a distance from the place where the employee is working.

Next, the employer would be given 30 days within which to give effect to a change in an employee's marital and dependency status.

Now, those are the modifications we suggest with respect to wages and salaries. We also have some improvements with respect to dividends.

First, we suggest that the payor corporation be permitted to give an annual receipt instead of a receipt with each dividend payment. It is obvious that that will simplify the procedure very much. In fact, dividend payors have told us that this change will greatly simplify their problem.

For example, one dividend payor has indicated that the substitution of an annual receipt for a quarterly receipt would halve the additional expense of collection at the source.

Senator CLARK. What do you do when there is a change in the ownership? Suppose you give a receipt for a year and then there is a change in the ownership?

Mr. TARLEAU. We would go to the record owner.

Mr. FRIEDMAN. You would give a receipt for the year to each owner. There are just two owners, to which you would have to give two receipts. At the end of the year you would examine the book and find that Mr. Jones to be the holder of the stock for 6 months and you would give him a receipt for 6 months, and Mr. Smith would be the holder of the stock for 6 months and you would give him a receipt for 6 months.

Senator DANAHY. Moreover, every person dealing in the stock would deal with it just like a transaction ex-dividend.

Mr. TARLEAU. They would have to.

Senator DANAHER. Transfer the burden of adjustment from the payor to the buyer or trader, which would work all right.

Mr. PAUL. The next change we suggest is with respect to dividends paid by credit unions, saving and loan associations, building and loan associations, cooperative banks, and farm cooperatives.

There we recommend an exemption from withholding, and the reason is obviously that those dividends are small in amount and paid to a very large number of persons.

Senator CLARK. Sometimes not more than 15 cents.

Mr. PAUL. That is right.

Senator CLARK. Some are so small that they literally amount to 15 cents.

Mr. PAUL. That is right. They are very comparable to interest on savings deposits.

You remember one of the major complaints made by the American Banking Association was that the collection at the source system would seriously threaten the nominee and street name systems of registration of corporate stocks. The proposed system for the treatment of the nominee problem eliminates any ground for this complaint. This system provides for gross withholding from the nominee, for the issuance of a receipt to the nominee by the payer corporation, and to the actual owner by the nominee. We have discussed this new, revised procedure with Mr. Mylander of the American Banking Association, I think it was with Mr. Mylander, and it has been agreed that under the revised procedure the nominee system can be preserved.

You recall one of the points to which the Commissioner called particular attention was the statement in the report by the American Banking Association that one bank had estimated it would require the services of a crew of 12 men for at least 12 months to register the stock now held in nominee form. This would be entirely unnecessary under the revised procedure.

Mr. FRIEDMAN. I talked to Mr. Mylander on this point.

Senator CLARK. He made a very impressive point, to my mind.

Mr. PAUL. The other suggested modifications for dividends would give the corporation more time within which to give effect to exemption certificates and would place the responsibility upon the stockholder to notify the withholding agent that the stockholder is exempt from withholding.

Now, with respect to coupon interest——

Senator DANAHER. Before you leave that, Mr. Paul, you are planning that these exemption certificates can be readily procured? What is your thought on that, Mr. Friedman?

Mr. FRIEDMAN. Our thought on that has been twofold: One, that you try to place them on the counters at banks; and, second, that a great many corporations, as a convenience to their stockholders, would include them with the last dividend check for the year.

The A. T. & T. said that is what they plan to do. They would include a copy of the exemption certificate, a blank copy, with their last dividend check, so that the dividend recipient would get it when he got his check, and he would be able to fill it out the next year.

Senator DANAHER. That would meet a lot of objections.

Mr. PAUL. When I finish my first statement I would like for Mr. Friedman to go into a number of those points, a number of those more

or less minor administrative details, to show just how all these steps will be mechanically taken care of, to show that we have considered this thing through on a practical basis.

We have not been entirely theoretical here.

Now, for coupon interest, we have developed a number of modifications. However, in view of the testimony before the committee as to the very large number of small coupons, and the problems imposed on the initial paying bank and the final obligor by the absence of evidence on the identity of the owners of the coupons, we now propose that coupon bond interest be completely exempted from withholding. The amount of revenue is very small, only \$40,000,000 in 1943 and \$80,000,000 in 1944.

Now, these objections do not apply to withholding from dividends or registered bond interest, which offer a much simpler problem. Moreover, the revenue from dividends is substantial, amounting to about \$200,000,000 in 1943 and about \$400,000,000 in 1944. The relationship is almost 10 to 1.

I want to emphasize that in suggesting the withdrawal of the system with respect to coupon interest, at least unregistered coupon interest, we are very emphatic in our recommendation that the system be kept as to dividends.

Now, these changes have been discussed with the Bureau which is assuming collection at the source. You know their attitude on that. They agree that the changes are desirable and that they will greatly simplify the whole problem.

I want to turn to Mr. Helvering's statement made a day or so ago here. I want to say at the beginning that there is not any question. We have never tried to pretend that the collection is not a good, hard job. However, I want to say, on the other hand, it seems to me, with all due respect, the Commissioner has overmagnified the problem, and I want to show particularly, item by item, how I think he has done that.

In the first place, you notice he made the point that 11,000 additional employees would be required to administer collection at the source.

Senator CLARK. That is in addition to the 5,400 that would be required under the House bill.

Mr. PAUL. That is true. But those 11,000 employees will not all be required at one time, in fact not until 1944. The fact is that only between 3,000 and 4,000 will be required during the calendar year 1943, and the rest of the 11,000 not until 1944. That means you are going to have time to deal with that problem and recruit the personnel.

Senator CLARK. Why is that, Mr. Paul? I do not see why it takes any more personnel to levy a withholding tax of 10 percent than it does a withholding tax of 5 percent.

Mr. PAUL. This distinction is not addressed to that point. The withholding will begin in 1943, if we put it in the statute. The wage returns will begin to come in, there will be a quarterly report, the first group will come in, say, 3 months after the beginning of the year, and then the dividends will not come in until the following year.

Mr. FRIEDMAN. It is not a dividend problem. The difference is, during the first year you get reports only from employers about the money, the amount of money they have withheld. It is not until

1944 that you get a statement from each employee, and it is not until 1944 that you have the problem of checking the statements of the employers against the income-tax returns filed by the employees.

That is, during the year 1943 nothing enters into the system having to do with the employee's part in it. During 1943 you are only dealing with the withholding checks, you are not dealing with the taxpayers at all. It is not until 1944 that you start having the taxpayers enter a credit on their returns, you know.

Mr. PAUL. The matching problem is the main one, and that does not come until 1944.

Mr. FRIEDMAN. There is another thing there. In 1944 you have the problem of taking the employer's quarterly returns during 1943 and balancing them with all the slips he sends in, in order to make sure that the two agree, that the total of all the slips equals the amount he has paid. You do not have to do anything on that until you come to 1944.

All you have to do during 1943 is to get the returns from the employers and to list them.

Mr. PAUL. The next point made by the Commissioner had to do with the personnel problem, and he emphasized this particularly before the Ways and Means Committee, and he complained, and I think he very validly complained, that he was unable to undertake the collection at the source when he had a priority classification, personnel-wise, No. 5. We thought that was a very valid complaint, and I strongly recommended to the Budget that he be given a reclassification. The Budget, being interested in collection at the source and thinking it was very important to have it in the statute, reclassified the Commissioner No. 2. So he now stands just next to the military in status with respect to personnel.

Senator CLARK. The salaries may have had something to do with the difficulty.

Mr. PAUL. That is true. You remember the Commissioner indicated that he had raised his initial deputy salary from \$1,800 to \$2,000.

Senator CLARK. He told me he recommended it. I did not know whether it went into effect.

Mr. PAUL. He told me he had done that. I think I am correct in stating that.

Senator CLARK. He said the fellows would just quit, because they would get better jobs elsewhere.

Mr. PAUL. As to this personnel question, I am not entirely familiar with the ramifications of all this personnel-rating problem, but I know when somebody wants to leave to go to another Department he has to secure permission.

Senator CLARK. But you cannot do anything about them going into private employment.

Mr. PAUL. That is true. This point of personnel classification was very strongly emphasized by the Commissioner.

Senator CLARK. The requirements for the personnel today are much higher than they formerly were, because of the increasing complexity of the whole subject.

Mr. PAUL. That is true as to the personnel that is more devoted to the income tax itself.

Senator CLARK. That is what I am talking about. It used to be that anybody who could read and write was able to get by as a deputy collector.

Mr. PAUL. In respect to collecting at the source there will be great need for more or less routine work. You remember the Commissioner explained that on the estimate of cost by referring to the fact that a great many employees would be low-paid employees.

Now, the Commissioner spoke of the number of forms required. He used the figure of 100,000,000 forms. Well, as a matter of fact, about 75,000,000 to 80,000,000 are now necessary under the information at the source system which is in vogue, and that collection at the source system will replace the information at the source system, so of course the real additional number of forms is only about 20,000,000.

The Commissioner's statement called attention to the need of seven different forms for the administration of collection at the source, and of these forms only three are new; four of the forms replacing those now in use.

Now, the next item made by the Commissioner was with respect to machines. It has been recognized right along that we had a machine problem. We have been assured by the War Production Board that the Bureau's needs can be met. It may be that it may be necessary to introduce some overtime, but we have taken all the steps we can there. The Secretary has written a letter to Mr. Nelson asking for formal assurance on the point, and I think we will get the formal assurance.

Senator GERRY. Mr. Paul, do you think the employers could get the machines?

Mr. PAUL. That question has also been taken up with Mr. Nelson. I think I am correct in saying that the employers can get the machines if they are operating their present machines at a reasonable level of output.

Senator GERRY. Yes.

Mr. PAUL. In other words, there may be some who will not get machines if they are only using the present machines on an 8-hour basis. I think we will be able to get the machines.

Besides that, as I will show in a minute, not so many machines are needed as may be imagined. Hardly any of the machinery, moreover, will be needed, for the reasons we have just indicated, until 1944.

Now, the Commissioner spoke of the number of delinquent employers. He used the figure of 750,000 delinquent employers out of a total of about 2,700,000 withholding agents. Since the number of withholding agents is about the same as the number of employers under the social security tax, it would seem reasonable to compare standards on that basis, and there are only about 250,000 delinquent employers each quarter under the social-security tax, and I would not suppose that there would be any greater rate of delinquency under the one system than under the other.

Senator CLARK. Social security is much easier to administer.

Mr. PAUL. That is true.

Senator CLARK. I mean, that is a gross tax, and this, of course, would have to give consideration to exemptions.

Mr. PAUL. That is true, but under this new improvement something of that distinction has been wiped out.

Senator DANAHER. By the adoption of bands in the table.

Senator CLARK. Of course the bands is a step in the direction of gross tax. I would be opposed to gross withholding because it is very inequitable, but with the band and grade application it seems to me it is not inequitable enough to cause serious objection.

