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THE REVENUE BILL OF 1943

DECEMBER 22, 1943.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 3687]

The Committee on Finance, to whom was referred the bill (H. R. 3687) to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments and, as amended, recommend that the bill do pass.

GENERAL

Your committee concurs in the action of the House as to the general magnitude of the additional revenue which ought to be provided by the Congress at this time. It gave especial attention to the factors tending toward inflation, to the mounting Federal debt, and to the burden of present taxes imposed on the American people. In arriving at its conclusion not to seek more than a fourth of the $10,500,000,000 of additional funds requested by the Treasury your committee was influenced by the fact that, between the time the Treasury representatives testified before the Ways and Means Committee and their appearance before your committee, the Bureau of the Budget lowered by $11,000,000,000 its previous estimate of the current year's deficit.

This reduction is due in a large part to the lowering of estimated Government expenditures in certain lines of war goods. These stoppages of output cannot free resources immediately for other types of production and there are instances of at least small-scale

unemployment of both men and resources. In view of this, it would appear that income payments in 1944 will be lower than the $156,900,000,000, estimated by the Treasury. If any amount of steel and other metals is released for limited civilian production, as now appears inevitable, the total amount of civilian goods may be greater than in 1943. Together these trends would leave the inflationary gap smaller than was anticipated.

Your committee was not convinced that a sum as great as proposed by the Treasury could equitably be raised at this time in the manner suggested by the Treasury, that is, in the main, by higher rates of individual income taxes. In his testimony before your committee, Secretary Morgenthau indicated that the Treasury Department preferred a bill raising only two to three billion dollars to one which would include more by resort to a general retail sales tax. Aside from its merits, about which there was some difference of opinion, the Treasury's position in this matter weighed heavily in the minds of committee members.

In general your committee agrees with the objectives of the House bill. It is believed that the individual income tax burden should not be appreciably increased over that of existing law, since individuals will be paying for the next 2 years, a carry-over of liability for the lesser of the years 1942 and 1943. So far as corporation taxes are concerned, your committee is in agreement with the House bill that any increase in corporate taxes should be by way of excess-profits tax rather than normal and surtax.

Your committee has made a number of administrative or technical amendments, which it is believed will improve the existing tax law and remove certain inequities.

REVENUE ESTIMATES

It is estimated that your committee bill will increase Federal revenues by $2,275,600,000 during a full year of operation at calendar year 1944 levels of income and business activity. This figure compares with an estimated increase of $2,139,300,000 under the bill as passed by the House. Net receipts from income and excess profits taxes will be increased by $1,167,600,000 under the committee bill, of which corporate taxes will account for $502,700,000 and individual $664,900,000. Changes in the rates of tax applied to commodities and services will add $1,011,100,000 to Federal receipts, while net postal revenue will be increased by $96,900,000. Net Federal receipts, including net postal revenue, will be increased from $41,324,000,000 under present law to $43,599,600,000 under the committee bill. As trust-fund items are not involved in the determination of the Budget deficit, these figures do not allow for the effect on Federal cash receipts of freezing, at 1943 levels, the rates of certain social-security taxes, which are, in the main, held in trust by the Government for the purpose of paying social-security benefits.

A summary comparison, by major sources, of the increases in revenue over present law, of the House bill and the committee bill is shown in the following table:

TABLE 1.—*Comparison of revenue increases under House bill and Senate Finance Committee bill, by major sources*

Source	Estimated additional, or reduction in (−), revenue[1] (in millions of dollars)	
	House bill	Senate Finance Committee bill
Individual income and Victory taxes	$154.8	$664.9
Corporation income and excess profits taxes	616.0	502.7
Taxes on commodities and services	1,197.2	1,011.1
Employment taxes		−1,400.0
Net postal revenue	171.3	96.9
Total, including employment taxes	2,139.3	875.6
Total, excluding employment taxes	2,139.3	2,275.6

[1] For a full year of operation, at levels of income and business activity estimated for the calendar year 1944; excludes nonrecurring increases or decreases, and those which are completely offset by changes in expenditures.

Staff of Joint Committee on Internal Revenue Taxation, Dec. 21, 1943.

A detailed comparison of the revenue effect of the committee bill and the House bill is shown below:

TABLE 2.—*Estimated tax liability under the Senate Finance Committee bill and the House bill (H. R. 3687), as compared with the tax liability under the present law, for a full year of operation*[1]

[In millions of dollars]

General and special accounts and net postal revenue	Yield of present law	Yield of House bill	Yield of Senate Finance Committee bill	Increase (+) or decrease (−) over yield of present law	
				House bill	Senate Finance Committee bill
1. Internal revenue:					
(1) Income and excess-profits taxes:					
Corporation:					
Income [2]	4,734.6	4,666.6	4,667.6	−68.0	−67.0
Excess-profits tax	10,888.8	11,648.8	11,521.8	760.0	633.0
Declared value excess-profits tax	105.6	105.6	105.6		
Total corporation (gross)	15,729.0	16,421.0	16,295.0	692.0	566.0
Less post-war credit	1,088.9	1,164.9	1,152.2	76.0	63.3
Total corporation (net)	14,640.1	15,256.1	15,142.8	616.0	502.7
Individual:					
Net income tax	14,105.5	17,752.1	14,830.4	3,646.6	724.9
Victory tax (net)	3,491.8		3,431.8	−3,491.8	−60.0
Total individual	17,597.3	17,752.1	18,262.2	154.8	[3] 664.9
Total income and excess-profits taxes	32,237.4	33,008.2	33,405.0	770.8	1,167.6

See footnotes at end of table.

TABLE 2.—*Estimated tax liability under the Senate Finance Committee bill and the House bill (H. R. 3687), as compared with the tax liability under the present law, for a full year of operation.*—Continued

[In millions of dollars]

General and special accounts and net postal revenue	Yield of present law	Yield of House bill	Yield of Senate Finance Committee bill	Increase (+) or decrease (−) over yield of present law	
				House bill	Senate Finance Committee bill
1. Internal revenue—Continued.					
(2) Miscellaneous internal revenue:					
Capital stock, estate, and gift taxes:					
Capital stock tax	365.0	365.0	365.0	.....	.....
Estate tax	522.4	522.4	522.4	.....	.....
Gift tax	40.2	40.2	40.2	.....	.....
Total capital stock, estate, and gift taxes	927.6	927.6	927.6	.....	.....
Taxes on commodities and services:					
Liquor taxes:					
Distilled spirits (domestic and imported) (excise tax)[2] [4]	735.2	1,105.2	1,101.2	370.0	366.0
Fermented malt liquors [3]	504.0	574.0	574.0	70.0	70.0
Rectification tax [3]	11.5	11.5	11.5	.....	.....
Wines (domestic and imported) (excise tax)[3]	36.6	54.6	54.6	18.0	18.0
Special taxes on connection with liquor occupations	11.0	11.0	11.0	.....	.....
Container stamps	9.4	9.4	9.4	.....	.....
Floor-stocks taxes	.6	.6	.6	.....	.....
All other	1.6	1.6	1.6	.....	.....
Total liquor taxes	1,309.9	1,767.9	1,763.9	458.0	454.0
Tobacco taxes:					
Cigarettes (small) [3]	892.8	892.8	892.8	.....	.....
Tobacco (chewing and smoking) [3]	45.0	45.0	45.0	.....	.....
Cigars (large) [3]	31.7	31.7	31.7	.....	.....
Snuff	7.0	7.0	7.0	.....	.....
Cigarette papers and tubes	1.3	1.3	1.3	.....	.....
All other [3]	.1	.1	.1	.....	.....
Total tobacco taxes	977.9	977.9	977.9	.....	.....
Stamp taxes:					
Issues of securities, bond transfers, and deeds of conveyance	25.0	25.0	25.0	.....	.....
Stock transfers	19.0	19.0	19.0	.....	.....
Playing cards [3]	7.5	7.5	7.5	.....	.....
Silver bullion sales or transfers	(5)	(5)	.....	.....	.....
Total stamp taxes	51.6	51.6	51.6	.....	.....
Manufacturers' excise taxes:					
Gasoline	251.1	251.1	251.1	.....	.....
Lubricating oils	54.3	54.3	54.3	.....	.....
Passenger automobiles and motorcycles	.9	.9	.9	.....	.....
Automobile trucks, busses, and trailers	3.5	3.5	3.5	.....	.....
Parts and accessories for automobiles	25.0	25.0	25.0	.....	.....
Tires and inner tubes	40.0	40.0	40.0	.....	.....
Electrical energy	48.5	48.5	48.5	.....	.....
Electric, gas, and oil appliances	3.6	3.6	3.6	.....	.....
Electric light bulbs	5.0	25.0	15.0	20.0	10.0
Radio receiving sets, phonograph records, and musical instruments	3.5	3.5	3.5	.....	.....
Refrigerators, refrigerating apparatus, and air-conditioners	1.1	1.1	1.1	.....	.....
Business and store machines	2.8	2.8	2.8	.....	.....
Photographic apparatus	11.9	11.9	11.9	.....	.....

See footnotes at end of table.

TABLE 2.—*Estimated tax liability under the Senate Finance Committee bill and the House bill (H. R. 3687), as compared with the tax liability under the present law, for a full year of operation.*—Continued

[In millions of dollars]

General and special accounts and net postal revenue	Yield of present law	Yield of House bill	Yield of Senate Finance Committee bill	Increase (+) or decrease (−) over yield of present law	
				House bill	Senate Finance Committee bill
1. Internal revenue—Continued.					
(2) Miscellaneous internal revenue—Con.					
Taxes on commodities and services—Continued.					
Manufacturers' excise taxes—Con.					
Matches	10.5	10.5	10.5	----------	----------
Luggage [6]	5.0	----------	----------	−5.0	−5.0
Sporting goods	2.0	2.0	2.0	----------	----------
Firearms, shells, pistols, and revolvers	.8	.8	.8	----------	----------
Total manufacturers' excise taxes	469.5	484.5	474.5	15.0	5.0
Retailers' excise taxes:					
Jewelry, etc	89.2	161.7	165.3	72.5	76.1
Furs	38.2	93.0	74.7	54.8	36.5
Toilet preparations	35.0	86.4	69.3	51.4	34.3
Luggage, [6] handbags, wallets, etc	----------	58.4	35.0	58.4	35.0
Total retailers' excise taxes	162.4	399.5	344.3	237.1	181.9
Miscellaneous taxes:					
Telephone, telegraph, radio, and cable facilities, leased wires, etc	121.2	170.0	171.1	48.8	49.9
Telephone bill, local service	97.8	146.7	146.7	48.9	48.9
Transportation of oil by pipe line	14.5	14.5	14.5	----------	----------
Transportation of persons	141.8	216.8	216.8	75.0	75.0
Transportation of property	170.3	170.3	170.3	----------	----------
General admissions, etc	163.5	327.0	298.0	163.5	134.5
Cabarets, etc	19.4	110.7	74.2	91.3	54.8
Club dues and initiation fees	6.2	11.3	11.3	5.1	5.1
Leases of safe deposit boxes	6.5	6.5	6.5	----------	----------
Use of motor vehicles and boats	115.5	115.5	115.5	----------	----------
Coconut and other vegetable oils processed [2]	2.0	2.0	2.0	----------	----------
Oleomargarine, etc., including special taxes and adulterated butter	3.1	3.1	3.1	----------	----------
Sugar tax	61.0	61.0	61.0	----------	----------
Coin-operated amusement and gaming devices	12.2	12.2	12.2	----------	----------
Bowling alleys and billiard and pool tables	1.8	28.8	3.8	27.0	2.0
Pari-mutuel wagering	----------	27.5	----------	27.5	----------
All other, including repealed taxes [7]	1.2	1.2	1.2	----------	----------
Total miscellaneous taxes	938.0	1,425.1	1,308.2	487.1	370.2
Total taxes on commodities and services	3,909.3	5,106.5	4,920.4	1,197.2	1,011.1
Total miscellaneous internal revenue	4,836.0	6,034.1	5,848.0	1,197.2	1,011.1
(3) Employment taxes:					
Employment by other than carriers:					
Federal Insurance Contributions Act	2,799.0	2,799.0	1,399.0	----------	−1,400.0
Federal Unemployment Tax Act	207.0	207.0	207.0	----------	----------
Total	3,006.0	3,006.0	1,606.0	----------	−1,400.0

See footnotes at end of table.

TABLE 2.—*Estimated tax liability under the Senate Finance Committee bill and the House bill (H. R. 3687), as compared with the tax liability under the present law, for a full year of operation.*—Continued

[In millions of dollars]

General and special accounts and net postal revenue	Yield of present law	Yield of House bill	Yield of Senate Finance Committee bill	Increase (+) or decrease (−) over yield of present law	
				House bill	Senate Finance Committee bill
1. Internal revenue—Continued.					
(3) Employment taxes—Continued.					
Employment by other than carriers—Continued.					
Taxes on carriers and their employees (chap. 9, subchap. B of the Internal Revenue Code)	262.7	262.7	262.7	.....	.....
Total employment taxes	3,268.7	3,268.7	1,868.7	.....	−1,400.0
Total internal revenue	40,343.0	42,311.0	41,121.7	1,968.0	778.7
2. Railroad unemployment insurance contributions	12.1	12.1	12.1	.....	.....
3. Customs	400.0	400.0	400.0	.....	.....
4. Miscellaneous receipts [5]	577.5	577.5	577.5	.....	.....
Total yield, general and special accounts [6]	41,332.6	43,300.6	42,111.3	1,968.0	778.7
5. Net postal revenue: [9]					
First class:					
Local delivery letters	+25.9	+69.9	+69.9	+44.0	+44.0
Other than local delivery letters	+140.2	+140.2	+140.2	.....	.....
Air mail, domestic	−3.1	+7.9	+7.9	+11.0	+11.0
Second class	−86.0	−86.0	−86.0	.....	.....
Third class	−24.0	+50.4	−24.0	+74.4	.....
Fourth class	−17.9	−13.4	−13.4	+4.5	+4.5
Special services:					
Registry	−8.3	−3.8	−3.8	+4.5	+4.5
Insurance	−1.5	+5.0	+5.0	+6.5	+6.5
Collect on delivery	−4.5	+0.9	+0.9	+5.4	+5.4
Special delivery	−0.6	−0.6	−0.6	.....	.....
Money order	−6.7	+14.3	+14.3	+21.0	+21.0
Other	−22.1	−22.1	−22.1	.....	.....
Total net postal revenue	−8.6	+162.7	+88.3	+171.3	+96.9
Total yield, general and special accounts, and net postal revenue	41,324.0	43,463.3	42,199.6	2,139.3	[3] 875.6

[1] Estimates of the yield of the committee bill and of present law are at levels of income and business activity estimated for the calendar year 1944, and do not take into consideration nonrecurring changes in revenue, or those caused by the termination of governmental excise tax exemptions which are completely offset by changes in expenditure.