Mr. PAUL. It is not gross withholding, because those amounts take contemplation of the status of the different types of withholders. Even this figure of 250,000, of course, that are delinquent—we use the word “delinquent”. That is a harsh word, but all that it really means in a great many cases is they are late in filing their returns.

Another point is they are usually the small employers and they do not loom too large in percentage.

I want to call attention next to the statement read by the Commissioner to the House Ways and Means Committee on May 22, 1942. The Commissioner said:

I have no doubt that a withholding tax could be satisfactorily administered in normal times. Since these are not normal times, if withholding is to be part of any tax plan the work cannot be done unless the Bureau is to be given priority status with respect to personnel, equipment, and space subordinate alone to the military forces.

As I told you, that has been done, and in addition we have improved the mechanism so much that it ought to be easier now than it was on May 22. You will notice that the statement that I have quoted really expresses no doubt that a collection at the source was feasible if the priority status was obtained.

Now, turning to industry, you have with respect to employers much the same problem in relation to collection at the source as you do with respect to social security. Of course, as you pointed out a moment ago, Senator Clark, the social security is on a gross basis, but we have met part of that distinction by this new table.

I point out here that employers do handle social-security problems without serious difficulty. Canadian employers are handling a system very similar to the one we have proposed, and there has been no serious difficulty.

I referred a moment ago to the fact that we made a field survey. That survey suggested that more than two-thirds of all the employers in the country are not in need of additional equipment. That is, two-thirds of the employees are in firms indicating no need for additional equipment, and fewer than one-third indicating a need for additional equipment. Again, some of this need for additional equipment will be eliminated by the modifications, changes and improvements that we have suggested. Most of the firms that indicated a need for additional equipment are now using their machines no more than 8 hours a day. Again, the indicated needs for additional machines are relatively small in comparison to the machines now in actual use—only about 10 percent additional.

Now, the need for additional personnel. That is fairly widespread, but it is small in the total number, that is, the additional number needed is relatively small. In all this field trip we found very few employers expressing any serious concern about being able to get the personnel they needed.

Now, the Commissioner's statement laid stress on the estimate of the American Banking Association to cost. These estimates were based on a misunderstanding of the law in respect to collection at the source. They were, for instance, based on the assumption that the

paying agent would need to prepare five copies of a receipt along with each dividend check, and that the proposed system would necessitate the elimination of the "nominee" and "street name" systems of registration of corporate stocks. Neither of these assumptions is valid.

Moreover, our original proposal contemplated only one receipt with each dividend check; and our revised procedure contemplates only one a year, to be prepared as a duplicate of the information return sent to the Bureau. The nominee system would not be disturbed. The estimates of the American Banking Association are, therefore, many times too high. The additional burden on payors of dividends would be relatively slight.

In general, for both employers and payors of dividends, much of the work required under collection at source replaces work now being done in the preparation of information returns. It should be noted that of 454 employers interviewed, 88 percent were favorably disposed to collection at the source and only 6 percent were really, definitely opposed to it.

We thought it was important. We first surveyed the field as to employers, and we then undertook to make a survey—and that is still in progress—as to employees. So far, we have only interviewed 172 employees in Baltimore and Minneapolis, and of those 172 employees, 76 percent were favorable and only 14 percent opposed. Eighty-four percent said the withholding would have no effect on their bond purchases, and only 8 percent said they would reduce their bond payments.

Now those are the detailed considerations that I wanted to point out to the subcommittee.

In conclusion, I want to say that it is no exaggeration to say that collection at the source is, to our way of thinking, one of the most important parts of the revenue bill as passed by the House. We realize that the burden is substantial. I think you will be convinced that we have labored rather assiduously to work out the complexities and problems that we saw as we went along.

I just cannot believe that the problems now remaining are insuperable. They have been conquered in a number of other countries, Canada particularly.

Senator CLARK. What does Canada do? Will you tell us briefly how they operate?

Mr. PAUL. Mr. Friedman has studied that in detail and I will have him describe the Canadian system, which is the nearest, as I understand it, to ours.

Senator CLARK. That is the reason why I asked about Canada.

Senator GERRY. How long has Canada had it working?

Mr. FRIEDMAN. As part of the National Defense Statute, over 2 years.

Senator GERRY. Does that mean the withholding part of it?

Mr. FRIEDMAN. That is right. British Columbia, one of the Provinces of Canada, has also had a withholding system in effect that I think is a year older than the general Canadian law. The general Canadian law is over 2 years old now.

Great Britain has had it working, of course, for a longer time yet.

Mr. PAUL. Although their system is not comparable to ours.

Senator GERRY. I got some Canadian legislation so I could look at it, but I haven't had time to go through it.

Mr. FRIEDMAN. I do not know how they are able to work the British system, because it is about six times as complicated as this is.

Mr. PAUL. You have got a different situation in Great Britain than you have here. Of course, they have been doing it a great many years.

The reason why we think collection at the source is so important is because we have lowered the exemptions, our income taxes have changed until it is really a mass tax now. You take a person making \$3,000 a year, married and no dependents, his tax liability, under the House bill, is about \$324. I do not believe that the average person making \$3,000 a year is going to be able to budget that amount of money. Other pressures will come in during the year, and he will find, when it comes to the time for payment under the conventional method now in vogue, that he just hasn't got the money.

Mr. Helvering spoke the other day on the point of Bureau prestige and I am just as anxious about the Bureau prestige as anybody, but there is another angle to that. It is not only a matter of making the collection at the source work.

If we do not have it work we are going to have so many defaulting taxpayers, and so much trouble at that end of the picture, that I think we have got the jeopardy of Bureau prestige there.

Senator CLARK. You mean you will not get the money because the fellow just does not have it?

Mr. PAUL. Yes; he does not have it. There is nothing you can do about it then. You can file liens on his salary, and so on, which will certainly be an unpopular procedure. We are just afraid, without collection at the source, with our present rate and our present spread of the incidence of taxation, that the system will break down. I do not think I put it too strongly when I say not only Bureau prestige is involved but the future of the income tax may be involved.

Senator GERRY. How much do you figure this will raise with the amendments you have suggested?

Mr. PAUL. The figure was a billion and a quarter at the 5 percent rate. That will be somewhat reduced, but not very much reduced, if we leave out coupon bond interest.

Senator DANAHER. When you say "raise," to adopt your own words, what you really mean is you will increase your tax collection by an estimated one billion and a quarter?

Mr. PAUL. I do not mean we will increase our tax collections by a billion and a quarter, I mean we will advance our collections.

Senator CLARK. You will advance your collections for the next year.

Mr. PAUL. That is right. I do not think, by a long shot, that would increase our tax collections by that amount, because you would collect a great part of that billion and a quarter next year, or the year following, say in 1944.

In other words, we are not contending that it would raise the tax collections a billion and a quarter by reason of collection at the source, we contend only that it would advance the collection of a billion and a quarter, approximately, a year.

Senator DANAHER. So that actually, if everyone in 1944 paid up, the aggregate would be the same in either case, I mean as to the total collections.

Mr. PAUL. That is true. But from the inflation standpoint, that time factor is very important.

Senator CLARK. You mean you would receive a billion and a quarter in revenue based on the tax for the past year.

Mr. PAUL. No, no. The general effect of the House bill is on an annual basis, not a collection basis. The House bill, on an annual basis, yields somewhere between four and five billion in the first fiscal year, 1943.

The final point I would like to make in respect to this whole matter of collection at the source has reference to the Ruml plan. It may or may not be that the committee will wish to accept that plan, in some modified form, but it would seem to us that one of the principal modifications of the plan necessarily would be to tie it up or link it with collection at the source.

If we are going to do that, we are going to have the collection-at-the-source system available.

Senator CLARK. I may say, Mr. Paul, as far as I am concerned, the first thing that appealed to me about the Ruml plan was that it seemed to make machinery by which you could get currently withheld taxes and it would be susceptible of having the collection-at-the-source plan coupled with it without the double taxation which is provided by the House plan for collection at the source.

There is only the doubt whether the collection-at-the-source plan is administratively feasible.

Mr. PAUL. I had not intended this morning to go into the Ruml plan.

Senator CLARK. We would be very glad indeed to have you do that. I do not know that the subcommittee would be required to report to the full committee on it.

Mr. PAUL. I would be glad to go into the Ruml plan. I think we might have Mr. Friedman first deal with the more detailed aspects of the procedure, and then if you want to come back to the Ruml plan after that, I will be very glad to discuss it on a sort of informal basis with you.

Senator CLARK. Yes.

Senator DANAHER. Before you turn the meeting over to Mr. Friedman, Mr. Paul, I will direct your attention to this two-age table, dated July 30.

Will you please explain, in the lower half of that table, under the caption, "Withholding agents," the columns that list those who are exempt from the withholding tax?

Mr. PAUL. I think that, as far as any value is concerned, we could strike the table under "Withholding agents" at the extreme right. The important one is the number of withholding agents who are exempt. That is on the left and that totals 3,500,000, and below that you will see what is really more important, and that is those that are subject to the withholding tax, and that is 60,000 Federal Government, 200,000 State and local governments, and 2,440,000 other employees. The reason why we have the railroad employees plus the persons covered by the Social Security is that the Railroad Retirement Act treats them on a separate basis, refers to them separately.

In other words, there are 6,200,000 potential withholding agents, of which 2,700,000 would be withholding agents under our procedure.

Senator DANAHER. Restating it, 2,700,000 are actual and 3,500,000 are exempt.

Mr. PAUL. That is right.

Senator DANAHER. And your purpose in including them in the table was simply to illustrate that there was that number who were being exempted, is that not so?

Mr. PAUL. That is right. That will indicate to you one of the reasons why we did exempt those, because of the vast multiplication of the problem if we had withholding as to domestics, farm labor, and so on.

Senator DANAHER. I have only one other question.

Is it contemplated, with reference to footnote 1, that anybody in the military service would be liable to a withholding tax, irrespective of the nature of his service or the rate of pay?

Mr. FRIEDMAN. All military services are exempt.

Mr. WELLS. It does take into account that during the first part of the year they are subject to withholding.

Senator DANAHER. I just wanted to make sure that there is no question of withholding from Army and Navy men in actual service.

Senator GERRY. Are domestic servants and farm labor included in the withholding?

Mr. PAUL. No; they are exempt.

Senator GERRY. That is what I thought.

Senator CLARK. Mr. Paul, one other point that was raised by the Commissioner that you have not mentioned was the difficulty which he anticipated, or at least suggested, with regard to State, municipalities, school districts, governmental agencies, and things of that sort. What do you think about that?

Mr. PAUL. I think Senator Danaher asked me a question about that at the original hearing. His question went to the matter of enforcement, and I think I said I did not believe we could take steps to enforce, or I could hardly imagine the Federal Government suing the city of Detroit if it failed to comply with the provisions, or suing the city of Detroit for delinquency.

I understood that we would get the cooperation of these State governments and city governments. I do not think that any of our investigation has disclosed any unwillingness on their part to cooperate.

Senator CLARK. Mayor LaGuardia testified against it here. I think he said it would cost the city of New York \$850,000.

Senator DANAHER. I think what he did say was that there were 165,000 employees in the city of New York and that it would cost them \$200,000 for new machines, and it would cost them approximately \$150,000 to \$200,000 additional to administer the plan. That is my recollection of it.

Mr. PAUL. My recollection is that it was \$200,000 additional also, Senator Danaher. I still think we have got to consider all those estimates in the light of some misconception of the plan, and in the light also of the fact that he was talking about a plan that we have very much improved.

Senator DANAHER. This much is a possibility, though, it is not, that you might find your War Department or your Navy Department right here saying, "We are so busy trying to run the war that we just cannot withhold from the civilian employees."

Mr. PAUL. Let us cross that bridge when we come to it. I haven't heard of anybody notifying the Treasury to that effect. Mr. Helvering spoke of some Bureau getting in touch with him, but he did not

say, as I recollect it, what Bureau that was. We have received no information from other bureaus.

I want to say this, that we have discussed this withholding at the source with a number of other bureaus in an advisory way, trying to get their reaction, and some of them are very enthusiastic about it. I can mention particularly the Federal Reserve, the Budget, and I think some of the others.

Mr. TARLEAU. The O. P. A., Mr. Henderson.

Mr. PAUL. The O. P. A., Mr. Henderson, and Mr. Gilbert are very strong for it.

Senator DANAHER. Anybody that has anything to do with the fiscal affairs is for it?

Mr. PAUL. That is right.

Senator GERRY. You have got your Navy Department, where I think you will have some trouble with the casualties, and things like that. What are you going to do with the withholding, for example, in the matter of the personnel in the Navy Department? You will have dependents. I am on the Naval Affairs Committee and I know we have had a lot of trouble with them. You are bound to meet that problem, I think, and you might as well face it.

Mr. PAUL. I do not want to look the other way.

Senator GERRY. That is why I was bringing it up. I know we have had a lot of hearings on it, and we have had to work some things out on it.

Mr. PAUL. I would like to say I think we can meet most of those problems as we come to them. Maybe we can think of better ideas as we go along. No system of this sort would be perfect when you start, but we have got to get started because it is going to be necessary in the long run, and it is not going to be any easier if we put it off.

In fact, this is about our last clear chance to get the system in the statute.

Senator GERRY. What sort of trouble do you have in the States, in, say, Ohio, that has a very elaborate system of sales tax, in respect to withholding, I mean, whether they cooperate with you? I myself do not know anything about the Ohio tax.

Mr. PAUL. Well, they have the stamp plan of sales tax.

Senator CLARK. They have a plan in which they tear a stamp in two and give the person back half of it, and if he wants to turn it in as a gift to some charitable institution he can turn it into cash for that purpose and no other purpose.

Mr. PAUL. I might say we considered the possibility of various stamp plans in the beginning, and we shivered at some of the problems.

Senator CLARK. We will come back to the stamp tax later. I want to ask you one question, Mr. Paul. It has nothing to do with what we are talking about, but I have been trying to think to ask you about it for some time. I think I have had as many letters in favor of the mandatory extension of 3 months instead of a discretionary extension by the Commissioner as on any other subject. What is the attitude of the Treasury on that?

Mr. PAUL. I do not know whether I understand the question.

Senator CLARK. At the present time you can apply to the Commissioner for an extension of time, and if he wants to give it to you, he can give it to you.

The National Association of Accountants, and a great many people, are very much in favor of making mandatory extensions of 3 months.

Mr. TARLEAU. That is right. They have written to us on that, as a matter of fact.

Senator CLARK. I have had about as many letters on that as on any other subject.

Mr. TARLEAU. Mr. Blough and myself are preparing a memorandum for Mr. Paul which, when he gets through with the collection at the source and the Ruml plan, and various other matters that take up his time, we would like to get his attention directed to, just to see whether there cannot be worked out some system to make easier the accountant's problem.

Mr. PAUL. I recognize the fact that the accountants have a particularly serious problem. I have seen it in actual operation. The war has produced for them, as well as for others, a critical situation.

Mr. TARLEAU. It has doubled the personnel they need.

Senator CLARK. Yes.

Thank you, Mr. Paul.

(The tables submitted by Mr. Paul are as follows:)

Estimated number of workers receiving wages at some time during calendar year 1942, number of such workers subject to filing an income-tax return, and number subject to withholding tax, also number of withholding agents

[All figures are in thousands]

	Total number of persons receiving wages at some time during year	Number of persons	
		Subject to filing regular income-tax returns under H. R. 7378	Subject to withholding
Exempt from withholding tax:			
Agriculture.....	3,000	300	1,400
Domestic.....	2,000	400	1,000
Casual.....	1,000	200	800
Military (full year of service) ¹	2,000	800	800
Self-employed.....	(*)	1,000	(*)
Total.....	8,000	2,700	4,000
Subject to withholding tax:			
Federal Government ²	2,000	1,500	1,500
State and local governments.....	3,000	2,000	2,000
All other—Railroad employees, plus persons covered by social security ³	49,000	27,300	23,500
Total.....	54,000	28,800	27,000
Total.....	62,000	31,500	31,000

WITHHOLDING AGENTS (THE EMPLOYERS OF THE WORKERS LISTED IN EACH COLUMN ABOVE)

Exempt from withholding tax:			
Farmers.....	1,500		400
Housewives.....	2,000		525
Casuals ⁴			
Total.....	3,500		925

See footnotes at end of table.

Estimated number of workers receiving wages at some time during calendar year 1942, number of such workers subject to filing an income-tax return, and number subject to withholding tax, also number of withholding agents—Continued

WITHHOLDING AGENTS (THE EMPLOYERS OF THE WORKERS LISTED IN EACH COLUMN ABOVE—Continued)

[All figures are in thousands]

	Total number of persons receiving wages at some time during year	Number of persons	
		Subject to filing regular income-tax returns under H. R. 7378	Subject to withholding
Subject to withholding tax:			
Federal Government ¹	60		60
State and local governments	200		200
All other—Railroad employees plus persons covered by social security ²	2,440		2,440
Total	2,700		2,700
Total	6,200		3,625

¹ Not included.

² While the military personnel spending the full year in active service will increase in the calendar year 1943, it is assumed that the increase will be replaced in civil life, so that at the level of income of the calendar year 1942 the estimated number of persons subject to withholding under H. R. 7378 is still 27,000,000.

³ Excludes the military forces.

⁴ Excludes persons employed at any time during the year in agricultural, domestic, or governmental work.

⁵ Withholding agents for casuals are included under housewives or under other agents who have employees subject to withholding.

Source: Treasury Department, Division of Research and Statistics, July 30, 1942.

TABLE 1.—Amounts to be withheld from wages and salaries under a 5 percent rate—weekly basis

Number of dependents	Single persons, not heads of families						Married person with employed spouse ¹					
	None	1	2	3	4	5 or more	None	1	2	3	4	5 or more
Weekly wage:												
\$0 to \$9.99												
\$10 to \$14.99	\$0.10						\$0.20					
\$15 to \$19.99	.30						.50					
\$20 to \$24.99	.60	\$0.10					.70	\$0.30				
\$25 to \$29.99	.80	.40					1.10	.70	\$0.20			
\$30 to \$39.99	1.20	.80	\$0.30				1.60	1.20	.70	\$0.30		
\$40 to \$49.99	1.70	1.30	.80	\$0.40			2.10	1.70	1.20	.80	\$0.40	
\$50 to \$59.99	2.20	1.80	1.30	.90	\$0.50	\$0.10	2.60	2.20	1.70	1.30	.90	\$0.50
\$60 to \$69.99	2.70	2.30	1.80	1.40	1.00	.60	3.10	2.70	2.20	1.80	1.40	1.00
\$70 to \$79.99	3.20	2.80	2.30	1.90	1.50	1.10	3.60	3.20	2.70	2.30	1.90	1.50
\$80 to \$89.99	3.70	3.30	2.80	2.40	2.00	1.60	4.10	3.70	3.20	2.80	2.40	2.00
\$90 to \$99.99	4.20	3.80	3.30	2.90	2.50	2.10	4.60	4.20	3.70	3.30	2.90	2.50
\$100 to \$109.99	4.70	4.30	3.80	3.40	3.00	2.60	5.10	4.70	4.20	3.80	3.40	3.00
\$110 to \$119.99	5.20	4.80	4.30	3.90	3.50	3.10	5.60	5.20	4.70	4.30	3.90	3.50
\$120 to \$129.99	5.70	5.30	4.80	4.40	4.00	3.60	6.10	5.70	5.20	4.80	4.40	4.00
\$130 to \$139.99	6.20	5.80	5.30	4.90	4.50	4.10	6.60	6.20	5.70	5.30	4.90	4.50
\$140 to \$149.99	6.70	6.30	5.80	5.40	5.00	4.60	7.10	6.70	6.20	5.80	5.40	5.00
\$150 to \$159.99	7.20	6.80	6.30	5.90	5.50	5.10	7.60	7.20	6.70	6.30	5.90	5.50
\$160 to \$169.99	7.70	7.30	6.80	6.40	6.00	5.60	8.10	7.70	7.20	6.80	6.40	6.00
\$170 to \$179.99	8.20	7.80	7.30	6.90	6.50	6.10	8.60	8.20	7.70	7.30	6.90	6.50
\$180 to \$189.99	8.70	8.30	7.80	7.40	7.00	6.60	9.10	8.70	8.20	7.80	7.40	7.00
\$190 to \$199.99	9.20	8.80	8.30	7.90	7.50	7.10						

¹ No allowance for working wife credit.