[2] Collections for credit to trust funds are not included.

[3] Excludes a nonrecurring loss of $195 millions over calendar years 1943-48 owing to the repeal of certain provisions of the Current Tax Payment Act of 1943 (so-called second windfall tax).

[4] These estimates are after allowances for draw-backs of $19.7 millions under the House bill, $23.7 millions under the Senate Finance Committee bill, and $14.8 millions under present law.

[5] Less than $50,000.

[6] The tax on luggage has been changed from a manufacturers' excise to a retailers' excise tax.

[7] Includes collections from taxes on narcotics; taxes under the National Firearms Act; and the tax on hydraulic mining, all of which are effective currently. In addition, includes collections from repealed taxes not reinstated by the Revenue Act of 1941; and collections from the following excise taxes repealed by the Revenue Act of 1942: rubber articles, electric signs, optical equipment, and washing machines.

[8] Excludes postal surplus, if any, shown separately below.

[9] Excess of revenue over expenditure; based upon the Cost Ascertainment Report for the Fiscal Year 1942, of the Post Office Department; nonpostal services excluded.

NOTE.—Figures are rounded and will not necessarily add to totals.

Staff of Joint Committee on Internal Revenue Taxation, Dec. 21, 1943.

SUMMARY OF PRINCIPAL CHANGES

1. Individual Income Taxes

When referred to your committee, H. R. 3687 contained provisions designed to eliminate the present Victory tax, which was thought to be unduly complicated, by integrating it with the income tax in such manner that practically none of the at least 11,000,000 persons now subject only to Victory tax would be removed from the income-tax-paying class. Early in its consideration of the individual income-tax provisions of the House bill your committee agreed to the principle that no taxpayers should be eliminated from the rolls at this time. Consistent with this action, it was decided not to adopt an integration proposal advocated by the Treasury because it would have freed 9,000,000 persons of any income tax whatsoever.

The House bill repealed the Victory tax and replaced it by an increase in the normal tax rate from 6 to 10 percent, together with slight adjustments in surtax rates, for those subject to regular income tax, and by a so-called "minimum" tax of 3 percent of the net income in excess of certain special exemptions varying with family status so as to retain under the income tax, those subject only to the Victory tax. Your committee agreed to retain the Victory tax, with certain modifications, rather than adopt the minimum tax concept of the House bill. The committee took this stand not because it was convinced that retention of the Victory tax would make income tax computations less complicated for taxpayers than the provisions of the House bill, but rather because it seemed unwise to confront taxpayers making out their March 15, 1944, returns with two different methods of tax computation, one of which would apply with respect to the final return for 1943, the other of which would apply with respect to the declaration of estimated tax for 1944.

The Victory tax has been simplified by your committee by provisions which change it to a tax of 3 percent of the Victory tax net income in excess of $624 regardless of family status. Present law provides for a 5 percent rate of gross Victory tax applied to the same base as in your committee bill, but by a system of credits varying with family status, the 5 percent gross rate under present law is reduced to net rates of 3.75 percent for single persons and 3 percent for married persons, and further reduced by 0.1 percent for each dependent. As every taxpayer will compute his Victory tax for 1944 at a 3 percent rate under the committee bill, and will no longer have to compute current credits against his tax, it is thought that your committee bill will remove a considerable amount of confusion from the minds of taxpayers.

Your committee agreed to the House bill provisions repealing the allowance of earned income credit and the deduction for certain Federal excise taxes paid. As the burden under existing law is not substantially changed by the committee bill, it was decided to retain the withholding exemptions, rates, and tables provided in existing law.

The individual income tax provisions of your committee bill will add $664,900,000 to Federal revenues in a full year of operation, while those of the House bill would have brought in only $154,800,000 additional.

In the following tables there is shown a comparison of the individual income tax burden at various levels, under present law, the House bill and your committee bill:

TABLE 3.—*Comparison of total income-tax burden (including one-half of unforgiven tax) under present law, House bill, and Finance Committee bill (assuming no change in income)*

Net income before personal exemption	Single person			Married person, no dependents			Married person, 2 dependents		
	Present law [1]	House bill	Finance Committee bill [1]	Present law [1]	House bill	Finance Committee bill [1]	Present law [1]	House bill	Finance Committee bill [1]
$600	$17.00	$23.00	$20.28	$1.28	----------	$1.28	$1.19	----------	$1.28
$750	50.85	57.50	53.78	6.28	$1.50	6.28	5.86	----------	6.28
$800	63.23	70.10	66.05	7.95	3.00	7.95	7.41	----------	7.95
$1,000	118.40	126.13	120.74	14.61	9.00	14.61	13.64	$3.00	14.61
$1,200	168.13	176.73	170.01	21.28	15.00	21.28	19.86	9.00	21.28
$1,500	242.73	252.63	243.91	79.28	69.00	88.28	29.19	18.00	31.28
$1,800	317.33	328.53	317.81	157.38	150.10	168.18	38.53	27.00	41.28
$2,000	367.06	379.13	367.08	205.45	201.50	217.45	57.75	33.00	66.95
$2,500	491.40	505.63	490.24	325.61	328.00	340.61	171.69	150.38	190.99
$3,000	632.60	649.00	630.28	445.78	454.50	463.78	290.74	276.88	314.16
$4,000	915.01	935.75	910.36	713.11	734.50	737.11	532.22	533.25	563.86
$5,000	1,219.93	1,245.00	1,212.95	987.20	1,021.25	1,017.20	804.08	820.00	843.95
$6,000	1,547.35	1,576.75	1,538.03	1,267.28	1,344.00	1,333.28	1,080.44	1,111.25	1,128.53
$7,000	1,897.27	1,926.00	1,885.61	1,613.36	1,675.75	1,658.36	1,397.31	1,443.00	1,453.61
$8,000	2,269.68	2,292.75	2,255.70	1,971.44	2,035.50	2,019.44	1,718.66	1,778.25	1,783.20
$9,000	2,664.60	2,682.00	2,648.28	2,335.53	2,402.25	2,389.53	2,080.53	2,145.00	2,153.28
$10,000	3,082.02	3,093.75	3,063.36	2,735.61	2,805.00	2,795.61	2,446.89	2,516.25	2,527.86
$15,000	5,513.35	5,515.75	5,477.03	5,039.78	5,134.50	5,123.78	4,676.94	4,775.75	4,793.03
$20,000	8,477.93	8,472.00	8,399.95	7,906.45	8,034.50	7,990.45	7,453.75	7,597.00	7,580.95
$25,000	11,847.52	11,833.25	11,727.86	11,187.11	11,348.50	11,271.11	10,676.06	10,863.75	10,814.36
$30,000	15,436.48	15,413.88	15,275.16	14,710.78	14,905.50	14,794.78	14,164.99	14,397.13	14,314.41
$40,000	23,067.15	22,995.13	22,774.74	22,163.11	22,432.50	22,247.11	21,547.85	21,869.88	21,719.49
$50,000	31,283.96	31,211.38	30,769.33	30,240.58	30,626.00	30,225.95	29,497.21	30,040.63	29,682.58
$60,000	39,922.63	39,894.50	39,185.78	38,855.63	39,285.50	38,618.78	38,088.63	38,676.50	38,051.78
$70,000	48,898.82	48,915.13	47,939.74	47,808.19	48,282.50	47,349.11	47,017.57	47,649.88	46,758.49
$80,000	58,212.49	58,273.25	57,031.20	57,098.24	57,617.06	56,416.95	56,283.99	56,960.75	55,802.70
$90,000	67,863.68	67,968.88	66,460.16	66,725.80	67,280.00	65,822.28	65,887.93	66,609.13	65,184.41
$100,000	77,745.49	77,960.13	76,119.74	76,581.86	77,287.50	75,466.11	75,738.24	76,584.88	74,812.49
$150,000	128,324.51	129,291.38	125,587.66	127,155.13	128,573.00	124,918.28	126,285.76	127,854.63	124,248.91
$200,000	180,028.54	181,222.63	176,180.58	178,843.41	180,495.50	175,495.45	177,958.29	179,768.38	174,810.33
$250,000	232,300.69	233,717.00	227,341.61	231,107.69	232,982.00	226,648.61	230,214.69	232,247.00	225,955.61
$500,000	493,689.58	496,217.00	483,174.95	492,496.58	495,482.00	482,481.95	491,603.58	494,747.00	481,788.95
$750,000	753,827.00	754,327.00	739,008.28	753,250.00	754,250.00	738,315.28	752,973.00	754,173.00	737,622.28
$1,000,000	1,006,327.00	1,006,827.00	994,841.61	1,005,750.00	1,006,750.00	994,148.61	1,005,473.00	1,006,673.00	993,455.61
$2,000,000	2,016,327.00	2,016,827.00	2,016,827.00	2,015,750.00	2,016,750.00	2,016,750.00	2,015,473.00	2,016,673.00	2,016,673.00
$5,000,000	5,046,327.00	5,046,827.00	5,046,827.00	5,045,750.00	5,046,750.00	5,046,750.00	5,045,473.00	5,046,673.00	5,046,673.00

[1] Victory tax computed on a gross income equal to ten-ninths of net income.

TABLE 1.—*Comparison of effective rates of total income tax (including one-half of unforgiven tax) under present law, House bill, and Finance Committee bill*

Net income before personal exemption	Single person			Married person, no dependents			Married person, 2 dependents		
	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$600	2.833	3.833	3.380	0.213	----------	0.213	0.198	----------	0.213
$750	6.780	7.666	7.170	.837	0.200	.837	.781	----------	.837
$800	7.903	8.762	8.256	.993	.375	.993	.926	----------	.993
$1,000	11.840	12.613	12.074	1.461	.900	1.461	1.364	0.300	1.461
$1,200	14.010	14.727	14.167	1.773	1.250	1.773	1.655	.750	1.773
$1,500	16.182	16.842	16.260	5.285	4.600	5.885	1.946	1.200	2.085
$1,800	17.629	18.251	17.656	8.743	8.383	9.343	2.140	1.500	2.293
$2,000	18.353	18.956	18.354	10.272	10.075	10.872	2.887	1.650	3.347
$2,500	19.656	20.225	19.609	13.024	13.120	13.624	6.867	6.015	7.639
$3,000	21.086	21.633	21.009	14.859	15.150	15.459	9.691	9.229	10.472
$4,000	22.875	23.393	22.759	17.827	18.362	18.427	13.305	13.331	14.096
$5,000	24.398	24.900	24.259	19.744	20.425	20.344	16.081	16.400	16.879
$6,000	25.789	26.279	25.633	21.621	22.400	22.221	18.007	18.520	18.808
$7,000	27.103	27.514	26.937	23.090	23.939	23.690	19.961	20.614	20.765
$8,000	28.371	28.659	28.196	24.643	25.443	25.243	21.483	22.228	22.290
$9,000	29.606	29.800	29.425	25.950	26.691	26.550	23.117	23.833	23.925
$10,000	30.820	30.937	30.633	27.356	28.050	27.956	24.468	25.162	25.278
$15,000	36.755	36.771	36.513	33.598	34.230	34.158	31.179	31.838	31.953
$20,000	42.389	42.360	41.999	39.532	40.172	39.952	37.268	37.985	37.904
$25,000	47.390	47.333	46.911	44.748	45.394	45.048	42.704	43.455	43.257
$30,000	51.454	51.379	50.917	49.035	49.685	49.315	47.216	47.990	47.714
$40,000	57.667	57.487	56.936	55.407	56.081	55.617	53.869	54.674	54.298
$50,000	62.567	62.422	61.538	60.481	61.252	60.451	58.994	60.081	59.365
$60,000	66.537	66.490	65.309	64.759	65.475	64.364	63.481	64.460	63.419
$70,000	69.855	69.878	68.485	68.297	68.975	67.641	67.167	68.071	66.797
$80,000	72.765	72.841	71.289	71.372	72.021	70.521	70.354	71.200	69.753
$90,000	75.404	75.520	73.844	74.139	74.765	73.135	73.208	74.010	72.427
$100,000	77.745	77.990	76.119	76.591	77.287	75.466	75.738	76.594	74.812
$150,000	85.549	86.194	83.725	84.770	85.715	83.278	84.190	85.236	82.832
$200,000	90.014	90.611	88.090	89.421	90.247	87.747	88.979	89.884	87.405
$250,000	92.920	93.486	90.936	92.443	93.192	90.659	92.085	92.898	90.382
$500,000	98.737	99.243	96.634	98.499	99.096	96.496	98.320	98.919	96.357
$750,000	100.510	100.576	98.534	100.433	100.568	98.442	100.396	100.556	98.349
$1,000,000	100.632	100.682	99.484	100.575	100.675	99.414	100.547	100.667	99.345
$2,000,000	100.816	100.841	100.841	100.787	100.837	100.837	100.773	100.833	100.833
$5,000,000	100.926	100.936	100.936	100.915	100.935	100.935	100.909	100.933	100.933

TABLE 5.—*Comparison of total income tax burden (excluding unforgiven tax) under present law, House bill, and Finance Committee bill*