TABLE 1.—Amounts to be withheld from wages and salaries under a 5 percent rate—weekly basis—Continued

Number of dependents	Married person with spouse not employed					Head of family						
	None	1	2	3	4	5 or more	None	1	2	3	4	5 or more
Weekly wage:												
0 to \$9.99												
\$10 to \$14.99												
\$15 to \$19.99												
\$20 to \$24.99												
\$25 to \$29.99	.10						.10	.10				
\$30 to \$39.99	.40						.40	.40				
\$40 to \$49.99	.90	.50	.10				.90	.90	.50	.10		
\$50 to \$59.99	1.40	1.00	.60	.20			1.40	1.40	1.00	.60	.20	
\$60 to \$69.99	1.90	1.50	1.10	.70	.20		1.90	1.90	1.50	1.10	.70	.20
\$70 to \$79.99	2.40	2.00	1.60	1.20	.70	.30	2.40	2.40	2.00	1.60	1.20	.70
\$80 to \$89.99	2.90	2.50	2.10	1.70	1.20	.80	2.90	2.90	2.50	2.10	1.70	1.20
\$90 to \$99.99	3.40	3.00	2.60	2.20	1.70	1.30	3.40	3.40	3.00	2.60	2.20	1.70
\$100 to \$109.99	3.90	3.50	3.10	2.70	2.20	1.80	3.90	3.90	3.50	3.10	2.70	2.20
\$110 to \$119.99	4.40	4.00	3.60	3.20	2.70	2.30	4.40	4.40	4.00	3.60	3.20	2.70
\$120 to \$129.99	4.90	4.50	4.10	3.70	3.20	2.80	4.90	4.90	4.50	4.10	3.70	3.20
\$130 to \$139.99	5.40	5.00	4.60	4.20	3.70	3.30	5.40	5.40	5.00	4.60	4.20	3.70
\$140 to \$149.99	5.90	5.50	5.10	4.70	4.20	3.80	5.90	5.90	5.50	5.10	4.70	4.20
\$150 to \$159.99	6.40	6.00	5.60	5.20	4.70	4.30	6.40	6.40	6.00	5.60	5.20	4.70
\$160 to \$169.99	6.90	6.50	6.10	5.70	5.20	4.80	6.90	6.90	6.50	6.10	5.70	5.20
\$170 to \$179.99	7.40	7.00	6.60	6.20	5.70	5.30	7.40	7.40	7.00	6.60	6.20	5.70
\$180 to \$189.99	7.90	7.50	7.10	6.70	6.20	5.80	7.90	7.90	7.50	7.10	6.70	6.20
\$190 to \$199.99	8.40	8.00	7.60	7.20	6.70	6.30	8.40	8.40	8.00	7.60	7.20	6.70

Source: Treasury Department, Division of Tax Research, Aug. 14, 1942.

Senator CLARK. Will you go right ahead, Mr. Friedman?

STATEMENT OF MILTON FRIEDMAN, DIVISION OF TAX RESEARCH, TREASURY DEPARTMENT

Senator DANAHER. I think, Mr. Paul, before you abandon that last answer to Senator Clark, you should perhaps make apparent that you are talking about corporation returns as distinguished from individual returns under the quarterly payment plan. That is where the problem arises; is it not?

Mr. PAUL. Yes; because those are returns, by and large, prepared by accountants.

Senator DANAHER. What Mr. Tarleau was talking about and what Mr. Paul was talking about is merely corporation returns.

Mr. TARLEAU. Yes; it is a schedule, and the difficulties in corporate returns are much greater than in individual returns.

Mr. PAUL. Would not that apply to partnership returns, too?

Mr. TARLEAU. To a considerable extent. The principal problem is in the corporate field.

Senator CLARK. All right, Mr. Friedman.

Mr. FRIEDMAN. I would like to call attention first to one point that arose in connection with this discussion of delinquency, and that is the comparison between the social-security situation and this one.

It is true that the withholding process is slightly more complicated here than under Social Security; but, on the other hand, the kind of reports that the employers have to make is very much simpler under the withholding plan than under Social Security.

As you know, under social security each quarter the employer has to send in a report for every single employee; he has to give the total wages for that employee during that quarter, and the amount of tax that is deducted from his wage.

Under our proposed plan the only kind of report he would have to give in each quarter would be for all his employees put together. He would not have to put it down for each employee separately. He would have to show the total amount of wages paid, the total amount of taxes withheld.

That quarterly report is essentially a transmission document for the money he remits. He would have to give a separate report for each employee only at the end of the year, once a year. So that the quarterly return he has to make is much simpler than under the social-security system, and for that reason I think that you would have a good deal less delinquency.

Senator GERRY. Would he have to swear to the annual report of each employee, or did you take that out?

Mr. FRIEDMAN. He just has to swear to the covering document.

Senator GERRY. Just one document?

Mr. FRIEDMAN. That is right. The reason I emphasize that is because I know one of the reasons you have a good many delinquent returns under social security is because it is quite a nuisance to prepare these statements for each individual employee. Many times the employer will just wait for the collector to come around and prepare it for him.

You will not have that problem quarterly with this system, because all they have to do is put down the total amount of money they have paid out and the total amount of money they have deducted. So, on that score, I think delinquencies would be less under this scheme than they would be under the social-security plan.

One more point might be made about this problem of Federal, State, and local government agencies.

We interviewed some of the specific offices in New York, the board of transportation, for example, and in other cities, and also one of our men in Chicago talked to an association there, the name of which I have forgotten for the moment, but it is an association of municipal and local governments, and the people who run that association were most cooperative.

They said immediately this bill became law they would start to prepare material for localities and municipalities that were their members, telling them exactly how to go about handling the withholding returns, and giving them a great deal of information and help, and these people thought that there would be no problem at all but there would be cooperation from their members.

That applies to the cities and municipalities. We, of course, did not cover the States.

One more point on that subject that is worth going into is on this table that is at the bottom of Mr. Paul's statement. It gives at the top the number of people who would be subject to withholding. You will notice in the last column, at the top, there is a total of 27,000,000 people who would be subject to the withholding tax, that is, people who would have money withheld from their salaries.

Of those 27,000,000 people, only three and one-half million are Federal employees and State and local employees. So that, while

there is a very real problem there, it relates to a relatively small part of the total that this system would cover. Some 23,500,000 employees are now covered by the social security, or the railroad retirement plan, and they are the big bulk.

Now, to go on with the administrative problem, what I would like to do, if I may, is not to describe in great detail every step in the process, but, rather, to indicate the points at which what the people are required to do under withholding replaces what they are now required to do.

I think one factor that gives rise to some misunderstanding is that the withholding is interpreted as entirely new and completely in addition to what people are now doing. It is not that at all. That holds true even for industry.

Much of what is required under withholding replaces what they now do.

The first step under withholding is for the employer to find out from his employees whether they are single or married and how many dependents they have, and we have provided a form for that. Now, a good part of that the employer must now do, because when he files the information return, the forms 1099, showing the total wages he has paid to an employee, he is required to indicate on that whether the employee is single or married. He does not have to indicate the number of dependents, but he does have to fill out whether he is single or married.

A great many concerns now make it standard practice, before they file their information returns, to get in contact with each of their employees and to have the employees indicate on the statement what their present addresses are, and whether they are single or married.

I know the A. T. & T., for example, in most of their principal branches, do that. Mr. Gretz has said they do. Now, you see, insofar as they do that, what they are required to do under this plan replaces what they are required to do already, it does not add to it. It merely means that the employee has to fill out a bit more information, but the employer has nothing more to do. He distributes these forms to the employees for the employees to fill out, just as he does now.

So that first subject of getting the information on the marital status is not completely new. A large part of it duplicates what he now does. The new part is what comes in between figuring out for each employee the amount to be withheld, subtracting that from his wage or salary and remitting that amount to the collector every quarter.

Senator DANAHY. Before you go on any further, it is a fact, is it not, that under the proposed amended withholding plan, the information return, as it now exists, would be done away with anyhow?

Mr. FRIEDMAN. Absolutely. It would be replaced.

Senator CLARK. So it is substituting one form for another.

Mr. FRIEDMAN. That is right. They are going to come to that at the end of the year. In the middle of the year, or during the year when he is actually withholding the tax and turning that over to the Federal Government, that is new, that is additional, but it is not a new process for him, it is identically what he does now under the social security.

The only difference between that and social security is that he has a slightly different method of figuring the withholding. Instead of multiplying the wage by 1 percent, as he now does, or by 2 percent as

you will after January 1, 1943, he looks it up on a table, or he makes a computation.

But the process of deducting it from the salary, or accumulating the amount so he knows how much he is taking from each employee and of paying it over to the Government follows in every detail what he now does under social security.

Now, we come to the end of the year. At the end of the year, he is required to send in a statement for each employee with the amount of wages he has paid him during the year, and the amount of taxes he has deducted, and that statement is almost the same as the present information return. This would do away entirely with the present information return, as Senator Danaher has remarked.

So, on the question of the amount of work, that is not an additional work. The only respect in which it is additional is that he now has to file the information return only for employees, if single, who earn more than \$500 a year, under the House Ways and Means Committee bill, or for married people who earn more than \$1,200. Under the withholding plan he would have to file such a return for all people from whom he withheld the tax, and that would be a larger number of persons.

So there is more work, because he has to do it for more people, but it is not entirely new or additional, for he saves all of his present work on information returns.

Now, it might be worth noting one point there, that in our plan as originally designed, you have a slightly different problem because we anticipated that he would enter that amount of money and that amount of tax on the same piece of paper on which he got the information from the employee at the beginning of the year about whether he was married, or single, and so on, and so forth.

The Ford Motor Co., especially, when we talked to them, objected to that procedure, because they said if they sent out these slips to the employees and for them to hand back, when they came back they would be grimy, dirty, and they could not put them through their machines, so they asked could we not give them two forms, one form at the beginning of the year to get the employee's status and another at the end of the year where they would fill out the information return just exactly as they do now.

So we modified that procedure to make it possible.

Senator DANAHER. The employer to retain the employee's statement and not send it in to us?

Mr. FRIEDMAN. That is right, but he would be required to retain it in his file so there would be a signed, certified statement, and if any question comes up we could go to the employer to get it.

A small employer would not want to do that, he would want to do what we first proposed. It would be simpler for him. But for the large employer it means he would get that file entered on his records and then forget about the file. I know the Ford people said that that would greatly simplify their task.

It is a very minor change, but it illustrates the type of change we have tried to make in response to the very practical problems such employers raised and that we had not foreseen.

That about completes the job for the employer. The withholding tax replaces the old information at source system. The additional problem is actually taking the money out of each pay envelope and accumulating it and paying it to the Government.

His quarterly return under this plan is much simpler than the quarterly plan under the Social Security. I do not think there is one employer that we went to that did not say, "Now, for God's sake, don't make us give a report for each quarter for each employee."

Senator DANAHER. On your master return, let me call it, the annual return, will he show the actual number of days worked, the period worked per employee?

Mr. FRIEDMAN. No.

Senator DANAHER. That would still be a matter of his own records anyhow?

Mr. FRIEDMAN. That is right. I am glad you raised that question, Senator Danaher, because one of the points that has aroused misunderstanding was the statement in the law that this return would show the period of employment covered.

All we have in mind by that would be, it would show whether the wages were for calendar year 1943 or for calendar year 1942. If the employer dismissed the employee, or if the employee left on July 1, let us say, the return would show this was for the period of calendar year 1943 up to July 1, but it would not show the number of weeks he had worked, or the number of days he worked. It would not have to show whether it was January, March, and April, or whether it was January, February, and March.

So, I am afraid some of the employers were misled by that statement in the law.

Senator GERRY. Is not one of your difficulties where there is a large increase in the factory due to war work and it increased the number of employees for a certain length of time and then they let them go, or they have a great many transient employees? Is not that one of the big difficulties, like these big contractors have, say?

Mr. FRIEDMAN. The employee who is employed, let us say, for 2 or 3 months raises no more problem than the employee who is employed for the whole year. He is treated just like the other fellow. The employer does not have to worry about where he goes to or where he came from.

When the employee comes into the hiring office and is hired, the personnel people will get from him this slip showing what his status is. That will be entered on the pay-roll record, when they make it out for him.

Senator GERRY. Yes; but where you have transients like that, of course, you are bound to increase your bookkeeping, because every new man that comes in you have to start with an original slip. Where you have a steady business, which may be very big or may be very small, a business that runs on the same scale from year to year, I do not imagine you have that problem.

The social-security statement, for example, must show exactly what you are going to put down, but it does not involve the detail of where you are starting out with a new type of work, a new development, and where you have a number of transient employees, if I may use that term.

Mr. FRIEDMAN. Senator Gerry, the employer, in any event, now even without withholding at source gets a personnel record for his files from each employee he hires, and in all cases he has to set up on his books for Social Security, if for no other reason, a separate account for the person. Now, he has to do that anyway, so that the only additional thing that this involves is that he gets the employee at the

beginning to tell him if he is married, and if so, how many dependents he has, and he enters that on this same employment record that he has to have anyway.

The only addition is getting this information at the beginning and making this report at the end.

Senator GERRY. It does mean additional work, because you have got many more people.

Mr. FRIEDMAN. That is right.

Senator GERRY. And, of course, it enters into your Treasury difficulties, your Internal Revenue difficulties, because you have got the scattered reports coming in from all over the country of these transitory employees.

Mr. FRIEDMAN. You are certainly right on that point. The problem of this moving about is more serious from the Bureau's point of view than it is from the employer's point of view. He does have more reports, but it is worth pointing out that much of the work for that additional report he has to do for the Social Security anyway.

One of the items on that report is the total amount of wages that this man earned during the period, and he has to get that anyway for Social Security. That is not additional work; the only addition is to add up the amount of taxes he has deducted.

So far as the real transients are concerned, if I may use that term, the waiters employed over at the Raleigh Hotel at a banquet, that would raise a very serious problem. To meet that problem, we have suggested here, as Mr. Paul indicated, that if an employer had hired an employee for less than a week and paid less than \$11, he would not have to fill out one of these forms.

Senator GERRY. Of course, you would get those cases, but those are much rarer cases. What I am thinking of is your large war work proposition, where you are bound to have a lot of transients, the sort of people who only go to work until they get a certain amount of money and then they move on, or for other reasons. You are bound to have more of them.

Mr. FRIEDMAN. We have one very interesting company that we interviewed up in Canada on that line, if you are interested in it, and that is the John English Co., that are making the Bren machine gun. Originally, 2 or 3 years ago, they were nothing but a small factory employing two or three hundred employees, and the factory now has 10,000 employees and is growing every day.

We went through their fiscal system in great detail. They were kind enough to show us the machines they were using and the actual forms that they were using. They have built up from a few hundred to 10,000 in the course of just a couple of years. The operations they had to go through in performing the collection-at-the-source function were identical, the machine operations were identical, with those that an American employer would have to go through under that scheme.

Now, as I say, we talked to them at great length, and they do not seem to be seriously troubled by the particular problem you are raising. They had, of course, the problem of building up their system so rapidly to meet such a rapid expansion of employees. I quite agree with you that, similarly, an American plant that was expanding very rapidly will have a problem anyway, but the additional problem raised by this is not as serious as it might at first appear.

Senator GERRY. I question whether your Canadian situation is comparable with ours. For example, Canada has been in the war

longer. It is a very much smaller country. It is very much easier to administer, as a general proposition, because you come into Ontario, and certain sections of the country where your manufacturing is, and I think that is rather a different problem, especially on the transitory feature, from our problem here, where people go from one place to another and the whole concentration has not developed to anything like the degree it has in Canada, or you haven't got the same situation.

Now, did you go into the Province of Quebec, for example, and try to find out what they are doing there?

Mr. FRIEDMAN. No; we did not go into the Province of Quebec.

Senator GERRY. Because you have got a real problem there.

Mr. FRIEDMAN. On account of the language problem.

Senator GERRY. Yes.

Mr. FRIEDMAN. The English people were telling us they were replacing as many people as they could by women.

Senator GERRY. You have got Toronto, Ontario, and those cities where you have got a very strong English tie. They have been in the war much longer. I think you have got a slightly different problem in Quebec.

Senator DANAHER. Let us see if this is not the fact: Administratively, the headache will be the collector's and the employee's, rather than the employer's in the case of the drifters.

Mr. FRIEDMAN. That is right. I think that is entirely right in the case of drifters.

Senator DANAHER. The employer, in the last analysis, may have to make more computations if he turns a man over 12 times a year than if he keeps the same man on the rolls a year. The return to you and the payment to you will be the same in each case, would it not?

Mr. FRIEDMAN. I think that is entirely right. The drifters raise more of a problem for the collectors and for the employees in keeping their receipts and putting them together.

Senator DANAHER. It is to the man's self-interest to make certain that he has got the receipts, or else he will not be able to get credit for the tax that is due, is not that true?

Mr. FRIEDMAN. Just with one qualification. Under the plan as proposed, if he does not have the receipts, he can still get credit for the tax, but he cannot get a quick refund if he has overpaid.

If he has not overpaid, there is no problem.

Senator DANAHER. That is self-policing to that extent, anyway.

Mr. FRIEDMAN. That is absolutely right.

Senator GERRY. Now, what happens if he has made a mistake and not withheld enough?

Mr. FRIEDMAN. If accidentally he does not withhold enough, nothing will happen. All that will happen will be that at the end of the year the employee will claim credit for a smaller amount than he should have been able to claim credit for.

Of course, if any employer systematically withholds a greater amount than he should, that would be a matter for investigation by the Bureau and for checking.

One of the great advantages of having the collection at the source linked with a regular income tax instead of having it entirely separate is that you have room for that type of adjustment. If, for example, you were collecting at the source, and that was all there was to it, it would be awfully important to make sure that there were absolutely no mistakes whatsoever, because it would be to the detriment of the

employee and to the detriment of the Government, but on a system like this, where at the end of the year the employee takes credit for the amount withheld and pays the rest, or where he can get a refund if too much has been withheld, minor errors do not cause much of a serious problem.

If an employee pays slightly more of his tax in advance than he otherwise would, that does not involve any permanent loss upon him, that does not involve any permanent loss to the Federal Government. I think that is one of the great virtues of maintaining the collection-at-the-source system and linking it with the regular income tax, because it gives you a margin for error, it gives you some leeway.

We can afford to use a simple table, like the one you have seen, which is not precise, just because it is a prepayment and it is not a final liability.

Senator DANAHER. Just curiously, I sometimes do have an idea, and I just had one.

I am wondering if you cannot integrate the possibility of allowing your employee, in case of suspected excessive withholdings, to pursue his complaint through the State departments of labor and factory inspection when available, and just tie in the possibility of utilizing already existing machinery where there are spot checks going on constantly, where there are Government and State employees in the State and Federal inspection services already, where they have the employer's records both as to individuals and as to the totals.

Mr. FRIEDMAN. I think that is an excellent idea, Senator Danaher.

Senator DANAHER. Now, this is a question that you have not covered. What are you going to do with the wife that is working and the husband that is working and each claims the credit? What is the employer's relation to that particular problem?

Mr. FRIEDMAN. On the slip which the employee fills out on his status, there is a question as to whether his wife is working. If he says his wife is working, the employer gives him only half the exemption for a married person whose wife is not working.

That is why, if you will notice, on that table there is a blank there for a married person whose spouse is employed.

In order to prevent injustice in those cases where the spouse may work only casually, for example a man's wife may clerk in a store for a week during the year; it would not be fair to give the man only half the exemption throughout the whole year.

The form also carries a question whether the spouse receives wages for regular services or for casual services. If the wife receives wages for casual services, the employer will give the husband the full exemption, but if the wife receives wages for regular services, the employer will give the husband only half the exemption. So that, I believe that problem is taken care of.

Senator GERRY. Now supposing the wife is working and the husband certifies that she is not, and she is working in one city, and he is working in another, and they both claim the total exemption? That means you have got to check up on them, the Treasury has got to check up on them; does it not?

Mr. FRIEDMAN. Well, the employer, of course, in that case, may I point out first, is entirely relieved from any responsibility. His only responsibility is to accept the employee's statement and put it into effect.

Of course, the Treasury does have to check it up, just as we now have to check it up on the information that people put in their annual returns once a year. What we would presumably do would be to make spot checks during the year on this type of thing and have the full check at the end of the year. I grant you there may be some cases of evasion through that method, but it is worth noting that that problem is not worse under this system than it now is, because under the present law if you do not withhold at all it is not until next January or February or March, when the man files his return, that you have a chance to check up on him.

If the husband and wife file wrongly you will have a chance to check up on them at that time. Under this, Senator, you can still check up on them at that time, but in addition, under this scheme, you can check up on them in advance.

Senator DANAHER. In any event, you would divide the credit between the two.

Mr. FRIEDMAN. Senator Gerry was citing the example where the husband had made a deliberate misstatement and said his wife was not working when she really was. Of course, there are very severe penalties provided for such misstatement.

We would catch up with him eventually, no question about that, because at the end of the next year we would put together his statement that his wife was not working and his wife's statement that she was working, and together with those statements would come the information from the employers that they were both working.

Senator GERRY. Probably, under that scheme, they would both work under different names.

Senator DANAHER. Yes; and they do right now, as a matter of fact.

Senator GERRY. They do right now. The only thing is, with the incentive of high wages, and that sort of thing, you are much more apt to have that sort of evasion attempted.

Of course, you have the other point that Senator Danaher raised, if you start checking up with the different agencies. There you could delay things terrifically, because if a lot of different agencies can go in and have a look at the books, especially in different localities, you are going to have the employers object to all the time having his records gone into.

I think on that point you will probably have to have one responsible head that does it, like the Treasury, that checks up, otherwise you would never stop having the books investigated.

Mr. FRIEDMAN. I think there is no question at all, Senator Gerry, but that there is room in this system, as in any system, for some evasion.

Senator GERRY. Yes.

Mr. FRIEDMAN. But the important thing, it would seem to us, is that there is no additional room for evasion over and above what there is in the present law, and there is much room for evasion under the present law. If this husband and wife wanted to both assume different names and file two income tax returns, both claiming the marriage exemption, say the husband filed as Mr. Jones and claimed the \$1,200 exemption and the wife filed as Mrs. Smith and claimed the \$1,200 exemption, you would still have the problem of trying to catch them.

So that those problems are all with us now.