Net income before personal exemption	Single person			Married person, no dependents			Married person, 2 dependents		
	Present law [1]	House bill	Finance Committee bill [1]	Present law [1]	House bill	Finance Committee bill [1]	Present law [1]	House bill	Finance Committee bill [1]
$600	$17.00	$23.00	$20.28	$1.28	----------	$1.28	$1.19	----------	$1.28
$750	50.85	57.50	52.78	6.28	$1.50	6.28	5.86	----------	6.28
$800	62.13	69.00	64.95	7.95	3.00	7.95	7.41	----------	7.95
$1,000	107.27	115.00	109.61	14.61	9.00	14.61	13.64	$3.00	14.61
$1,200	152.40	161.00	154.28	21.28	15.00	21.28	19.86	9.00	21.28
$1,500	220.10	230.00	221.28	79.28	69.00	88.28	29.19	18.00	31.28
$1,800	287.80	299.50	288.28	141.48	138.00	155.28	38.53	27.00	41.28
$2,000	332.93	345.00	332.95	187.95	184.00	199.95	57.75	33.00	66.95
$2,500	445.77	460.00	444.61	296.61	299.00	311.61	159.31	138.00	178.61
$3,000	573.60	590.00	571.28	405.28	414.00	423.28	266.86	253.00	290.28
$4,000	829.26	850.00	824.61	646.61	668.00	670.61	484.97	486.00	516.61
$5,000	1,104.93	1,130.00	1,097.95	893.95	928.00	923.95	730.08	746.00	769.95
$6,000	1,400.60	1,430.00	1,391.28	1,173.28	1,220.00	1,209.28	979.19	1,010.00	1,027.28
$7,000	1,716.27	1,745.00	1,704.61	1,460.31	1,520.00	1,502.61	1,264.31	1,310.00	1,320.61
$8,000	2,051.93	2,075.00	2,037.95	1,779.94	1,844.00	1,827.94	1,553.41	1,613.00	1,617.95
$9,000	2,407.60	2,425.00	2,391.28	2,107.28	2,174.00	2,161.28	1,878.53	1,943.00	1,951.28
$10,000	2,783.27	2,795.00	2,764.61	2,466.61	2,536.00	2,526.61	2,207.64	2,277.00	2,288.61
$15,000	4,967.60	4,970.00	4,931.28	4,533.28	4,628.00	4,617.28	4,207.19	4,306.00	4,323.28
$20,000	7,625.93	7,620.00	7,547.95	7,099.95	7,228.00	7,183.95	6,692.75	6,836.00	6,819.95
$25,000	10,644.27	10,630.00	10,524.61	10,034.61	10,196.00	10,118.61	9,574.31	9,762.00	9,712.61
$30,000	13,857.60	13,835.00	13,695.28	13,185.28	13,380.00	13,269.28	12,692.86	12,925.00	12,842.28
$40,000	20,692.02	20,620.00	20,399.61	19,846.61	20,116.00	19,930.61	19,289.97	19,612.00	19,461.61
$50,000	28,057.58	27,985.00	27,542.95	27,074.58	27,460.00	27,059.95	26,391.58	26,935.00	26,576.95
$60,000	35,798.13	35,770.00	35,061.28	34,794.13	35,224.00	34,557.28	34,090.13	34,678.00	34,053.28
$70,000	43,838.69	43,855.00	42,879.61	42,813.69	43,288.00	42,354.61	42,088.69	42,721.00	41,829.61
$80,000	52,179.24	52,240.00	50,997.95	51,133.24	51,652.00	50,451.95	50,387.24	51,064.00	49,905.95
$90,000	60,819.80	60,925.00	59,416.28	59,752.80	60,316.00	58,849.28	58,985.80	59,707.00	58,282.28
$100,000	69,665.36	69,910.00	68,039.61	68,584.36	69,280.00	67,458.61	67,803.36	68,650.00	66,877.61
$150,000	114,933.13	115,900.00	112,196.28	113,838.13	115,256.00	111,601.28	113,043.13	114,612.00	111,006.28
$200,000	161,200.91	162,395.00	157,352.95	160,091.91	161,744.00	156,743.95	159,282.91	161,093.00	156,134.95
$250,000	207,973.69	209,390.00	203,014.61	206,857.69	208,732.00	202,398.61	206,041.69	208,074.00	201,782.61
$500,000	441,862.58	444,390.00	431,347.95	440,746.58	443,732.00	430,731.95	439,930.58	443,074.00	430,115.95
$750,000	674,500.00	675,000.00	659,681.28	674,000.60	675,000.00	659,065.28	673,800.00	675,000.00	658,449.28
$1,000,000	899,500.00	900,000.00	888,014.61	899,000.00	900,000.00	887,398.61	898,800.00	900,000.00	886,782.61
$2,000,000	1,799,500.00	1,800,000.00	1,800,000.00	1,799,000.00	1,800,000.00	1,800,000.00	1,798,800.00	1,800,000.00	1,800,000.00
$5,000,000	4,499,500.00	4,500,000.00	4,500,000.00	4,499,000.00	4,500,000.00	4,500,000.00	4,498,800.00	4,500,000.00	4,500,000.00

[1] Victory tax computed on a gross income equal to ten-ninths of net income.

TABLE 6.—*Comparison of effective rates of total income tax (excluding unforgiven tax) under present law, House bill, and Finance Committee bill*

Net income before personal exemption	Single person			Married person, no dependents			Married person, 2 dependents		
	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$600	2.833	3.833	3.380	0.213	----------	0.213	0.198	----------	0.213
$750	6.780	7.666	7.170	.837	0.200	.837	.781	----------	.837
$800	7.766	8.625	8.118	.993	.375	.993	.926	----------	.993
$1,000	10.727	11.500	10.961	1.461	.900	1.461	1.364	0.300	1.461
$1,200	12.700	13.416	12.856	1.773	1.250	1.773	1.655	.750	1.773
$1,500	14.673	15 333	14.752	5.285	4.600	5.885	1.946	1.200	2.085
$1,800	15.988	16.611	16.015	8.026	7.666	8.626	2.140	1.500	2.293
$2,000	16.646	17.250	16.647	9.397	9.200	9.997	2.887	1.650	3.347
$2,500	17.830	18.400	17.784	11.864	11.960	12.464	6.372	5.520	7.144
$3,000	19.120	19.666	19.042	13.509	13.800	14.109	8.895	8.433	9.676
$4,000	20.731	21.250	20.615	16.165	16.700	16.765	12.124	12.150	12.915
$5,000	22.098	22.600	21.959	17.879	18.560	18.479	14.601	14.920	15.399
$6,000	23.343	23.833	23.188	19.554	20.333	20.154	16.319	16.833	17.121
$7,000	24.518	24.928	24.351	20.865	21.714	21.465	18.061	18.714	18.865
$8,000	25.649	25.937	25.474	22.249	23.050	22.849	19.417	20.162	20.224
$9,000	26.751	26.944	26.569	23.414	24.155	24.014	20.872	21.588	21.690
$10,000	27.832	27.950	27.646	24.666	25.360	25.266	22.076	22.770	22.886
$15,000	33.117	33.133	32.875	30.221	30.853	30.781	28.047	28.706	28.821
$20,000	38.129	38.100	37.739	35.499	36.140	35.919	33.463	34.180	34.099
$25,000	42.577	42.520	42.098	40.138	40.784	40.474	38.297	39.048	38.850
$30,000	46.192	46.116	45.654	43.950	44.600	44.230	42.309	43.083	42.807
$40,000	51.730	51.550	50.999	49.616	50.290	49.826	48.224	49.030	48.654
$50,000	56.115	55.970	55.085	54.149	54.920	54.119	52.783	53.870	53.153
$60,000	59.663	59.616	58.435	57.990	58.706	57.595	56.816	57.796	56.755
$70,000	62.626	62.650	61.256	61.162	61.840	60.506	60.126	61.030	59.756
$80,000	65.224	65.300	63.747	63.916	64.565	63.064	62.984	63.830	62.382
$90,000	67.577	67.694	66.018	66.392	67.017	65.388	65.539	66.341	64.758
$100,000	69.665	69.910	68.039	68.584	69.289	67.458	67.803	68.650	66.877
$150,000	76.622	77.266	74.797	75.892	76.837	74.400	75.362	76.408	74.004
$200,000	80.600	81.197	78.676	80.045	80.872	78.371	79.641	80.546	78.067
$250,000	83.189	83.756	81.205	82.743	83.492	80.959	82.416	83.229	80.713
$500,000	88.372	88.878	86.269	88.149	88.746	86.146	87.986	88.614	86.023
$750,000	89.933	90.000	87.957	89.866	90.000	87.875	89.840	90.000	87.793
$1,000,000	89.950	90.000	88.801	89.900	90.000	88.739	89.880	90.000	88.678
$2,000,000	89.975	90.000	90.000	89.950	90.000	90.000	89.940	90.000	90.000
$5,000,000	89.990	90.000	90.000	89.980	90.000	90.000	89.976	90.000	90.000

2. Corporation Income and Excess Profits Taxes

Your committee agreed to the House bill provisions raising the rate of excess profits tax from 90 percent to 95 percent and increasing the specific exemption, for excess profits tax purposes, from $5,000 to $10,000. With respect to the excess profits tax invested capital credit which the House measure reduced by one point for the second, third, and top brackets of invested capital, your committee limited the one-point reduction to the second and third brackets only, in the belief that corporate earnings at a rate of 5 percent or less on invested capital were not excessive even in wartime.

The following table compares the percentage rates of credit on invested capital under present law, the House bill, and your committee bill:

Table 7.—*Credit on invested capital*

Invested capital	Present law	House bill	Senate Finance Committee bill
		Percent	
First $5,000,000	8	8	8
$5,000,000 to $10,000,000	7	6	6
$10,000,000 to $200,000,000	6	5	5
Over $200,000,000	5	4	5

The provisions of the House bill would have increased the revenue from corporation income and excess profits taxes by $616,000,000, while those of your committee bill will result in an increased yield of $502,700,000.

3. Excise Taxes and Postal Rates

The following table compares the excise tax and postal rates under present law, the House bill, and the committee bill, and shows as well the revenue effects of the changes proposed:

Table 8.—*Comparison of excise taxes and postal rates under present law, House bill (H. R. 3687), and Senate Finance Committee bill*

Article or service	Present law	House bill	Senate Finance Committee bill	Estimated additional revenue [1]	
				House bill	Senate Finance Committee bill
1. Distilled spirits	$6 per gallon	$9 per gallon	$9 per gallon	[2] $370.0	[3] $366.0
(Draw-back on non-beverage alcohol).	$3.75 per gallon	$5 per gallon	$6 per gallon	(4)	(4)
2. Beer	$7 per barrel	$8 per barrel	$8 per barrel	70.0	70.0
3. Wine:					
(a) Still:					
Under 14 percent alcohol.	10 cents per gallon	15 cents per gallon	15 cents per gallon		
14 to 21 percent alcohol.	40 cents per gallon	60 cents per gallon	60 cents per gallon		
Over 21 percent alcohol.	$1 per gallon	$2 per gallon	$2 per gallon	18.0	18.0
(b) Sparkling	10 cents per half pint.	15 cents per half pint.	15 cents per half pint.		
(c) Other	5 cents per half pint.	10 cents per half pint.	10 cents per half pint.		

See footnotes at end of table.

TABLE 8.—*Comparison of excise taxes and postal rates under present law, House bill (H. R. 3687), and Senate Finance Committee bill*—Continued

Article or service	Present law	House bill	Senate Finance Committee bill	Estimated additional revenue [1]: House bill	Estimated additional revenue [1]: Senate Finance Committee bill
4. General admissions, lease of boxes or seats, etc.	1 cent per 10 cents + 11 percent of charge.	2 cents per 10 cents + 20 percent of charge.	1 cent per 5 cents + 20 percent of charge.	$163.5	$134.5
5. Cabarets	5 percent of charge	30 percent of charge.	do	91.3	54.8
6. Club dues and initiation fees.	11 percent of charge.	20 percent of charge.	do	5.1	5.1
7. Bowling alleys, billiard parlors.	$10 per alley; $10 per table	do; $20 per table	$20 per alley; $20 per table	27.0	2.0
8. Transportation of persons.	10 percent of charge.	15 percent of charge.	15 percent of charge.	75.0	75.0
9. Communications:					
(a) Toll service	20 percent of charge.	25 percent of charge.	25 percent of charge.	48.8	49.9
(b) Telegraph, etc.:					
(1) Domestic	15 percent of charge.	do	do		
(2) International.	10 percent of charge.	15 percent of charge.	10 percent of charge.		
(c) Leased wires, etc.	15 percent of charge.	20 percent of charge.	25 percent of charge.		
(d) Wire and equipment services.	5 percent of charge	7 percent of charge.	8 percent of charge		
10. Local telephone service.	10 percent of charge.	15 percent of charge.	15 percent of charge.	48.9	48.9
11. Jewelry	10 percent of retail price.	20 percent of retail price; silverplated flatware exempted.	20 percent of retail price; except watches retailing for not more than $65 and alarm clocks retailing for not more than $5, 10 percent.	72.5	76.1
12. Furs and fur-trimmed articles.	do	25 percent of retail price.	20 percent of retail price.	54.8	36.5
13. Luggage, handbags, wallets, etc.	10 percent of manufacturers, sales price on luggage only.	do	15 percent of retail price.	53.4	30.0
14. Toilet preparations	10 percent of retail price.	do	20 percent of retail price.	51.4	34.3
15. Electric-light bulbs and tubes.	5 percent of manufacturers' sales price.	25 percent of manufacturers' sales price.	15 percent of manufacturers' sales price.	20.0	10.0
16. Pari-mutuel wagering.	do	5 percent of amount wagered.	do	27.5	-------
Additional revenue from excises.	-------	-------	-------	1,197.2	1,011.1

POSTAL RATES

(a) First class, local	2 cents per ounce	3 cents per ounce	3 cents per ounce	$44.0	$44.0
(b) Air mail	6 cents per ounce	8 cents per ounce	8 cents per ounce	11.0	11.0
(c) Third class	1 cent and 1½ cents per 2 ounces.	2 and 3 cents per 2 ounces.	1 cent and 1½ cents per 2 ounces.	74.4	-------
(d) Fourth class	Various	Present law increased by 3 percent, or 1 cent, whichever is greater.	Present law rate increased by 3 percent, or 1 cent, whichever is greater.	4.5	4.5
(e) Registered mail	15 cents to $1 per article.	20 cents to $1.35 per article.	20 cents to $1.35 per article.	4.5	4.5
(f) Insured mail	5 to 35 cents per article.	10 to 70 cents per article.	10 to 70 cents per article.	6.5	6.5
(g) C. O. D. mail	12 to 45 cents per article.	24 to 90 cents per article.	24 to 90 cents per article.	5.4	5.4

See footnotes at end of table.

TABLE 8.—*Comparison of excise taxes and postal rates under present law, House bill (H. R. 3687), and Senate Finance Committee bill*—Continued

Article or service	Present law	House bill	Senate Finance Committee bill	Estimated additional revenue [1]	
				House bill	Senate Finance Committee bill
(h) Money orders	6 to 22 cents per article.	10 to 37 cents per article.	10 to 37 cents per article.	$21.0	$21.0
Additional revenue from postal rates.				171.3	96.9
Additional revenue from excise taxes and postal rates.				1,368.5	1,108.0

[1] Estimated change in budget position of the United States for a full year of operation at levels of business for the calendar year 1944. In millions of dollars.
[2] Estimated additional net revenue yield after allowance for increased draw-back on nonbeverage alcohol of $4,900,000.
[3] Estimated additional net revenue yield after allowance for increased draw-back on nonbeverage alcohol of $8,900,000.
[4] Revenue effect included immediately above.