Senator CLARK. That is prima facie evidence of fraud.

Mr. FRIEDMAN. It certainly is.

Senator GERRY. It is prima facie evidence of fraud, and the only question that passed in my mind is, would it be more difficult for the Treasury to check up on it? I doubt it.

Mr. FRIEDMAN. It would be the same problem, I think, as we have now.

Senator GERRY. I was just raising the question.

Mr. FRIEDMAN. Yes, sir.

Senator GERRY. I think the problem might be the same. Of course the only thing I can see, there is more incentive in this to do it, because you are withholding more.

Mr. FRIEDMAN. But there is no more incentive with the same tax rate. You ultimately have the same incentive. In fact, I would say the incentive is less. Let me explain why I think that.

You come to the end of the year with no withholding and you are suddenly faced with the problem of paying a lot of money in tax and you do not have that money, you scratch your head trying to figure how to get out of it, and one way to get out is to claim more exemption than you are entitled to. Under this plan you file your report with the employer at the beginning of the year, in advance, before you have any problem of paying the entire withholding. The money is going to be withheld, they are going to pay it in small amounts each week.

You know your employer is going to be awfully annoyed at you if you file erroneous information and he finds out about it, not because it is his business to check up on it, but he is not going to trust an employee who gives him wrong information for any purpose. I think it is more likely, for those reasons, that you will get correct information on this exemption certificate than you will at the end of the year when you suddenly come up against the problem of paying the income tax, and when you are dealing with the impersonal Federal Government and not the employer.

Senator GERRY. I think the Government would be more apt to catch up with him, in the long run, with this system. I think there is no question about that. I think you have made a good answer on that.

Mr. FRIEDMAN. So far as Senator Danaher's point is concerned, there is one point that I think ought to be mentioned, and that is that the employer has no incentive to withhold too much, unless he intends actually to abscond with the money, unless he intends not to turn over to the Federal Treasury the actual amount he has withheld.

I do not believe we are going to have many people like that, and I do not believe it is going to be difficult to catch people like that.

Senator DANAHER. Let me add, in further reply to Senator Gerry's comment about a surplus of agents having access to books, that my comment was limited to those cases of evasion to which you had already referred, Senator Gerry, and, second, to the fact that the unemployment compensation officers who are already on the job under existing law have complete records and, moreover, have access to records and do make complete checks all the time. Consequently, any individual employee complained that there was an intentional withholding of an excess from him, I was simply saying if you gave to such an employee access to an agency that is already on the ground and has that particular complaint run down, that the Treasury could take the result of the investigation and could make its report. You would not have

to duplicate it, you would not have to duplicate what the Government is already paying for, and that is an inspection service that runs into every State. In my State there are at least 1,300 employees in the unemployment compensation division alone. So, you have got a considerable staff right on the ground, Senator.

Most of us overlook the fact that we have got a lot of agencies that we can utilize.

Senator GERRY. I think I misunderstood what you had in mind.

Mr. FRIEDMAN. I would like to point out in that connection, one additional thing, and that is that for almost 2½ million out of the 2,700,000 employees, you are already checking on them. You get almost the same figures for social security, the basic wage figures which are going to be the base of your check are the same essentially, with very minor differences, under this plan as under social security.

You already have a field staff that is investigating already those exact, same items and in that connection you have no really very great additional problem, because the Bureau of Internal Revenue handles that, of course. They already have their people out in the field checking on the social security returns. The same check does for both, except for the accuracy with which the employer computes the amount to be withheld. That is the only additional item, and that I do not think would be very serious, a very serious problem, because if the employer does not understate or misstate his wages for social security taxes, he is not going to misstate the amount he withholds for this purpose, because he has just as much an incentive in the one case as in the other.

Senator DANAHER. You will find the wages-and-hours law inspectors and the unemployment compensation people have almost always got it at hand.

Mr. FRIEDMAN. One of the things that employers repeatedly emphasize, that we had not realized along that line, is the extent to which they have had to change their records in order to comply with the wages-and-hours law. We have not realized the extent to which they have changed their pay periods to comply with it.

We have had people who paid semimonthly, and they paid—or they changed to pay weekly or biweekly, because the wages-and-hours law required them to pay on a weekly basis.

Senator CLARK. Of course, that is one of the complaints that I get most frequently from businessmen all over the country, is the diversity of forms that they are required to make out. A fellow will say he has already had the necessary information set up on his books by his own accountants and his own auditor, and then the O. P. A. will come along and require him to set up the same information on an entirely different set of forms, or the W. P. B. will require him to set up the same information on an entirely different set of forms, and the Social Security will do likewise, and so on.

The businessman claims that is a very great burden on him. In many cases, the same information is required by different bureaus to be set up on different forms.

Mr. FRIEDMAN. I think they have a very fundamental complaint on that score. We require the employer, for example, to make his quarterly report on a simple, 1-page form, which is identical with the first part of the more detailed Social Security form. In addition to that, the only other form the employer has to deal with is this form on

which he reports the amount of wages and the amount of taxes, and that is replacing the information form that he now has to use.

That is not a new form, it just takes the place of what he is already using. So the only additional form we are introducing into this is the simple, 1-page form that accompanies the remission of taxes.

Senator DANAHER. You do not mean remission, you mean remittance, don't you?

Mr. FRIEDMAN. You are right, yes; I mean the remittance of taxes.

That is the only additional form, and that is practically identical, the top part is, with the Social Security form.

I note the objection that there is additional work involved, and that was the actual deduction of the amount each week from the employee's pay. Now, it is worth emphasizing in that respect that that too, entirely aside from Social Security, is not a new operation. We ask the employer in every case how many deductions he is now making from his pay.

We found 1 employer who is making over 20 deductions from the pay checks. The average number of deductions runs about 8 or 9.

Mr. PAUL. What were some of those other deductions?

Mr. FRIEDMAN. There were, of course, Social Security and War Bonds, the two that practically everybody had. Union dues are very widespread. Advances for vacations and for sickness; an insurance scheme that the plant had for perhaps medical insurance or hospital insurance, Red Cross, Community Chest, a deduction for badge fees, the amount that they paid for the badge, a deduction in one case, as I remember, for glasses that the firm sold to the employees because it was a type of work in which they need a special kind of glass.

Senator DANAHER. A retirement fund, probably.

Mr. FRIEDMAN. Yes, a retirement-fund deduction; a deduction, in the case of coal mines, for example, for goods bought at the company's store, and in some places for rent in company houses. I cannot remember very many of the others, but we were just amazed at the number.

We would say to an employer, when we first started, "Now, you have 1 or 2 other deductions," and he would start listing them, and lo and behold, there would be 10 or 12. The problem of deductions is not a new problem for the employers. They know how to do it.

Senator DANAHER. One of the leading officials of the American Federation of Labor sitting next to me at dinner not long ago told me that in one of the largest plants in a New England State which he has had occasion to investigate, the largest single payment in cash was \$5.74, all the balance having been taken out of the employee's pay checks by way of deductions on one or another of these bases you mentioned. \$5.74!

Mr. PAUL. There might be garnishee orders in some of these cases.

Mr. FRIEDMAN. We never heard an employer mention garnishee orders, I might say.

I think that about covers the problem for the employers, and I think it really is worth emphasizing that it is much less bad than it looks offhand, because to the extent to which it replaces the present work and to the extent to which it duplicates what he now has to do, it does not add any additional burden on him. I think there is no

question but if you tried to introduce this in 1925, or 1935 even, before the social security system had gone into effect, it would have been a tremendously greater problem.

I think the introduction of the social-security deduction was a much greater problem than this, just because you were starting something brand new, you were giving the employer new operations to perform that he had never performed before. Now he is used to it, he knows how to handle it, he has got the set-up to handle it, and it is much less serious than it would have been if you had not had all the experience with social security, with union-dues deductions, with war-bond deductions, and the like.

I think many of the estimates that the employers had given on the extra cost and the extra machine needs are definitely overestimates, simply because they had not worked out the plan in detail.

As they have time really to fit the plan into their operations, and especially the business-machine companies have time to absorb it and to give advice to their clients about ways to handle it, the extra work is going to diminish.

I know I myself was in Detroit, interviewing employers there, and we went to the business-machine companies, the Elliott Fisher and the Sundstrand Co., the Burroughs Co., and the International Business Machines Co., and in the course of our discussions with them we were able to work out three, or four, or five, or six different things that we had never thought about before, that would reduce the work of handling this on the different machines these people had.

All the people told us once this thing went into effect, they would get their people immediately to working out simplifications in handling it, and would immediately advise their clients about the simplifications, and would help the clients in figuring out ways to put it on the books.

That kind of thing that you can foretell in advance makes a tremendous difference.

Let me give you one example. We visited the Detroit Timken Axle Co. in Detroit. They were using the International Business Machines setup. They figured they would need several additional machines of several expensive types, or multiply their machine forms, or multiply the books. When we talked to the I. B. M. people who service this outfit, we worked out with them a scheme that would eliminate the additional machines, and they developed a very simple process that they could handle on the present machines. The people at the Detroit Timken Axle Co. could not have conceivably thought of that in advance, but they will be informed by the I. B. M. people about the possibility of using this system. Their need for the machines, which we included in our figures because they stated they needed them, will be completely wiped out.

I am personally convinced there will be many cases of that type in here.

I would like to pass on, if I may, to the dividend part of it. What we are requiring of them on the dividend part of it is not all new. As you know, they now have to furnish information at the end of the year for every person to whom they have paid dividends of more than \$100 a year. That covers about 40 percent, or something like that, of the people to whom they pay dividends.

But in order to know whether they are going to pay a person more than \$100 a year, they have to keep track of a great many people, a

great many more people than that, because they do not know until the final dividend is declared and the final dividend is paid, and they do not know because a person may buy more shares of stock in the meantime, they do not know until the end of the year to which people they are going to pay more than \$100. In fact, they give reports for 40 percent, they keep the records now for perhaps 60 or 70 percent of the people, and the records that they would have to keep under this system would be identical. They would have to accumulate the total amount of dividends paid, and 5 percent of which to people who were subject to the withholding would be withheld and they would enter that on the same kind of form that they now use, Form 1099.

Under our revised procedure they could run off a duplicate of that at the same time that they were making it. Almost all of these people make it on special forms, on the fanfold type of typewriters, and they could very easily have a carbon slipped in. They could use that duplicate as a receipt to send to the dividend recipient and they are through with it. They do not have any extra operation at all except to send this receipt to the dividend recipient, and they can do that by inclosing it either in the last dividend check of the year, or the first dividend check of the next year, so they do not have the additional mailing.

Senator DANAHER. Or the next stockholder's letter telling them where there is no dividend.

Mr. FRIEDMAN. Yes.

Mr. PAUL. I noticed in this morning's paper the dividend deductions had not been as serious as had been anticipated.