Staff of Joint Committee on Internal Revenue Taxation, Dec. 21, 1943.

DRAW-BACK ON ALCOHOL USED FOR NONBEVERAGE PURPOSES

The House bill raised the tax on distilled spirits from $6 to $9 per gallon and raised the draw-back on spirits used for nonbeverage purposes from $3.75 to $5. Your committee proposal makes no change in the tax rate but increases the draw-back from $5 to $6. The change from existing law has the result of increasing the net tax on nonbeverage alcohol from $2.25 to $3. The House provisions raised this net tax to $4. The combined House provisions raises $370,000,000 in new revenue while the committee proposal will bring in $366,000,000.

A technical change provides that the draw-back shall be allowed at the time the tax-paid alcohol is used in the manufacture of a nonbeverage product rather than at the time the product is sold. The product may be held for a considerable time before sale so that under present law some hardship is inflicted in delaying the payment of the draw-back until the product is sold.

ADMISSIONS TAX

The House bill increased the tax on admissions from 1 cent to 2 cents for every 10 cents or fraction thereof, bringing in additional revenue of $163,500,000. While your committee felt that admissions should bear an additional levy it is believed that the House provisions put a heavy burden on the low-price tickets that are not divisible by 10 cents. For example, the tax on a 15-cent ticket would be 4 cents, or 26.7 percent of the total price of admission, as compared to a 20-percent tax on a 10- or 20-cent ticket. This situation is eased by the committee rate of 1 cent for every 5 cents. This will bring in $134,500,000 in revenue over existing law.

CABARETS

The House bill raised the tax on cabarets from 5 percent to 30 percent of the total charge, bringing in $91,300,000 in additional revenues.

Your committee modifies this increase to 20 percent, reducing the estimated additional yield to $54,800,000. It appeared that the suddenness of the increase from 5 percent to as high as 30 percent would interfere seriously with patronage and jeopardize the revenue yield. Cabarets is defined so as to include many local eating places that simply offer recorded music and dancing facilities.

BOWLING ALLEYS AND BILLIARD PARLORS

The House bill shifted the tax on bowling alleys from a flat $10 per alley to 20 percent of the charge, and the tax on billiard parlors was raised from $10 to $20 per table. This brings in $27,000,000 in new revenue. The greatest part of this increase is from the change in the bowling alley tax from a per alley to a percent-of-charge basis.

This shift appeared to be unduly burdensome for a participant sport such as bowling. Further, the tax on a per game basis would require a great deal of bookkeeping and auditing that would not be required on a flat tax per alley. Hence, your committee set the bowling-alley tax at $20 per alley, reducing the combined revenue increase in the House bill to $2,000,000.

A committee amendment exempts from the tax billiard and pool tables in hospitals when there is no charge for their use.

FUR AND FUR-TRIMMED ARTICLES

The House bill increases the tax on fur and fur-trimmed articles from 10 to 25 percent of the retail price, adding $54,800,000 in revenue. Your committee felt that many fur articles were not luxuries and in some parts of the country they were necessary items of apparel. For these reasons it was thought advisable to make the increase only to 20 percent resulting in an increase of $36,500,000 over present law.

LUGGAGE, HANDBAGS, WALLETS, ETC.

At present there is a tax of 10 percent of the manufacturer's price on luggage only. The House bill shifts this tax to the retail price, raises the rate to 25 percent, and includes in the base such articles as handbags, wallets, toilet sets, and the like. Together these changes increase revenue $53,400,000. Your committee reduced this rate to 15 percent of the retail price making the new revenue $30,000,000. It was felt that 25 percent was too high an initial rate on the items brought under the tax for the first time. Shifting from a manufacturer's base to a retail base, with the rate increase to 25 percent would mean an effective tax increase on luggage of over 400 percent. Of these articles handbags particularly are an essential part of a woman's apparel.

TOILET PREPARATIONS

In the House bill the present tax on toilet preparations is raised from 10 to 25 percent of the retail price bringing in additional revenue of $51,400,000. This tax includes cosmetics, shaving cream, and hair preparations and the like. In order to gain uniformity of tax rates your committee has reduced the increase to 20 percent of the retail price in accord with the tax on furs and jewelry. The committee provisions will bring in $34,300,000 in new revenue.

JEWELRY

In the House bill the tax on jewelry was increased from 10 to 20 percent of the retail price and silver-plated flatware was exempted from the entire tax, resulting together in new revenue of $72,500,000. Your committee concurs in the increased rate but proposes that the exemption for silver-plated flatware be eliminated. It was thought advisable, however, that watches retailing at $65 and under and alarm clocks retailing at $5 and under be left only subject to the old rate of 10 percent, since these are not necessarily luxury items. The retail price of the average precision watch required for railroad workers is roughly $65. The combined changes will increase the present yield by $76,100,000.

ELECTRIC LIGHT BULBS AND TUBES

The House bill raises this tax from 5 to 25 percent of the manufacturer's sales price, bringing in $20,000,000 in additional revenue. These articles are for the most part necessary in the home and are also an important item of business expense. Hence, your committee reduced the rate increase to 15 percent making the added revenue $10,000,000.

PARI-MUTUEL WAGERING

In the House bill a tax of 5 percent of the total amount wagered is placed on pari-mutuel wagering. Your committee believes this source of revenue should be reserved for the States.

THIRD-CLASS POSTAGE

With the purpose of eliminating the perennial postal deficit, particularly as it resulted from very low rates on particular services, the House introduced changes in the rates for local delivery, third and fourth class, and the special services. The several changes would add $171,300,000 in revenue. Your committee agreed to the House provisions with the exception of doubling the rate on third class. Generally, third class covers all printed matter not included in the periodical or newspaper definition for the lower second-class rate. This includes books, advertising matter, and various types of religious and charitable matter. Users of third-class mail usually do so on a large scale so that the sudden rate change would interfere with existing business relationships. This will reduce the estimated additional yield to $96,900,000.

REPEAL OF TAX ON VACUUM CLEANERS

During the early part of the emergency an excise tax was placed on vacuum cleaners. At the present time the tax is meaningless since the article has not been manufactured since 1942. It does, however, threaten to put this industry at a competitive disadvantage as compared to producers of other untaxed electrical appliances when manufacture is resumed. It was therefore felt advisable to repeal this tax now.

FEDERAL GOVERNMENTAL EXCISE TAX EXEMPTIONS

The House bill removed many excise tax exemptions of the Federal Government. In most cases it is necessary to provide special records of tax-free sales which in the long run involves more paper work and inconvenience than Government payment of the taxes along with the price of the articles. Your committee concurs in this economy measure but it was recommended by the departments that in a few cases, where, for instance, the Government was purchasing the full output of certain articles such as firearms, shells and cartridges, it is simpler to continue the Government exemption. In addition, for the duration of the war only, the Secretary of the Treasury is given the authority to continue or restore the Federal Government exemption wherever he determines that the imposition of any of the taxes in question will cause substantial burden or expense and that the full benefit of the exemption, if granted, will accrue to the United States. The House bill only specified certain of these exemptions that would be continued for the duration.

In connection with the cessation of the governmental exemption from the tax on the transportation of persons the House bill provided the tax be paid out of special funds appropriated for that purpose. This would also require reports to Congress on all official travel giving name of the employee, destination, purpose, and other pertinent details. While sympathetic with the purpose of cutting unnecessary official travel your committee removed these provisions as involving too much clerical expense.

Your committee continues these exemptions from certain taxes as they apply to the American National Red Cross.

COMMUNICATIONS

Your committee agreed to retain the present rate of 10 percent on international telegraph, cable, or radio dispatches rather than raise the rate to 15 percent as did the House bill. It was believed that the lower rate would foster comity and trade between countries.

The rate of tax on leased wires, which was raised from 15 percent to 20 percent by the House bill, was further raised to 25 percent by your committee to conform with the rate on competing services: long-distance telephone and domestic telegraph, cable, or radio dispatches. A corresponding increase to 8 percent was made by your committee in the rate of tax, 5 percent under present law, and 7 percent under the House bill, applicable to wire and equipment service.

FLOOR-STOCKS TAX ADJUSTMENTS

It was brought to the committee's attention that in the case of distilled spirits, wines, and fermented malt liquors, upon which floor-stocks taxes, corresponding to the respective rate increases, are imposed in this bill, there might result extremely heavy burdens upon certain dealers if, when the increases in tax are terminated, there is not provided some form of adjustment for floor stocks then on hand. As there was insufficient time to study this question fully, it was decided to take the matter up in the next tax bill.

FREEZING PAY-ROLL TAX

The committee recommends that pay-roll taxes for old age and survivors' benefits be frozen at existing rates of 1 percent upon employers and 1 percent upon employees for 1 year from January 1, 1944, instead of increasing to 2 percent on employers and 2 percent on employees as would otherwise be required by the existing social-security law. The committee believes that the present and prospective revenues from this tax will amply protect the full and complete solvency of the old-age and survivors' benefits fund. When the social-security law was rewritten in 1939 the reserves for these purposes were changed from the basis of a so-called full reserve to the basis of a contingent reserve. And the statute itself indicates the congressional judgment—based upon the report of an advisory committee of experts—as to what yardstick should be applied to measure the adequacy of these contingent reserves.

Title 2 of the Social Security Act was amended in 1939 to require the board of trustees of the old-age and survivors' trust fund to—

> report immediately to Congress whenever the Board of Trustees is of the opinion that during the ensuing five fiscal years the Trust Fund will exceed three times the highest annual expenditures anticipated during that five-fiscal-year period

In other words, Congress indicated that these contingent reserves are adequate whenever they exceed three times the highest cost of the system in any one of 5 subsequent years. Congress has twice applied this rule and, as a result, has twice postponed the statutory increase in pay-roll taxes.

The committee has again applied this rule to the current situation. It finds that for the fiscal year ending June 30, 1943, $1,130,000,000 was collected in these particular pay-roll taxes; that the cost of benefits for the fiscal year was $149,000,000 plus $27,000,000 in administrative expenses; that the balance of $954,000,000 went into the contingent reserve; that this produced a reserve of $4,300,000,000 last June 30. The heaviest annual cost in benefits and administrative expenses from 1943 to 1948 is estimated by the Social Security Board from a low of $415,000,000 under normal circumstances to a high of $813,000,000 under abnormal circumstances. Thus the present reserve is about 11 (instead of 3) times the low and better than 5 times the highest. Chairman Altmeyer, of the Social Security Board, testifies that if no employer or employee contributions whatever were collected in 1944 the reserve assets on December 31, 1944, will amount to about $4,600,000,000, which is more than 3 times the estimated expenditures 5 years later in 1949. Manifestly, something like another billion dollars will be added to the reserve in 1944 by the maintenance of the existing pay-roll taxes at existing levels. Therefore, it seems apparent that these contingent reserves are far more than meet the statutory test without any increase in pay-roll taxes in 1944. Under such circumstances—and in view of all the other tax drains now confronted by workers and employers—the committee does not believe that these pay-roll taxes should be allowed to increase 100 percent on next January 1, as would be the automatic case in the absence of this legislation.

It should be further noted in this connection that the receipts of these old age and survivors' benefits funds and their balances are far greater than contemplated in the original establishment of the

system. The formal report of the Senate Finance Committee in 1939 estimated the reserve at the end of 1943 at $2,651,000,000. Actually it will be nearer $4,850,000,000. We shall collect more in 1944 pay-roll taxes at the existing 1 percent rates on employers and 1 percent on employees than it was expected and prophesied we would collect at the contemplated rate of 2 percent on each.

It should be clearly understood that this recommendation of the committee has nothing to do with the question of the expansion of social-security benefits or coverage. Congress will meet this issue later. We are concerned at the moment solely with the problem of financing existing benefits and coverage. New rates will have to be arranged to meet new obligations. But it is the committee's judgment that present rates are more than adequate for all present obligations. It is for this reason that the committee recommends the freezing of social-security pay-roll taxes for old-age and survivors' benefits at existing levels for the calendar year 1944.

It should be clearly recognized in this connection that when Congress changed the character of these reserve funds in 1939, putting them on a contingent or a pay-as-we-go basis, it recognized the difference in character between private insurance and public insurance, which is tax supported. For example, the system as originally set up contemplated an ultimate reserve of approximately $50,000,000,000 in another 40 years. The interest on $50,000,000,000 at 3 percent is $1,500,000,000 per annum. It makes no difference to the taxpayer whether this $1,500,000,000 is appropriated to pay the interest on $50,000,000,000 of Government bonds in a reserve fund or whether it is a direct appropriation to the support of the old age and survivors system; but it makes a tremendous difference to the taxpayer whether there has also been the needless accumulation of these enormous Government reserves as the result of taxation. It is obviously true that the change to the basis of contingent reserves, as contemplated by the amended statutes, that Congress obligates itself in the future to make whatever direct appropriations (in lieu of appropriations for interest on bonds in reserve) are necessary to maintain the full and complete solvency of the old-age and survivors benefits funds, because there could be no more solemn public trust. This is inherent in the decision made by Congress in 1939. The statutory rule, requiring contingent reserves which are at least three times as large as the total cost of the system in any one of 5 subsequent years, is a complete measure of contingent protection and always gives Congress at least 5 years' notice of any possibility of delinquency.

4. Miscellaneous Provisions

MUSTERING OUT PAY

Your committee has exempted from the income tax amounts received during the taxable year as mustering out payments for military and naval personnel.

LAST-IN FIRST-OUT INVENTORY

Your committee inserted a provision in the Revenue Act of 1942 which provided relief for taxpayers employing last-in first-out method of inventory valuation in event of forced inventory liquidation. The

inventory liquidations contemplated by your committee were those attributable to war conditions beyond the control of the taxpayer. However, some inventories in 1941 were affected by such conditions. It is, therefore, the opinion of your committee that this relief should be extended to taxable years beginning in 1941. There are several technical corrections in this provision. First, the provision is applied to the declared value excess profits tax as well as the income and excess profits tax. Second, instead of limiting the adjustment to the year of liquidation, proper adjustment is permitted for years prior to the year of liquidation in order to give effect to the operations of the carry-back provisions of existing law. In addition, in order to prevent a double deduction, the items of inventory involved in the replacement are to be included in purchases at a cost equal to the base stock inventory cost of the item involved in the liquidation. All of these changes are made retroactive to the year 1941.

PARTIALLY WORTHLESS BAD DEBTS

Your committee has inserted a provision to apply to all taxable years beginning after December 31, 1938, which permits the Commissioner to allow a deduction for a debt recoverable in part in an amount not in excess of the debt charged off within the taxable year. This was the rule in effect prior to the Revenue Act of 1942. Under the Revenue Act of 1942 as construed by The Tax Court of the United States in the case of the *Estate of Harris Fahnestock, Deceased* (2 T. C., 96), it appears that a determination of the part that became worthless during the year is required. To remedy this situation, your committee has restored the law in effect prior to the Revenue Act of 1942.

CONTRIBUTIONS TO VETERANS' ORGANIZATIONS

Under existing law, if an individual makes a contribution to posts or organizations of war veterans, he is allowed a deduction in computing his income. However, a corporation is not allowed any deduction if it makes a contribution to such an organization. This provision permits a corporation to deduct such contributions to the same extent that it is entitled to deduct charitable contributions.

DIVIDENDS PAID ON PREFERRED STOCK OF UTILITIES

Your committee has made the following changes in the provisions of existing law allowing a credit for surtax purposes for dividends paid on preferred stock of public utilities.

(1) The credit is not to apply to any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. Thus arrearage dividends for taxable years prior to October 1, 1942, will not be allowed as a credit for surtax purposes.

(2) Preferred stock issued on or after October 1, 1942, to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace qualifying preferred stock, is treated as coming within the section to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds, debentures, or preferred stock issued prior to October 1, 1942.

(3) A provision is inserted to make it clear that the credit shall apply only to the surtax and not to the normal or excess-profits tax. This is to carry out the intent of the original statute and for that reason is made retroactive to cover taxable years ending after December 31, 1941.

RETURNS BY TAX-EXEMPT ORGANIZATIONS

Under existing law a large group of corporations enjoy tax exemption and many of these are not required to file information returns. It has come to the attention of your committee that large numbers of these exempt corporations and organizations are directly competing with companies required to pay income taxes, and that this practice is becoming more widespread and affording a loophole for tax evasion and avoidance.

These organizations were originally given this tax exemption on the theory that they were not operated for profit, and that none of their proceeds inured to the benefit of shareholders. However, many of these organizations are now engaged in operation of apartment houses, office buildings, and other businesses which directly compete with individuals and corporations required to pay taxes on income derived from like operations. Under the House bill, these exempt corporations are required to file returns of income for taxable years beginning after December 31, 1942, in order to secure sufficient information to determine whether such corporations should be subject to taxation. The House bill continued the exemption of existing law, in the case of religious, educational, and charitable organizations as set forth in the bill. Your committee is in agreement with the House provision with the following exceptions:

(1) The exemption of existing law is continued with respect to organizations for the prevention of cruelty to children or animals.

(2) The exemption of existing law is continued with respect to Government-owned corporations, or agencies or instrumentalities thereof.

(3) The exemption of existing law is continued with respect to fraternal beneficiary societies, orders, or associations, (*a*) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (*b*) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

PENALTIES CONNECTED WITH ESTIMATED TAX

Your committee has revised the penalties connected with the filing and payment of estimated tax under the Current Tax Payment Act of 1943. There are considerable complications in the present law which are traceable to the difficulty of estimating a year's income ahead of time. The many unknowns in such a prediction cause numerous cases of hardship, especially for merchants, small businessmen, farmers, and commission salesmen. The penalties which are changed are those for substantial underestimate of the tax, for failure to file an estimate, and failure to pay an installment of the tax.

1. Substantial underestimate of the tax.

This is a penalty which has caused the greatest complaint. The committee bill, while it does not change the amount of the penalty, does exempt from penalty the declaration under which the taxpayer makes a timely payment of estimated tax within each quarter of the year in an amount at least as great as though computed on the basis of the net income of the taxpayer for the preceding taxable year.

2. Failure to file an estimate of tax or failure to pay an installment of the estimated tax.

The penalties for failure to file a declaration and for failure to pay an installment of the estimated tax are rearranged to make them commensurate with the failure and to graduate them according to the length of time the failure continues. It is also provided that the penalties are not applicable where there is reasonable cause for the delay.

BACK PAY OF INDIVIDUALS

The House adopted a provision relating to the taxes on back pay received by an individual for services rendered in a prior year because of alleged unfair labor practice under the National Labor Relations Act, or a violation of the Fair Labor Standards Act, or a retroactive increase approved by the National War Labor Board. Your committee was unable to agree with this provision because of its limited application and it has, therefore, been omitted from the bill.

LIQUIDATION OF CORPORATIONS

Your committee has adopted a provision, similar to section 112 (b) (7) of the Revenue Act of 1938, which will permit a corporation to liquidate without the recognition of a gain or loss to the shareholders with respect to certain classes of property. This permits a corporation to liquidate property which is not reflected in its earnings and profits account, because the increase in value has not been realized without recognition of gain or loss to the shareholder. The distribution in complete cancelation or redemption of all the stock and the transfer of all the property under the liquidation must occur within some one calendar month in 1944.

REORGANIZATIONS OF CERTAIN INSOLVENT CORPORATIONS

Your committee has granted relief in the case of reorganizations of certain insolvent corporations where property is transferred to another corporation pursuant to receivership, foreclosure, or bankruptcy proceedings, or where there has been a reorganization through adjustment of the capital or debt structure of an existing corporation. In general, no gain or loss is recognized where such a transfer of property has been made, and the new corporation is entitled to the same basis which such assets had in the hands of the transferor. In certain cases of a reorganization by adjustment of capital or debt structure of an existing corporation, the company is treated as a new corporation, and the same rules thus made applicable as in the case where a new corporation is formed on reorganization. Certain rules are laid down for the treatment of gain or loss of security holders. This section is fully explained in the technical part of the report dealing with section 115.

In general, gain or loss is recognized to the security holders when they surrender their old securities for new securities pursuant to the reorganization. To the extent that the provisions are retroactive, the treatment previously accorded the securities holders is frozen.

SALE OF RADIO PROPERTY BY ORDER OF THE FEDERAL COMMUNICATIONS COMMISSION

In line with its policy of separating joint ownership of competing radio stations the Federal Communications Commission may order the sale of certain radio properties and in such a sale the companies may realize a capital gain. In involuntary conversions, the gain is not taxable if the proceeds of the sale are used in the purchase of similar property or in the establishment of a replacement fund. Due to wartime restrictions, the purchase of new radio property may be difficult. However, the bill treats such sales as involuntary conversions at the taxpayer's election. There may be situations where the taxpayer is unable to convert the proceeds of the sale into related properties. Therefore, the bill also contains an additional relief provision, under which the capital gain will not, at the taxpayer's election, be subject to taxation in the year of sale, to the extent that the basis of the remaining depreciable property in the hands of the taxpayer is reduced by the amount of the gain from the sale.

PERCENTAGE DEPLETION

Under the House bill, percentage depletion is extended to flake graphite, vermiculite, potash, beryl, feldspar, mica, lepidolite, and spodumene, in addition to those minerals presently receiving it, and discovery depletion is consequently terminated with respect to these minerals. The extension to flake graphite applies to years beginning after December 31, 1942, but the extensions made by this bill and the Revenue Act of 1942 are limited to the duration of the war.

Your committee makes three changes in this provision. It includes a mineral by the name of talc, and in the case of potash, it reduces the rate from 23 percent to 15 percent and makes the allowance permanent and not limited to the duration of the war.

DECLARATION OF GROSS INCOME FROM THE PROPERTY IN THE CASE OF PERCENTAGE DEPLETION

Section 114 (b) (4) of the code is amended to include a definition of "gross income from the property" for purposes of percentage depletion of mines. It also defines the scope of income from mining for the purposes of section 731 and section 735. The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.

The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the

Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

COST-OF-LIVING ALLOWANCES FOR FEDERAL EMPLOYEES IN FOREIGN SERVICE

The committee bill provides a new subsection to section 116 of the Internal Revenue Code to exempt from gross income the cost-of-living allowances granted personnel of the Government assigned for foreign duty.

Relief is essential to Government personnel stationed in foreign countries who are having a very difficult time and who are reported to be experiencing in the face of rapidly rising living costs a diminution from 22 to 59 percent of the individual amounts it is now possible to provide personnel to assist in meeting official requirements. Under present regulations inclusion of these allowances is required and the income tax thus nullifies in large measure the efficacy of the allowances to meet official expenses incurred by personnel on foreign assignment, and granted in order to meet official requirements.

The personnel of the Government do not choose the posts to which they are assigned, and they have no control over the costs which there are experienced. They are sent to the posts because highly important duties of the Government must there be accomplished. Payment of allowances to meet the extra costs of living at individual posts is indistinguishable from the payment of allowances to defray the expenses of operation of the establishment, the official entertainment which is necessarily undertaken, the travel personnel is ordered to perform or the rental paid for quarters appropriate to house essential activities.

The Secretary of State has reported that at posts in the countries now associated with us in common war against the enemy and in those neutral states of supreme importance to us where the Foreign Service is performing a vitally important part in the Nation's war effort, the cost of living continues to mount higher and higher and the financial difficulties of our officers and employees grow progressively worse, threatening the efficiency and morale of this important group of personnel. The Department has neither the authority nor the funds to compensate such personnel for the extra burden which falls upon them by reason of the tax levied on cost of living allowances. The situation is acute and as the allowances are to meet official needs as distinguished from personal requirements, the exclusion of such allowances from tax consideration for this class of personnel is in the public interest.

STOCKS OF SUBSIDIARY RAILROADS

After passage of the Transportation Act of 1920 and in furtherance of the national policy then adopted of consolidating railroads into a limited number of systems, railroads made substantial investment in the stocks of other lines. Such acquisitions were approved by the Interstate Commerce Commission as initial steps in the direction of the desired efficiencies and economies expected to result from the ultimate consolidation of the railroads into a small number of large systems.

Since the depression of 1930, many of the conditions which encouraged investment by railroads in the securities of other lines, have

changed or disappeared. While many railroads desired to dispose of these securities, the present law will not permit any losses incurred from the sale to be deducted from their ordinary income. Since such losses are regarded under the present law as capital losses, they can only be offset against capital gains. Your committee has provided relief for this situation by permitting the loss on the sale or exchange of certain railroad company subsidiaries to be treated as an ordinary loss and not as a capital loss. The relief is confined to a corporation whose principal business is that of a common carrier by railroad or to a corporation the assets of which consist principally of stock in a common carrier by railroad and which does not itself operate a business other than of a common carrier by railroad. The stocks must be held by the taxpayer pursuant to due authorization by public authority if and so far as such authority is required by law.

DECLARED VALUE EXCESS PROFITS TAX

Under existing law, capital gains and losses are required to be taken into account in computing the income for declared value excess profits tax purposes. Since it is very difficult for taxpayers to determine capital gains or losses in advance of the close of the taxable year, it is not believed they should enter into this computation. The declared value excess profits tax is imposed only for the purpose of insuring a proper declared value for capital stock tax purposes, and, therefore, the amount of such income cannot be definitely determined until after the capital stock value has been declared. Accordingly, your committee does not deem it equitable to require the taxpayer to estimate what his capital gains or losses might be for the income tax year following the close of his capital stock tax year. Accordingly, the effect of the amendment is to eliminate capital gains and losses from income for declared value excess profits tax purposes.

TIMBER RELIEF

Your committee is of the opinion that various timber owners are seriously handicapped under the Federal income and excess profits tax laws. The law discriminates against taxpayers who dispose of timber by cutting it as compared with those who sell timber outright. The income realized from the cutting of timber is now taxed as ordinary income at full income and excess profits tax rates and not at capital gain rates. In short, if the taxpayer cuts his own timber he loses the benefit of the capital gain rate which applies when he sells the same timber outright to another. Similarly, owners who sell their timber on a so-called cutting contract under which the owner retains an economic interest in the property are held to have leased their property and are therefore not accorded under present law capital-gains treatment of any increase in value realized over the depletion basis.

In order to remedy this situation, it is proposed to amend the existing law as follows:

If the taxpayer so elects upon his return, the cutting of timber during the year by the taxpayer who owns or has a contract right to cut such timber is treated as a sale or exchange of the timber cut during the year and such cut timber is considered property used in a trade

or business of the taxpayer for the purpose of section 117 (j) of the Internal Revenue Code provided the taxpayer has owned such timber or held such contract right for a period of more than 6 months prior to the beginning of such year. Where such an election is made, gain or loss to the taxpayer is recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber. The fair market value is determined as of the first day of the taxable year in which the timber is cut.

The election which is made is binding on the taxpayer with respect to all timber which he owns or which he has a contract right to cut and is also made binding for all subsequent years unless the Commissioner, upon the showing of undue hardship, permits the taxpayer to revoke his election.

If an owner of timber disposes of it under a contract by virtue of which he retains an economic interest in such timber, the amount received by such owner is to be treated in a similar manner.

This latter provision will afford relief to those who have leased their property under a contract whereby they retain an economic interest in the timber and are not entitled under the present law to capital gains treatment because of that fact.

The amendments made by your committee are effective as to taxable years beginning after December 31, 1943 except with respect to the amendment dealing with the owner who has leased his property and who retains an economic interest in the timber. The latter amendment is effective as if it were a part of the Internal Revenue Code and of each prior revenue law on the date of its enactment.

AVOIDANCE OF INCOME AND EXCESS-PROFITS TAXES

Your committee is in general agreement with the objective of the House provision designed to prevent avoidance of income and excess-profits taxes. The House report stated that some corporations with large excess profits have been indulging in the practice of purchasing corporations with current, past, or prospective losses, deficits, or large current or unused excess-profits credits for the purpose of reducing excess profits and income taxes. It is stated in the House report that it is the custom of many reputable attorneys to advise clients not to indulge in such transfers since they feel that the courts can interpret the present law so as to invalidate them, and if the courts should not act the impression has been prevalent that Congress would take direct action to close this loophole. Your committee believe that the House provision goes much further than the objectives sought. It creates a realm of uncertainty in connection with any acquisition which might result in any reduction of tax liability or be availed of in reduction of tax liability by any person or persons. Your committee has restricted the section so that it will apply only to situations where any person or persons acquire, on or after October 8, 1940, directly or indirectly, control (more than 50 percent) of a corporation, and the principal purpose for which such acquisition was made in evasion or avoidance of Federal income or excess-profits tax by securing the benefit of a deduction, credit, or other allowance, which such person would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. As is indicated in

greater detail in the technical part of this report, this section does not apply to bona fide liquidations under section 112 (b) (6) of the code or to transfers within a controlled or affiliated group where the control existed prior to October 8, 1940.