Mr. FRIEDMAN. The only other additional work the dividend recipient has to do is on these exemption certificates that corporate owners and individuals with low incomes now file.

Now, what happens is this: The corporation, or the dividend payer, now maintains a dividend record. What he would do is to separate that dividend record into two parts, one part for people from whom they could receive exemption certificates, but that part they would do everything exactly as they are now doing, except at the end of the year they would send us the exemption certificate indicating on it the amount of dividends paid, like the information return.

As for the other part, I have already described it. Their only extra procedure is to put on 95 percent of the dividends instead of 100 percent of the dividends, and to send the stockholder a receipt at the end of the year, which would be a duplication of the information return they send to us. So the extra work involved is very minor.

Senator DANAHER. Suppose we have an individual with a portfolio of 20 stocks, none of which yield \$100 per year, and assume an aggregate receipt, let us say, of \$1,000, would there be any withholding at any stage of the game from that particular citizen?

Mr. FRIEDMAN. Yes.

Senator DANAHER. Where would that occur?

Mr. FRIEDMAN. I am sorry, I am afraid I did not express myself very clearly.

This \$100 requirement is the present requirement for the information return. It would be eliminated in the withholding plan. One of the great advantages of the dividend withholding plan is, it is possible now for the man to receive \$1,000 in dividends from twenty

corporations and yet for us to have no record that he receives a cent of dividends, because he is not required to report unless he receives more than \$100 from any corporation.

Under this plan we will have a record for every cent he has received. That, I think, is one of the advantages under this plan in tightening up the control on the dividend angle of it.

I had not mentioned, in that connection, that the estimates that the American Bankers Association made on dividends were just several times, or many times as large as their actual cost, because they were making the system out to be about as complicated as it could conceivably be made, while we make it as simple as it can conceivably be made.

They received 5 receipts for each dividend check, or 20 receipts, and under our new, modified plan they would have 1 instead of 20, and that one would be a duplicate of the form they now make in a great many cases. So I do not think the amount of extra work involved in that is at all significant.

We had an estimate from the American Telephone & Telegraph Co. as to their approximate costs. They were the company that Mr. Paul referred to as saying it would cut their costs in half if we substituted the annual receipt for the quarterly receipt. Now, I followed that estimate up on the basis of the American Bankers Association statement that there were 100,000,000 dividend checks a year, and totaled them up for the whole country, and the total for all dividend payors was something in the neighborhood of about a billion and a half dollars, and the total amount of tax that would be withheld by them was in the neighborhood, in 1943, of about \$200,000,000 and in 1944 of about \$400,000,000.

I might add that the A. T. & T. estimate is an overestimate.

Senator DANAHER. Now, what would be the effect if it was traded in the open market, unless there is a gross withholding?

Mr. FRIEDMAN. Under the nominee system, if a man had stock under the nominee he would have 5 percent of gross withheld from his dividends, and then the corporation would send to the nominee a receipt for the amount of dividends withheld, just as it now sends the information slip for the amount of dividends that had been paid.

The nominee is now required, in order to clear himself on the books from that amount, to break that one information slip down into a slip for each actual owner, which he is required to send to the Bureau of Internal Revenue as an information slip. We would use exactly the same procedure, except the broken-down receipt would be made in duplicate, one copy would go to the actual owner and one copy to the Bureau.

That would be the only extra step in particular aside from that extra step, that is, making out the duplicate to send to the actual owner so the actual owner would know what has been withheld, there is no bit of difference between that procedure and what we now do.

Senator DANAHER. Let me see if I can pursue that one step further and perhaps clear up any possible doubt on it.

Suppose an individual citizen goes to a broker and places an order for 100 shares of some stock, the withholding tax having adhered against the prior owner, how does that new customer, the new buyer, suffer in withholding, or, in the alternative, how does he ascertain that that amount in fact has been withheld so that he buys, as I put it earlier, ex-dividend, or ex-tax?

Mr. FRIEDMAN. There is no problem of ex-tax in that sense, because the tax is a part of the dividend essentially, and ex-dividend and ex-tax are the same thing. What happens in that case depends on how these 100 shares of stock were held before.

If they were held in the name of the actual owner, why, then there is no problem, because when the 100 shares of stock are transferred there is an entry made in the books of the corporation that the 100 shares of stock were transferred. The former individual is closed off on the books. In that case a slip will be sent to him showing the amount of dividends paid, the amount of tax withheld, and a duplicate of that will go to the Bureau. That is all there is to it. You start a fresh page.

On the other hand, however, suppose the 100 shares was held in the broker's name for the actual owner so the broker got the dividend in the first instance, and then passed it on to the actual owner, and suppose when it is transferred the broker still holds it in his own name as nominee, the broker is now required to break up the dividends he has received into the parts attributable to each person, and to send the Bureau a statement to that effect.

He would do the same thing under this procedure, except he would send a duplicate of it to each actual owner. So the broker has no additional work except to make the forms out in duplicate instead of one copy. That is the present Form 1087. It is the form that Mr. Atkeson drew to your attention the last time as W-6, I think it was.

So, your whole system is not changed in the slightest, except for this duplicate.

Finally, let us come to the problem of the Bureau. In the case of the Bureau, too, much of the work that is required under withholding replaces what they are now doing.

As Mr. Paul pointed out, the Bureau estimated that there would be 100,000,000 forms of all kinds. As he also pointed out, 75 to 80 million of those would be necessary in the absence of withholding, because the Bureau now gets information slips from all employers about their employees; it now gets information slips from dividend payors about the amount of dividend paid; it now has the problem of associating those information slips with the tax returns filed by the individuals.

It would still have identically the same problem. The only place at that point where the Bureau's problem is increased is that you would have more of these slips, you would increase the number of slips by about 20 or 25 percent, because instead of having the \$100 limit of dividends, you would have no limit, and in the case of employees, instead of having \$500 and \$1,200 income the only question would be whether tax has been withheld.

Now, it is not a new kind of thing, it is doing the same kind of thing that they are now doing.

The Bureau now must check employer's records as to wages paid for Social Security purposes. It would still have to do that. That is not a new job. The only thing that is new is that in checking them it would have to check both the amount of tax withheld and the wage, so that through this process much of what appears to be extra work for the Bureau as well as for the employer and dividend payor merely replaces what those people and agencies now do.

I think there is nothing more on that score that I need to say about the Bureau, except I should say one thing in complete fairness.

There is one extra step that I have not mentioned in the matter of making these returns. The getting of these returns into the withholding agencies each quarter is a new step. It is similar to the Social Security return, but there is the extra amount of money in the handling and processing of those returns that is a completely new addition. But once again that, too, is more of the same rather than the new operation, because it is the same process as they now go through in getting Social Security returns in, and they would have to do just a little more than that. But nowhere in this withholding process is there anything of a new kind with which the Bureau has not had a good deal of experience.

Throughout, it is a question of doing some more of the same type of thing.

I think that is all I have to say, unless you would like me to go into the Canadian situation at any length.

Senator CLARK. Are there any questions?

Senator DANAHER. I have only one other thought on that point.

In the event of withholding from the owner of stock and no taxes due ultimately, where does he get his refund?

Mr. FRIEDMAN. You thinking of a corporation or an individual?

Senator DANAHER. I am talking about an individual.

Mr. FRIEDMAN. An individual will file an income tax return, and that income tax return will constitute an automatic claim for refund.

If he wishes to, he may attach his receipts that he got from the corporation, he might attach his receipts to his income tax form. In that case, if his refund is less than \$50, the Bureau will pay it to him immediately on the evidence of the receipt. If his return is more than \$50, the Bureau will have to wait until it has checked his receipts with the receipts of the employer, or the corporation, the duplicate copy that they have gotten, and then they will pay the refund.

But the income tax return which he files is an automatic claim for refund. He does not have to do anything else. Now, if it was an obligor corporation, if it was a corporation and, therefore, exempt, it would take the credit on its corporate income tax return. If it had a tax due it would offset the credit against the tax. There would be no problem.

If it were a deficit corporation and had no tax due, that would be a claim for refund just as in the case of the individual.

Senator DANAHER. Thank you.

Mr. PAUL. Senator Clark, you suggested earlier in the morning that you would like to hear something about the Canadian practice.

Senator CLARK. Yes; we will hear you on that briefly, Mr. Friedman.

Mr. FRIEDMAN. The Canadian tax sounds a lot different from ours, in the way it is applied now, but as it works out in the machine and pay-roll information, it is the same thing. What the Canadians do is to levy a gross tax, with two exceptions.

That is, they have, let us say, 5 percent on the total wage. The first exception is that that gross tax does not apply to anybody whose income is below the exemption limit. For a single person, as I remember it—and this figure is from my memory—it is \$660, and for a married person it is \$1,200. If a man receives less than that, if his rate of pay is less than that, they withhold nothing. If his rate of pay is more than that, they withhold 5 percent of the gross amount.

The second exception is that they allow for the number of dependents, and they do that by means of a tax credit. I do not remember the amounts.

Let us say, for example, it is 50 cents of tax per week per dependent. So, if a man has two dependents, they will take off a dollar from the tax as they would otherwise compute it.

Now, in order to know whether he is entitled to a \$660 exclusion or a \$1,200 exclusion, and how much of a dependency credit he is entitled to, they have to get from him information on his marital and dependency status, exactly as provided in our law. There too, if he changes his status, he has to notify them and they have to give it effect.

The computation of the tax, while it sounds different, works out about the same thing in actual operation as under the original plan as we had it in the bill, because they have to make a multiplication in order to get the tax and a subtraction to allow for his dependency credit. The only difference in our bill is that they subtract first and then multiply. The arithmetical operations of the process are the same, they are only done in a different order.

As I say, in the interview we made of the employers in Canada, we specifically went into the question: Suppose we substituted our tax for theirs, what would happen?

It would turn out that you would change the names of certain operations and the order in which you would do them, but you would perform exactly the same operation.

Under our table form, for many employers, with this table, it would be much simpler than what the employers themselves say. However, the employers are planning to introduce a new system of collection at the source in which they, too, plan to use a table method.

I should point out in that connection that the table method is not better for all employers, and we propose that it be made optional and not compulsory. There are certain types of machines under which the actual computation method is simpler than the table method, and we propose that those employers be permitted to use that method, and that the table method be made optional for those employers for whom it is the simpler.

The Canadians withhold from dividends and registered bond interest essentially the same way as we propose. There is no real difference there.

Senator GERRY. Is the Canadian system based a bit more on the English system? In other words, is not the Government granted larger powers than we grant the Treasury, on account of our Constitution, so that it is a board that has greater powers? They do have greater powers in England, I know.

Mr. FRIEDMAN. That is true.

Senator GERRY. Is the Canadian system the same system?

Mr. FRIEDMAN. That is true in the general tax administration of Canada, but as it happens it does not particularly affect the withholding at source.