Your committee retained the provision giving the Commissioner authority to make allowances or adjustments in proper cases. The success of such a provision will depend upon a sane and intelligent administration. It should not be used to upset or overturn bona fide transactions or to harass and annoy taxpayers who have acquired such property in bona fide acquisitions with no intent to avoid or evade Federal income or profits taxes.

HOBBY LOSSES

Your committee has adopted a provision, similar to that passed by the Senate in 1942, which restricts the allowance of losses from business ventures from being applied against the ordinary income of the taxpayer in certain instances. If an individual's deductions from a trade or business exceed the gross income from such a trade or business for 5 consecutive taxable years, the net income of the taxpayer for each of such years is required to be recomputed, and such deductions shall be allowed only to the extent of $20,000 plus the gross income attributable to such trade or business for the particular year. The provision adopted in 1942 allowed such deductons only to the extent of $10,000. Thus, under the committee bill, if a taxpayer conducted a trade or business for 5 consecutive years, and in each of such years he had a net loss of $50,000, his tax liability for each of such years would have to be recomputed and only $20,000 of such net loss could be applied against his other income for that year.

No deficiency or tax will be assessed for any taxable year beginning prior to January 1, 1944. However, if the year 1944 is the fifth consecutive year in which a taxpayer's deductions from a particular trade or business have exceeded his gross income from such trade or business, then his tax for 1944 will have to be recomputed, and only $20,000 of the excess loss from such trade or business can be offset against his income for 1944.

FOREIGN TAX CREDIT

Your committee has adopted several technical amendments in connection with the foreign tax credit. These amendments in general correct certain technical errors in the law which prevent the taxpayer from securing the correct credit which it is believed Congress intended should be granted when the law was adopted.

PERSONAL HOLDING COMPANIES AND CORPORATIONS ENGAGED IN FOREIGN TRADE

Corporations which are exempt from the excess profits tax unless they are members of an affiliated group, such as personal holding companies or corporations the greater part of whose income is derived from carrying on a trade or business outside of the United States, are given the right to continue their exemption and also to elect not to be included in a consolidated return of the group with which they are affiliated.

ALIENS BROUGHT INTO THE UNITED STATES UNDER AUTHORITY OF THE WAR MANPOWER COMMISSION

Under the program of the War Manpower Commission, due to the critical manpower shortage, it is contemplated bringing into the United States for a portion of the year residents of Puerto Rico and other places outside the United States. Such persons are treated as nonresident aliens for withholding purposes, and if they are subject to the 30-percent withholding rate applicable to nonresident alien individuals, it is believed that a tax will be collected far in excess of their true tax liability. Your committee provides that the rate of withholding in such cases should be 10 percent, and that the provisions of section 1622, relating to withholding for Social Security, shall not apply.

DOUBLE TAXATION OF TRUST INCOME

This section is designed to grant relief from double taxation which might occur by reason of the provisions of paragraphs (2) and (3) (A) of section 162 (d) of the Internal Revenue Code, in cases where income is taxed to the estate or trust in the year the income is received and may be taxed again to the beneficiary in a later year when distributed. Since the income which is distributed is allowed as a deduction to the estate or trust in the year of distribution, double taxation occurs only to the extent that the amount of distributed income which has been taxed to the estate or trust in a prior year exceeds the income of the estate or trust for the year of distribution and therefor is taxed to the beneficiary without a corresponding deduction to the estate or trust. Therefore, in such cases, this section prevents the inclusion in the income of the beneficiary of an amount in excess of the income of the estate or trust for the year of distribution.

Section 162 (d) of the code, as added by section 111 of the Revenue Act of 1942, was designed to close what were regarded as certain loopholes in the provisions of the income-tax laws relating to income of estates and trusts. It has been found that the provisions of that subsection have created difficulties in administration and interpretation and that they produce certain harsh results which should not be continued.

While the main objectives of this subsection are desirable and should be retained, it is advisable that the statute be revised so as to clarify and simplify its provisions and eliminate certain harsh results. Elimination of double taxation is all that can be accomplished in the present revenue bill. A complete revision of the subsection will be undertaken in connection with the next revenue bill.

TRUST FOR MAINTENANCE OR SUPPORT OF CERTAIN BENEFICIARIES

Your committee has given careful consideration to the decision of the Supreme Court in the case of R. Douglas Stuart (317 U. S. 154) which held that a father, who created an irrevocable trust containing a provision that the income thereof might, in the discretion of the trustees, be used for the support and maintenance or education of his minor children, was taxable on the trust income even though it was not actually used for such maintenance, education, or support but was accumulated in the trust.

Prior to the decision of the Supreme Court in the *Stuart case*, the Bureau of Internal Revenue, The Tax Court of the United States, and the lower courts had held that where the trust income or a portion thereof might, in the discretion of the trustees, have been used to support minor children of the grantor, only the amount of the trust income actually distributed for the support and maintenance of such beneficiaries was taxable to the grantor.

Your committee believes that the rule in effect prior to the Stuart case is a sound rule and has inserted a provision in the bill to restore the old rule. Under the bill, income of a trust is not taxable to the grantor merely because such income in the discretion of another person or the trustee may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. Your committee has added a clarifying amendment to make it certain that income is not taxable to the grantor in those cases where the discretion to apply or distribute the income is in another person, the trustee, or the grantor acting as trustee or cotrustee. The amendment is made retroactive to all taxable years where proper consents are filed so that all taxes, which would have been payable if this amendment had been in effect, will be paid.

MUTUAL FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES

Under existing law, fire insurance companies issuing perpetual premium policies are discriminated against by being taxed under section 207 of the Internal Revenue Code. One of the bases upon which companies are taxed under that section is net premium income. Since perpetual companies derive the largest part of their income from investments, and meet their losses and expenses from that source, it is clear that section 207 does not reach an equitable result as applied to them. Accordingly, your committee bill provides that fire insurance companies issuing exclusively perpetual or refundable single insurance premium policies are made taxable under section 204 of the Internal Revenue Code, which is applicable to stock companies. Under this provision, these companies are not required to include single deposit premiums in income and are denied any deduction for dividends paid or declared. This amendment is made applicable to taxable years beginning after December 31, 1941.

RETROACTIVE FISCAL YEAR TREATMENT

Your committee adopted the provisions of the House bill relative to treatment of fiscal year taxpayers. However, the House bill in making a retroactive change in the treatment of a fiscal year beginning in 1941 and ending after June 30, 1942, failed to correct an error in the present law relating to the post-war refund. Under the present law, the taxpayer is denied the full post-war refund on that part of his tax for the fiscal year 1942 computed at the 90-percent rate. Your committee bill corrects this error by allowing the taxpayer the full post-war relief with respect to the tax computed on the 1942 portion of its excess profits income.

EXCESS-PROFITS TAX TREATMENT OF TIMBER, COAL, AND NATURAL GAS

The House bill liberalized the excess-profits tax treatment given certain excess output and bonus income for mineral and timber property so as to extend such treatment to lessors of mineral property or a timber block, new coal and iron mines and timber blocks not in operation during the base period and certain natural-gas companies. The Senate committee agreed to the House provisions with the following exceptions: The relief granted to new coal and iron mines was extended to allow coal-mining or iron-mining property or a timber block which was not in operation during the base period an amount equal to one-half of the net income for such taxable year (computed with the allowance for depletion) from the coal-mining or iron-mining property, or from the timber block, as the case may be. The House bill only allowed an exemption of one-sixth of such net income. In the case of natural-gas companies, the relief under the committee amendment was granted only with respect to net income derived from the withdrawal from the natural-gas property in which the company owned an economic interest. Under the House bill, the relief was extended to the net income derived from the withdrawal, storage, and transportation by pipe line of natural gas. The amendments made by the House were made retroactive to taxable years beginning after December 31, 1941, only with respect to lessors of property in operation during the base period and with respect to natural-gas companies. Under the Senate bill, all of the amendments made by this section were made applicable with respect to taxable years beginning after December 31, 1941.

CREDIT UNDER EXCESS PROFITS TAX FOR DEBT RETIREMENT

Your committee adopted an amendment, explained fully in the technical part of this report, correcting an error in the provisions of post-war credit under the excess profits tax credit dealing with debt retirement.

VALUATION OF UNLISTED STOCK AND SECURITIES UNDER ESTATE TAX

An amendment to the estate-tax law in the House bill provided that in certain instances the value of unlisted stock and securities shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of comparable corporations which are listed on an exchange. Your committee did not deem it advisable to adopt such a provision as it was believed that too much weight might be given to this factor and not enough to other factors which are now taken into consideration in valuing the stock of closely held corporations.

GIFT TAX RELIEF

Section 502 of the House bill was intended to cover some of the hardships occasioned by the Sanford decision (*Sanford Estate* v. *Commissioner*, 308 U. S. 39), which was decided on November 6, 1939. However, the language adopted by the House does not reach the result intended. Under the *Sanford case*, it was held that the creation of a trust did not constitute a taxable gift, if the grantor, though reserving

no power to revest in himself, title to the corpus or income of the trust, reserved the power to name new beneficiaries or to change the interests of the existing beneficiaries. That decision was squarely contrary to assumptions of many grantors, and may entail considerable hardships. If the grantor now releases such powers, the gift-tax law creates a tax liability based on the gift-tax law now in force and the present value of the trust property. If the grantor does not release or part with such powers, it is possible under recent decisions that the income from such trusts shall be taxable to the grantor, even though the grantor cannot himself receive any part of the income or capital. By adding this trust income to the grantor's own income, the tax in many cases may exceed the grantor's own personal income. Some of these old irrevocable trusts were created when there was no gift tax; others were created when there was a gift-tax law. Your Senate committee has rewritten these provisions of the House bill to apply the rule in effect prior to the Sanford decision.

The amendment provides that a relinquishment of such powers with respect to the distribution of the property or income on or after January 1, 1939, and prior to January 1, 1945, shall not be deemed a transfer of property for gift-tax purposes. Thus in the case of property transferred in trust prior to the gift-tax law of June 6, 1932 (but not while the gift-tax law of 1924 was in effect), such powers may be released on or after January 1, 1939, and prior to January 1, 1945, without liability to the gift tax. This is also true with respect to a trust created after the gift-tax law of 1932 became effective, if no gift tax was due with respect to such property, subject to stated conditions. In the case of a trust created after June 6, 1932, which was of sufficient value, after claimed deductions and exclusions, to be subject to the gift tax, this section will grant relief only if a gift tax was paid with respect to such transfer and not credited or refunded. If the grantor merely reserved the right to appoint a new trustee, or to manage and control the trust, including the power to vote stock held in trust, no gift tax will arise from the release of such powers under existing law, and it is, therefore, unnecessary specifically to enumerate such powers in this provision.

LONGER STATUTE OF LIMITATIONS FOR BAD DEBTS AND WORTHLESS STOCK LOSSES

Under existing law the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Your committee, in the Revenue Act of 1942, provided relief for this inequitable situation by allowing a 7-year statute of limitations in such cases. Unfortunately, the 7-year statute applies only with respect to taxable year beginning after December 31, 1938. It has developed that there are certain bad debts which became worthless in the taxable year 1938 and which would come within the 7-year statute were it not for the fact that the provision is limited to taxable years ending after December 31, 1938. To correct this situation, your committee amends the Revenue Act of 1942 by extending this relief to the year 1938.

POWERS OF APPOINTMENT

Your committee has extended the time for release of powers of appointment for estate tax purposes from March 1, 1944, to January 1, 1945. It is also provided that a release of a power to appoint before January 1, 1945, is not subject to the gift tax. Your committee has extended this time, twice heretofore, in order to reexamine the provisions of the Revenue Act of 1942 dealing with this subject. It is believed that further time will be needed as this subject cannot be dealt with until the next revenue bill.

SECOND WINDFALL PROVISION

Your committee has repealed the so-called second windfall provision of the Current Tax Payment Act of 1943. This provision has resulted in a great many inequities and unduly complicates the return.

RENEGOTIATION OF WAR CONTRACTS

General Statement

The existing law has as its basic purpose the prevention of exorbitant and unconscionable costs of materials for war. To accomplish this purpose, the act not only gave authority to the departments charged with renegotiation to redetermine and refix prices, but also to recapture excessive profits on amounts already paid by the Government. This last power was an innovation in our system of government. In effect, it delegated to the departments concerned the power to determine excessive profits according to their discretion. The existing law provided no standards for this purpose. It defined excessive profits as "any amount of a contract or subcontract price which is found as a result of renegotiation to represent excessive profits." No recognition was given to the fact that a large part of excessive profits would have been recaptured through excess profits taxes. Furthermore, it was a recognition that the departments were unable in contracts for procurement of these materials to fix fair and reasonable prices. To a great extent this was difficult when we first entered the war, particularly with respect to new designs and demands for increased volume after contracts had been made. However, the statute included all materials and did not make provision that, when sufficient procurement experience had been gained, the responsibility for unreasonable costs should be put where it properly belongs, that is, in the procurement function of the departments. It is only through careful and proper procurement that it is possible to prevent payment of excessive prices, for costs once paid are difficult of recovery through a consideration of the profits of the particular individual, which bear little relation to what should have been the fair price of an item.

It is not believed that any other nation has relied upon a process of giving administrative authority to determine excessive profits according to the mere discretion of an administrative board other than through taxation and effective procurement means. In supplementing the taxing statute by such an innovation as that of empowering the executive departments thus to determine excessive profits, we must

make it clear and definite that this power is exercised in a fair, equitable, and constitutional manner.

The House bill represented a considerable improvement in this direction. Recognizing that the greater part, or in some cases, all, of these "excessive profits" will be recaptured through taxation, we have endeavored to amend the existing law to make this statute operate in a fair, just, and equitable manner. The following is a summary of the changes made by your committee over the House bill.

SUMMARY OF PRINCIPAL CHANGES

1. In determining excessive profits, your committee requires the following factors to be considered, in addition to those contained in the House bill.

(*a*) Financial problems in connection with reconversion. This factor was not in the House bill, but was contained as a factor in the House Ways and Means Committee report. Your committee deemed it advisable specifically to enumerate this factor in the statute.

(*b*) Consideration must also be given as to whether the profits remaining after the payment of estimated Federal income and excess profits taxes will be excessive. It is believed that in finding whether a contractor's profits are excessive, some consideration should be given to the Federal income and excess profits taxes which he may be called upon to pay with respect to such profits.

2. In determining items of cost all items allowable as deductions and exclusions for income and excess-profits taxes (excluding taxes measured by income) are allowed as items of cost to the extent allocable to such contracts and subcontracts. This includes the recomputation of the amortization deductions and carry-overs and carry-backs allocable to contracts and subcontracts. The House bill limited the deductions and inclusions to items of the character allowed as deductions and exclusions for income and excess profits tax purposes. Your committee was of the opinion that all such deductions and exclusions should be allowable which are properly allocable to such contracts or subcontracts, instead of merely items of the same character.

3. Your committee accepted the House definition of subcontract, but made it retroactive to be effective as of April 28, 1942, the date of the Renegotiation Act. It is believed that this definition expresses the meaning of the original definition of subcontracts as contained in the existing law.

4. Your committee adopted the House definition of standard commercial articles, with the exception of a provision which excluded from the definition an article specially made to specifications furnished by a department or by another contractor or subcontractor. It is believed that the other requirements contained in this definition are sufficient safeguards to enable fair and reasonable prices to be established by the procurement officers. Your committee defines a standard commercial article as one—

(A) Which is identical in every material respect with an article which was manufactured and sold, and in general civilian, industrial, or commercial use prior to January 1, 1940;

(B) Which is identical in every material respect with an article which is manufactured and sold, as a competitive product, by more than one manufacturer, or which is an article of the same kind and having the same use or uses as an article manufactured and sold, as a competitive product, by more than one manufacturer; and

(C) For which a maximum price has been established and is in effect under the Emergency Price Control Act of 1942, as amended, or under the act of October 2, 1942, entitled "An act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes," or which is sold at a price not in excess of the January 1, 1941, selling price.

An article made in whole or in part of substitute materials but otherwise identical in every material respect with the article with which it is compared under subparagraphs (A) and (B) shall be considered as identical in every material respect with such article with which it is so compared.

Under the House bill, a contract or subcontract for the making or furnishing of a standard commercial article may be exempted by the War Contracts Price Adjustment Board if, in the opinion of the Board, normal competitive conditions affecting the sale of such article exist. Your committee has specifically exempted standard commercial articles from renegotiation instead of leaving such exemption to the discretion of the War Contracts, Price Adjustment Board. It is believed that the departments have had sufficient experience to enable the procurement officers to fix a fair and reasonable price with respect to this type of article, particularly since the volume of such articles is apt to be decreased rather than increased in the future.

5. Under the House bill court review was granted in a de novo proceeding before The Tax Court of the United States. Your committee has substituted the Court of Claims for The Tax Court of the United States to handle this de novo proceeding. Some objection was made to conferring jurisdiction of renegotiation cases to The Tax Court of the United States by the Treasury, the Department of Justice, and the War Department. It was contended that to confer such jurisdiction upon The Tax Court might seriously interfere with the handling of tax cases by that court, particularly the relief cases under section 722 of the Internal Revenue Code, relating to the excess-profits tax. The Court of Claims, at the request of the contractor or subcontractor, is required to furnish a statement of its determination, of the facts used as a basis therefor, and of its reasons for such determination.

6. Your committee has increased the number of members of the War Contracts Price Adjustment Board from five to six members. The additional member shall be an officer or employee of the War Production Board and shall be appointed by the Chairman of the War Production Board. For this reason, four members of the Board shall constitute a quorum, instead of three as under the House bill.

7. The House bill provides that no proceeding to determine excessive profits shall be commenced more than 1 year after the close of the fiscal year in which such profits were received or accrued and, if such proceeding is not so commenced, then upon the expiration of 1 year following the close of the fiscal year, or 1 year following the date on which the financial statements required to be furnished to the Board

are filed, the liability as to excessive profits received or accrued shall be discharged. Thus, the statute would make the discharge of liability hinge upon the date of filing with the Board such financial statements as it might require.

Your committee removed this condition, so that the statute runs as to the time within which the renegotiation proceeding may be commenced after 1 year in which such profits were received or accrued.

8. Your committee bill exempts from renegotiation a contract with a common carrier for transportation, or with a public utility for gas or electrical energy where the price for performance is fixed in accordance with published rates or charges filed with, fixed, approved, or regulated by a Federal, State, or local public regulatory body. In the case of such contracts, the rates or charges so fixed or regulated are sufficient basis of a fair and reasonable price for the performance of such contracts.

9. Your committee bill also exempts contracts with a department which are awarded after advertisement and as a result of competitive bidding for the construction of buildings, structures, improvements, or facilities. It is believed that in the case of prices established as a result of such advertisement and competitive bidding there will be no need for further revision under renegotiation and therefore such contracts should be exempt.

10. If a contract is made for an article under a directive of the War Production Board at or below a price ceiling fixed by the Government (under the Emergency Control Act of 1942) the contract is exempt under your committee bill. In such a case the price may be regarded as fair and reasonable.

11. Your committee has extended the agricultural exemption granted under the House bill and made it retroactive to April 28, 1942, to include dairy products, canned, bottled, packed, or processed, or any product, the principal ingredient of which, is a dairy product.

12. Your committee has eliminated the House provision which disallowed as costs to the prime contractor any commission, percentage, brokerage, or contingent fee paid or payable to any person for, or in connection with, the soliciting or securing by such person of a contract with a department, unless such person is a bona fide established commercial or selling agency maintained by the contractor for the purpose of securing business. It is believed that this provision may result in a double recapture, once from the war broker in collecting excessive profits, and again from the contractor in disallowing him to deduct the fee or brokerage commission as an item of cost. Its elimination was recommended by the War Department.

13. It has been brought to the attention of the committee that the interpretation of the exemption of products of a mine, oil or gas well, or other mineral or natural deposits, or timber, which have not been processed, refined, or treated beyond the first form or state suitable for industrial use, as made by the departments whose contracts were originally made subject to renegotiation, has been questioned both by representatives of industry and by representatives of other departments of the Government. There has been suggested on the one hand that the state at which the exemption should have been applied was at a point closer to the depletion line and, on the other hand, certain representatives of industry have taken the position that the exempt status of certain other products has been set at a state prior to the

first form or state at which the same were suitable for industrial use. After consideration of the published regulations and exemptions of the departments in connection with this provision of the law, it was concluded that the application thereof which had been adopted by the departments was appropriate and within the limits of the discretion vested in the departments by the Congress to define, interpret, and apply this provision of the statute. Consequently, this section has been reenacted in its original form and, at the suggestion of the departments, there has been added a provision expressly authorizing the making of appropriate cost allowances in the case of an integrated producer who processes an exempted product up to and beyond the first form or state suitable for industrial use in order to place such producer in a position comparable with that of other producers who sell such products at the exempt stage.

14. Your committee has retained the policy of the House bill in granting court review of determinations of the Secretary made prior to the enactment of the Revenue Act of 1943, with respect to a fiscal year ending before July 1, 1943, as to the existence of excessive profits. This relief is granted whether or not such determination is embodied in an agreement with the contractor or subcontractor.

Your committee has considered the question of the application of the act to profits earned on deliveries prior to April 28, 1942, the date of enactment of the law. It was necessary to make the law applicable to all contracts in existence on April 28, 1942, even though entered into prior to that date, for otherwise many long-term contracts would have been wholly exempt from renegotiation during 1942 and 1943. It was never the intention of the Congress, however, that this provision should be used to recapture ruthlessly profits earned before Pearl Harbor, when this country was at peace. During this period, the volume and rate of profits normally was not in excess of that earned on civilian business. Moreover, at this time, the passage of the renegotiation law could not be anticipated, and many businesses, in good faith, declared dividends to their stockholders out of profits which are now claimed by the renegotiation boards. Your committee believes that uniformity can be accomplished through the review procedure provided in the bill.

In determining whether excessive profits exist, with respect to determinations made by the Secretary prior to the enactment of this bill with respect to a fiscal year ending before July 1, 1943, the amendments made by this act, which are not made applicable as of April 28, 1942, or to fiscal years ending before July 1, 1943, will not apply.

15. Your committee is in agreement with the statement in the House report that under the existing renegotiation law, or such law as amended by this bill, there is no authority to renegotiate the profits accruing to a company by reason of the increment in value of its long inventories (i. e., inventories over and above its normal requirements to fulfill existing contracts).

16. Sections 109 and 113 of the Criminal Code, and section 190 of the Revised Statutes, prevent certain persons by reason of service in a Government department from acting as counsel in the prosecution of claims against the United States for a certain period. The House bill exempted from these provisions persons connected with renegotiation of war contracts as to services from May 27, 1940, until 6 months after the termination of hostilities, except that such persons could

not prosecute claims against the United States involving any subject matter directly connected with which such person was employed, or during the period such a person is employed in a department charged with renegotiation. Your committee has eliminated this provision of the House bill, believing that these provisions of the statutes with respect to the prosecution of claims against the United States should not be abrogated, and that the House provision discriminates unfairly against persons in Government departments not handling renegotiation cases.

17. In general, the renegotiation amendments are effective only with respect to fiscal years ending after June 30, 1943. However, exceptions are made with respect to the following amendments:

1. The amendments defining subcontractor.
2. The agricultural exemption contained in (i) (1) (C).
3. The exemption of contracts or subcontracts with religious, charitable, or educational organizations (i) (1) (D).
4. Any contract or subcontract for an article made or furnished in obedience to a directive of the War Production Board (i) (1) (H).
5. Subcontracts under exempt prime contracts or subcontracts (i) (1) (I).
6. Costs allowed under regulations of the War Contracts Price Adjustment Board in the case of certain processors producing minerals, oil or gas, timber, and agricultural products (1) (3).
7. The provision citing section 403 as the Renegotiation Act.

All of the above exceptions become effective as of April 28, 1942. The provisions creating the War Contract Price Adjustment Board become effective on the effective date of this bill.

REPRICING OF WAR CONTRACTS

A new title is inserted as to repricing. Recapture of past profits does not wholly solve the problem of adequate profit control. It is even more important to prevent the recurrence of excessive profits by adjusting prices to a fair and reasonable basis for the future.

Such reductions of prices for future deliveries are vital in the interest of efficiency and inflation control as well as profit control. Taxes, flat profit limitations or other methods of profit recapture, reach only what is left after all payments, costs, and expenses of the producer have been met. For this reason they may tend to foster wasteful or unnecessary expenditures and even at best can do little to encourage reductions in costs. But in the war program control of costs is as important as the control of profits. With shortages of materials and labor, all producers must be encouraged to operate at their highest efficiency in order to obtain maximum production of war materials from available resources. The reduction of prices to a sound basis is one of the best methods to induce contractors to maintain efficiency. This pressure on prices of war materials tends to prevent waste of labor or materials, and unnecessary expenditures which contribute to inflation.

The present renegotiation statute directs the departments to renegotiate contract and subcontract prices to eliminate excessive

profits likely to be realized, and empowers the departments to reduce such prices under the statute. The House bill confers similar authority on the departments. Under it the Secretary is authorized to refix prices by agreement or order subject to appeal to the courts.

In the interest of clarity your committee proposes that the repricing authority be separated entirely from the renegotiation statute. The methods and considerations appropriate to the repricing power are different from those applicable to renegotiation on an over-all basis for the purpose of recapture. Actually, the authority to reprice is more analogous to the power to place compulsory orders contained in section 9 of the Selective Training and Service Act of 1940.

Accordingly, your committee has amended the House bill and the existing law to place the authority of the departments to adjust prices in a separate title, section 801, of your committee bill. Under it the Secretary of a department is given full power to adjust prices for articles and services supplied by contractors with his department or subcontractors thereunder. If this cannot be done by agreement the Secretary may do so by order. The contractor is protected, however, by an express right to sue the United States to obtain fair and just compensation for the articles or services supplied. The department will pay to the contractor the full amount of the price fixed by an order and, if the contractor thinks the price thus fixed unfair, he may bring suit against the Government to recover the difference in the amount paid and the amount which he believes should have been paid. Any new price fixed under this section applies only to deliveries after the date of the order. Thus, these price adjustments are prospective only and do not involve recapture. Consequently this authority will not overlap the over-all renegotiation for the purpose of recapture of past profits.

EFFECTIVE DATE AS TO REPRICING

The provisions as to repricing become effective as to deliveries made after the date of enactment of this bill, and terminates with the termination of hostilities.

DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

TITLE I.—INDIVIDUAL AND CORPORATION INCOME TAXES

SECTION 101. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE

This section, as in the House bill, provides that except where otherwise expressly indicated the amendments made by title I shall be applicable only with respect to taxable years beginning after December 31, 1943.

SECTION 102. VICTORY TAX

This section, for which there is no corresponding provision in the House bill, amends section 450 of the code (imposing the Victory tax) by reducing the rate of the Victory tax from 5 percent to 3 percent. It also repeals section 453 of the code (relating to credits against the Victory tax) and effects certain technical amendments made necessary by these substantive changes.

The House bill, in lieu of the Victory tax, provides for a minimum tax. The plan adopted by your committee obviates the necessity of amending the provisions relating to the rates of normal tax and surtax. Accordingly, there have been stricken from the bill those sections which relate to normal tax on individuals, surtax on individuals, alternative tax on individuals, repeal of the Victory tax, personal exemption and credit for dependents, returns of income, and certain technical amendments connected with the foregoing matters.

SECTION 103. REPEAL OF EARNED INCOME CREDIT

This section is the same as section 108 of the House bill. Subsection (a) of section 103 of your committee bill repeals several provisions of the code to eliminate the earned income credit. These are section 25 (a) (3) and (4), relating to earned income credit for normal tax purposes, section 185, relating to computation of earned income in the case of the members of a partnership, and section 47 (d), relating to computation of earned income in the case of a return for a period of less than 12 months. The elimination of the earned income credit is effective for taxable years beginning after December 31, 1943.

Subject to certain conditions set forth therein, section 116 (a) of the code now provides an exemption from tax for earned income derived from sources without the United States in the case of citizens of the United States who are bona fide residents of a foreign country during the entire taxable year. Except as otherwise provided in section 116 (a), earned income is determined by reference to the definition of earned income contained in section 25 (a). As a consequence of the repeal of section 25 (a) (3) and (4), subsection (b) of section 103

of the bill amends section 116 (a) (1) and (2) of the code to eliminate the references to section 25 (a). The definition of earned income previously contained in section 25 (a) (4) is inserted as paragraph (3) of section 116 (a) with an amendment authorizing the Commissioner with the approval of the Secretary to prescribe by regulations appropriate rules for the determination of earned income in the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors.