Senator GERRY. It would apply in this way: In the case of appeal they would go before the board and it would have more flexibility.

Mr. FRIEDMAN. I think that is true. Although, as I say, while true, it is not a very important element in the collection at source. It is an important element in other parts of the tax system. The Canadian collection at source system is entirely different from the British.

The British system is a completely different system.

Senator GERRY. I did not intend to get into that. I was just raising that one point.

Mr. FRIEDMAN. As I say, as to the British system, every time I look at it again I am struck with amazement as to how they can do it.

Senator CLARK. Thank you very much, Mr. Friedman.

Mr. Paul, could you have this statement of yours prepared for the full committee?

Mr. PAUL. Certainly.

Senator CLARK. I mean, have enough copies for the full committee?

Mr. PAUL. Yes, sir.

Senator CLARK. I am going to have the record printed as soon as I can.

Mr. PAUL. I will have it mimeographed by Monday.

Senator DANAHER. What do you think of the suggestion of this gentleman who wrote to the Wall Street Journal, Mr. Friedman, please?

Mr. FRIEDMAN. Well, the suggestion of this gentleman—I just had a chance to look at it, look it over, very briefly here, so I will answer off the cuff, as it were—comes down to asking the same thing as we propose doing, with just one exception, and that one exception is that he proposes that people be allowed to credit the amount withheld against their last year's tax liability.

Instead of carrying it over until 1944 he proposes, if I understand him, that each quarter in 1943, as you pay your 1942 taxes, you could credit the amount withheld against the tax that was then due.

Now, as you may recall, at one stage the Treasury suggested something similar to that, on a part-and-part basis, whereby part of his withholding could be credited against the past and part into the future, but it was finally discarded because it complicated matters very considerably. In the Bureau's records you would always have to be comparing 2 different years' returns with the 1 year's withholdings. We had the problem of some people who would take advantage of it and some people who would not.

Finally, if you did it as he suggested, you would always be left a year behind, you would never catch up, because you would always be crediting the current year's withholding against the last year's tax. One of the great virtues of the Treasury's plan, that is in the H. R. 7378 bill, is that it enables you to catch up and get on a current basis.

Senator CLARK. By paying double taxes.

Mr. FRIEDMAN. By paying double taxes for those people who have not accrued their tax liabilities.

Senator DANAHER. Which means everybody, practically.

Mr. FRIEDMAN. I should dissent to that and say that I am at least a minority of one.

Mr. PAUL. I am a minority, too.

Mr. FRIEDMAN. That makes two of us.

Mr. PAUL. Otherwise I would not dare to come down here.

Senator DANAHER. All right, thank you very much.

Senator CLARK. Mr. Paul, it is pretty late. I do not know whether you want to go into the Ruml plan or not, but if you want to, I know the committee will be glad to hear it.

Mr. PAUL. It is late, so I think I ought to take the time to indicate my ideas on it very generally.

We do not like the plan as well as the House bill. Now, I appreciate the criticism you have in mind with respect to the House bill, that there is an extra load of 5 percent. That is why we made it only 5 percent the first year, to lighten that load and get over what we call the hump as easily as possible.

The House bill means that the taxpayer having a tax liability at the rate of 19 percent would have, in that particular next year, a tax liability of 24 percent. However, we think instead of it being a defect it is, in many respects, a virtue, because it will, in this first year, have a substantial anti-inflationary effect, and we do not think that the hardship will be too great, particularly if before the bill is passed certain provisions are included to take care of unusually difficult and harsh cases.

However, going to the Ruml plan itself, it seems to us that the plan itself accomplishes one objective which makes it commendable, and that objective is it gets taxpayers to a certain degree on a current basis, but not entirely. I say, "not entirely" because under the Ruml plan you are always faced with the problem of an additional tax the following year, because the year in which you pay your estimated tax has a smaller income than the subsequent year.

So, in a sense, the Ruml plan really has the same effect that H. R. 7378 has.

Our basic thought in connection with the Ruml plan, if it is adopted is, therefore, that it is very essential that it be linked or coupled with collection at the source at a very substantial rate. The reason we suggest that is because if you do not do that, if you take the original unamended Ruml plan you do not accomplish another important objective, that is, the synchronization of tax payments with the receipt of income.

It seems to us that, from the point of view of an adequate and flexible fiscal policy for wartime, that is a very serious defect in the Ruml plan which can be largely cured by coupling with collection at the source with the original Ruml plan, and I understand Mr. Ruml had no objection to it.

Senator CLARK. It was not included in the original Ruml plan as he presented it to the committee, but it was included in the statement he accompanied with it.

Mr. PAUL. He did not originally recommend that but, as I understood his testimony the other day, he had no objection, and I think was inclined to favor it.

Now, the other broad aspect of the Ruml plan to which we object is applying it in an unlimited way. We suggested in the memorandum which is made a part of the record in these subcommittee hearings, page 61, a modification of the plan.

That modification is given at page 65. We suggest two types of modification: One is to cancel the 1941 or 1942 liabilities, whichever are smaller, or that the forgiveness or cancellation of the tax in the plan be limited to the normal tax plus the first bracket rate of surtax.

Other types of modification could be adopted. One person suggested to me a modification involving forgiveness to taxpayers having incomes of not more than \$10,000, but no forgiveness for taxpayers with incomes greater than \$10,000. Our suggestion or modification is more generous than that.

For instance, if you forgave at the 1941 rate, 4 percent normal tax plus 6 percent first bracket of surtax, that is, 10 percent. A man having an income of \$500,000 would thereby, under our modification, get a cancelation of tax liability of approximately \$50,000, which would be very substantial. There would still remain a very substantial tax on an income of \$500,000, and that we would suggest be spread as to payments over a reasonable period, say, 2 years.

Those are the two things we want to emphasize most. There are a lot of more minor aspects of the problem, but the two things we consider most important are, first, the coupling of the Ruml plan with collection at the source at a very drastic rate, say 20 percent. The 19 percent is the total in the House bill of the normal tax and first bracket of surtax.

Of course, that would be an awkward figure for withholding.

Senator DANAHER. Would you take, for example, a figure of income, annual income other than \$500,000? I only know a couple of fellows that get that. I would like you to bring it down on an income like \$20,000.

Mr. PAUL. Let us take a small one, something like \$5,000, and one at \$20,000.

While Mr. Friedman is computing that, I would like to bring out the other point, the other basic point, which is that we think a limitation should be put on the amount of tax forgiven.

First, the Ruml plan should be linked with collection at the source, and Mr. Ruml agrees with that; second, there should be a limitation on the amount of tax forgiveness.

As we pointed out the other day, that means you would, in practical effect, forgive the entire tax of 80 to 90 percent of the taxpayers. The only tax which would not be forgiven would be the limited remaining group, which limited remaining group is in a position financially to pay taxes and, generally speaking, does not need the Ruml plan.

Senator CLARK. Of course, you would defeat the primary purpose, which is to get the greatest amount of tax returns.

Mr. PAUL. You would defeat it as to only a small segment of the taxpaying group, and that is a segment which does not need the benefit of the plan.

There is one thing you do accomplish under our modification, that is, you enable corporations to get rid quickly, before, say 2 or 3 years, of the high-priced executives who are not worth the money that has been paid to them. They admit that.

Mr. FRIEDMAN. For a \$20,000 income for a married man with no dependents, his 1942 tax, under the existing rates, which would apply to 1942, would be \$4,614. The amount he would be forgiven would be \$1,794. That is for a \$20,000 man. That would leave him with \$2,820 to spread over 2 years to pay.

For a \$5,000 man I will have the figure in just a second.

Mr. PAUL. While he is getting the figure for the \$5,000 man, I might add one word, which I think is important: If you do not link collection at the source with the Ruml plan particularly you have, in our opinion, some inflationary effect.

You are going to release certain sums of money into the purchasing stream. The reason I say that is because while I agree that most small taxpayers have not accrued, in any technical sense, their taxes, while I agree that only the rare taxpayer, like Mr. Friedman, is in

the minority, I still think that a good many people have accomplished a sort of informal mental accrual, and that they will feel that they are relieved of this liability, that they can spend money which otherwise they would not feel free to spend.

Therefore, I feel somehow there will be some psychological release of spending power which would not be true otherwise.

Senator GERRY. Don't they have to buy more bonds then?

Mr. PAUL. Some will and some will not. I think you will find certain people were holding back on purchasing and will feel relieved, some will buy bonds, as you suggest, and others will say, "Now I can buy the cherished article that I felt I might go without."

Senator CLARK. Mr. Friedman, the other day you had three calculations on withholding, and Mr. Ruml suggested you make another one on the Ruml plan in connection with the withholding taxes. Did you do that?

Mr. FRIEDMAN. I did it the other day, but I do not have it here, I am sorry.

Senator CLARK. I would like to have that information.

Mr. FRIEDMAN. I have the example for the \$5,000 man ready.

A married person with no dependents, his total liability at existing rates would be \$375, he would have \$330 forgiven, leaving him \$45 to pay over 2 years. In this case a married man with no dependents having an income of \$3,500, he would have everything forgiven and then up to \$5,000 he only has a balance of \$45 that he has to pay in 2 years.

Senator CLARK. Mr. Paul, what would you say as to Senator Johnson's plan, from an administrative standpoint, of collecting the tax monthly?

Mr. PAUL. That would be a worse headache, even the Commissioner admits. In fact, I settled with the Commissioner at one time on collection at the source if we did not have monthly payments. In other words, the Commissioner just shudders when anybody mentions the idea of monthly payments.

It is apparently very difficult from the administrative standpoint.

We had contemplated at one time in the Ways and Means Committee a somewhat more elaborate method of getting over the hump, which we replaced by this reduction of the rate of withholding from 10 to 5 percent. At that time, we had several conferences with the Commissioner, and he agreed that that would not be much preferable to the other more elaborate scheme we had contemplated.

At that time, somebody had suggested this idea of monthly payments and the Commissioner said, "I will be glad to take this 5 percent if you can get rid of this monthly payment idea."

One point I hope you keep in mind is the fact that 1941 was a big-income year. There was a big war income in 1941, and there is a good deal of inequity in forgiving a tax on that income. You will notice, in our modification set forth in the record, that we suggested the forgiveness in 1942 rather than in 1941.

Senator DANAHER. May I ask you a question there?

Is not the 1941 income the tax we are just paying?

Mr. PAUL. That is right. That is the one Mr. Ruml proposed to forgive.

Senator CLARK. Mr. Ruml proposed to take the payment made in 1942 based on the 1941 income, and credit it to the 1942 income.

I guess it is now too late to do anything more today. We will just have to meet whenever we can. The full committee will meet Monday. If we have any further meeting, we will get together.

Senator DANAHER. It has been a very helpful meeting, just the same.

Thank you.

(Whereupon, at the hour of 1 p. m., the committee adjourned, subject to the call of the Chair.)

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