SECTION 104. CERTAIN FISCAL YEAR TAXPAYERS

This section is identical with section 109 of the House bill.

Under section 108 of the code, as added by section 140 of the Revenue Act of 1942, special rules were provided for the computation of the tax under sections 11, 12, 13, 14, and 15 of the code for a taxable year beginning in 1941 and ending after June 30, 1942. Such tax is the sum of the prorated portions of two tentative taxes The first tentative tax is computed under the law applicable to a taxable year beginning in 1941 (without regard to section 108) and at the rates prescribed for such a taxable year. The second tentative tax is computed under the law applicable to a taxable year beginning in 1941, with certain modifications relating to certain deductions and credits in the case of corporations, but at the rates specified for a taxable year beginning in 1942. The second tentative tax is to be computed without regard to section 108 except as certain provisions of the code are made specifically applicable in such computation by such section.

Under the law applicable to taxable years beginning in 1941 (other than section 108) used in computing the first tentative tax of a corporation, the excess profits tax imposed by subchapter E of chapter 2 is a deduction in computing net income. Under the law applicable in computing the second tentative tax, the income subject to the excess profits tax is a credit in computing normal tax net income and surtax net income.

The computation of the excess profits tax, under subchapter E of chapter 2, of corporations whose taxable year began in 1941 and ended after June 30, 1942, is prescribed in a manner similar to the computation under section 108 of the code, by section 710 (a) (3) of the code, as added by section 203 of the Revenue Act of 1942. As in section 108, the sum of the prorated portions of two tentative taxes constitutes the tax.

It was intended that the tentative tax computations in the case of corporations, both under section 108 and section 710 (a) (3) be computed upon a parallel basis. Thus the excess profits tax to be deducted in computing net income for the purposes of the first tentative tax under section 108 (a) (1) (A) should be the first tentative excess profits tax computed under section 710 (a) (3) (A). The income subject to excess profits tax to be credited in computing normal tax net income and surtax net income for the purpose of the second tentative tax computed under section 108 (a) (1) (B) should be the income subject to excess profits tax computed for the purpose of the second tentative excess profits tax determined under section 710 (a) (3) (B).

Through a technical inadvertence, however, section 108 (a) (1) (A) did not exclude consideration of section 710 (a) (3) in the computation of the first tentative tax. It thus appeared that the excess profits

tax to be deducted in computing normal tax net income for such computation might be the total excess profits tax computed under section 710 (a) (3) rather than the first tentative excess profits tax computed under section 710 (a) (3) (A). Moreover, in the computation of the second tentative tax under section 108 (a) (1) (B), reference to the increased excess profits tax rates and certain other technical changes in the base for computing the tax was inadvertently omitted.

The regulations promulgated by the Commissioner under section 108 give full force and effect to the method of computation intended under section 108 (a) (1) and section 710 (a) (3). Inasmuch as an amendment to section 108 to relate to taxable years beginning in 1943 and ending in 1944 was required in any event, your committee has made an exception to the decision to postpone to next year clarifying changes required as a result of the provisions added by the Revenue Act of 1942, and has therefore amended section 108 (a) (1) and section 710 (a) (3) retroactively so as to remove any technical ambiguity which might have inhered in such sections as added by the Revenue Act of 1942, to clarify their provisions, and to give express statutory approval to the regulations issued by the Commissioner.

Section 104 of the bill also adds a new subsection to section 108 of the code to provide for the computation of the tax imposed by sections 11, 12, 13, 14, and 15 in the case of taxable years beginning in 1943 and ending in 1944. It provides that in the case of a corporation or an individual the tax shall be in an amount equal to the sum of (a) that portion of the tentative tax (computed as if the law applicable to taxable years beginning on January 1, 1943, were applicable to such taxable year) which the number of days in such taxable year prior to January 1, 1944, bears to the total number of days in such taxable year plus (b) that portion of a tentative tax (computed as if the law applicable to taxable years beginning on January 1, 1944, were applicable to such taxable year) which the number of days in such taxable year after December 31, 1943, bears to the total number of days in such taxable year.

In section 104 of the bill, as in section 108 of the code, insurance companies subject to the provisions in supplement G, investment companies subject to the provisions of supplement Q, and Western Hemisphere trade corporations, as defined in section 109 of the code, are specifically exempted from section 108. In addition, this section does not apply to individuals who pay their taxes under supplement T.

Section 105. Exclusion From Gross Income of Mustering-Out Payments for Military and Naval Personnel

This section, for which there is no corresponding provision in the House bill, amends section 22 (b) of the Internal Revenue Code (relating to exclusions from gross income) by inserting at the end thereof subparagraph (14). Under this amendment, amounts received during the taxable year as mustering-out payments with respect to service in the military or naval forces of the United States shall not be included in gross income and shall not be subject to the Federal income tax.

SECTION 106. LAST-IN FIRST-OUT INVENTORY

This section, for which there is no corresponding provision in the House bill, renders the involuntary liquidation and replacement provisions of section 22 (d) (6) applicable to taxable years beginning in 1941, and effects certain minor technical corrections.

In the case of taxpayers using the elective inventory method, abnormalities have arisen in recent taxable years as the result of the liquidation of all or a substantial portion of the base stock, this liquidation having been unavoidable under existing war conditions. Section 22 (d) (6) permits the taxpayer in later years to replace its base stock and to secure a tax adjustment for the year of liquidation placing it in the same position with respect to taxes payable which it would have occupied if the liquidation had not occurred. The adjustment is limited, however, to taxable years beginning after December 31, 1941. The amendment would permit a like adjustment for taxable years beginning in 1941.

In connection with liquidations effected in 1942 and subsequent taxable years, the taxpayer is required to make its election with respect to replacement at the time of filing its return for the year of liquidation; in connection with 1941 liquidations, it is to be permitted to make its election within a period of 6 months following the date of the enactment of the Revenue Act of 1943.

The section effects three minor technical corrections in the wording of the liquidation and replacement provisions:

(1) The adjustment is as essential in the computation of the declared value excess profits tax as it is in the computation of income and excess profits taxes. Under the present law, it is limited, however, to taxes imposed "by this chapter (the income tax) and by subchapter E of chapter 2." The declared value excess profits tax is imposed by subchapter B of chapter 2. The amendment strikes from subparagraphs (A) and (E) the reference to "subchapter E," bringing within the provision the whole of chapter 2, including the tax imposed by subchapter B.

(2) The principal adjustment is to be made for the year of liquidation. This adjustment may have consequences in other years. Adjustments are to be made for all years affected. Under the wording of the present law, however, the adjustments are stated to be for the year of liquidation, the year of replacement, and intervening years. Proper adjustment for years prior to the year of liquidation affected through the operation of the various carry-back provisions should, of course, be made. Accordingly, adjustment for all taxable years affected, including those affected by carry-backs, is explicitly provided in subparagraphs (A) and (D) as amended by paragraphs (a) (2) and (a) (4) of this section.

(3) The items of inventory involved in the replacement are to be carried as items acquired at a cost equal to the base stock inventory cost of the item involved in the liquidation. It is believed that this is the effect of the present law, but subparagraph (C) has been reworded in the interest of clarity.

The several amendments proposed are made applicable to all taxable years to which the liquidation and replacement provisions are applicable.

SECTION 107. DENIAL OF DEDUCTION FOR FEDERAL EXCISE TAXES NOT DEDUCTIBLE UNDER SECTION 23 (a)

This section, which is the same as section 110 of the House bill, amends section 23 (c) (1) of the code which allows a deduction in computing net income for taxes paid or accrued during the taxable year. A new subparagraph is added to section 23 (c) (1) disallowing a deduction under this paragraph of the code for Federal import duties and Federal excise and stamp taxes. It is stated, however, that subsection (c) of section 23 shall not prevent such duties and taxes from being deducted under subsection (a) relating to deductions for trade or business expenses and, in the case of an individual, nontrade or nonbusiness expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. For example, the capital stock tax incurred by a corporation as a result of carrying on or doing business or the transportation tax paid by an individual in connection with a transaction for the production of income would not be denied deduction. In limiting the allowance of deductions for these taxes to subsection 23 (a) the amendment makes no change in the law respecting the taxable year for which these taxes are deductible.

SECTION 108. PARTIALLY WORTHLESS BAD DEBTS

Section 124 of the Revenue Act of 1942 amended the first sentence of section 23 (k) (1) of the code by changing the requirements for the deduction of totally worthless bad debts. At the time of this amendment the language throughout the sentence was made uniform with the result that the language respecting the deduction of partially worthless debts was recast. It was not intended that there should be any change with respect to the deductibility of partially worthless debts but the change in language has been subject to interpretation as a substantive amendment of the law respecting such deductions. To obviate this interpretation this section of your committee's bill, which is a new section not found in the bill passed by the House, restores the language in the code prior to the Revenue Act of 1942 for partially worthless debts. The change made by the 1942 act regarding totally worthless debts is not altered by this section. Inasmuch as the 1942 changes were made retroactive to taxable years beginning after December 31, 1938, the restoration of the law made by this section is likewise retroactive.

SECTION 109. CORPORATE CONTRIBUTIONS TO VETERANS' ORGANIZATIONS

This section, for which there is no corresponding provision in the House bill, amends section 23 (q) of the Internal Revenue Code (relating to charitable and other contributions by corporations) by inserting "veteran rehabilitation service" after "scientific" in paragraph (2). The effect of this insertion will be to include a veteran rehabilitation service as an additional basis to be considered in determining allowable deductions in the case of a corporation making charitable and other contributions within a taxable year to or for the use of a

corporation, trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

This section further amends section 23 (q) by inserting after paragraph (2) a new paragraph (3) which adds a new classification to be considered in determining allowable deductions in the case of a corporation making charitable and other contributions within a taxable year. The new category adds contributions to posts or organizations of war veterans, or auxiliary units of, or trusts or foundations for, any such posts or organizations, if such posts, organizations, units, trusts, or foundations are organized in the United States or any of its possessions, and if no part of their net earnings inure to the benefit of any private shareholder or individual.

Section 110. Special Deductions for Blind

This section, which is the same as section 111 of the House bill' adds a new subsection 23 (y) to the code. Such subsection provides that in the computation of net income a special deduction of $500 from gross income shall be allowed all blind individuals. For the purposes of this deduction, the term "blind individual" means an individual whose central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or whose visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20°. This definition corresponds to that adopted by the Social Security Board for the purpose of carrying out title X of the Social Security Act, as amended, relating to grants to States for aid to the blind. A person who is blind at any time on July 1st of the taxable year, which is the date determining his status for the purposes of this section will be entitled to this deduction for such taxable year.

Section 111. Credit for Dividends Paid on Preferred Stock of Public Utilities

This section, for which there is no corresponding provision in the bill passed by the House, amends section 26 (h) of the code, relating to credit for dividends paid on the preferred stock of public utilities. Section 26 (h) in its present form provides that public utilities which pay dividends on their preferred stock during the taxable year shall have a credit in an amount equal to such dividend payments. Such credit is a credit against the corporation's net income for purposes of computing its surtax net income.

Subsection (a) of this section amends paragraph (1) of section 26 (h), relating to the amount of the credit, to provide that for purposes of such credit the amount of dividends paid in a given taxable year shall not include any amount distributed in such year with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. It is further provided that if any distribution is made in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year, such distribution will be deemed to have been made with respect to the earliest year or years for which there are dividends unpaid and accumulated. Thus, if a public utility makes a distribution with respect to a prior taxable

year, it shall be considered that such distribution was made with respect to the earliest year or years for which there are dividends unpaid and accumulated, whether or not the public utility states that the distribution was made with respect to such year or years and even though the public utility states that the distribution was made with respect to a later year. Even though it has dividends unpaid and accumulated with respect to a taxable year ending prior to October 1, 1942, a public utility may, however, receive credit for dividends paid with respect to the current taxable year. If there are no dividends unpaid and accumulated with respect to a taxable year ending prior to October 1, 1942, a public utility may receive credit for dividends paid with respect to a prior taxable year which ended after October 1, 1942; and such credit may be in addition to a credit for dividends paid with respect to the current taxable year. However, if local law or its own charter requires a public utility to pay all unpaid and accumulated dividends before any dividends can be paid with respect to the current taxable year, such public utility will not receive credit for any distribution in the current taxable year to the extent that there are dividends unpaid and accumulated with respect to taxable years ending prior to October 1, 1942.

Subparagraph (2) (B) of section 26 (h), relating to the definition of preferred stock, provides that such stock must have been issued prior to October 1, 1942. Subsection (b) of this section amends such subparagraph (2) (B) to provide that any stock that was issued on or after October 1, 1942, shall be deemed for purposes of the credit provided in section 26 (h) to have been issued prior to October 1, 1942, if it was issued (including issuance either by the same corporation or another corporation in a transaction which is a reorganization within the meaning of section 112 (g) (1) of the code, or which is a transaction to which section 112 (b) (9) of the code is applicable, or which is a transaction subject to the provisions of supplement R of chapter 1 of the code, relating to exchanges and distributions in obedience to orders of the Securities and Exchange Commission) to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other stock which is preferred stock within the meaning of section 26 (h) (2) (B). Such new stock, however, shall be considered to have been issued prior to October 1, 1942, only to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds, debentures, or the other preferred stock which such new stock is issued to refund or replace. The determination of whether stock was issued to replace or refund bonds, debentures, or other preferred stock issued prior to October 1, 1942, shall be made under regulations prescribed by the Commissioner with the approval of the Secretary. If any stock issued on or after October 1, 1942, is considered by reason of this amendment to be stock issued prior to October 1, 1942, no credit shall be allowed for dividends paid on such stock unless such stock meets all the other requirements of a preferred stock provided in section 26 (h) (2) (B).

The amendments made by this section are, under section 101 of the bill, applicable with respect to taxable years beginning after December 31, 1943, but the amendment made by subsection (b) of this section is applicable with respect to any transaction occurring on or after

October 1, 1942, whether or not such transaction occurred before January 1, 1944, in determining whether given stock was issued prior to October 1, 1942. No credit, however, for dividends paid on stock which is deemed to have been issued prior to October 1, 1942, solely by reason of this amendment will be allowed for a taxable year beginning prior to January 1, 1944.

SECTION 112. RETURNS BY ORGANIZATIONS EXEMPT FROM TAXATION

This section, except for certain added provisions, is substantially similar to section 112 of the House bill. It amends section 54 by adding a new subsection (f), requiring organizations exempt from taxation under section 101 to file annual returns of their income, receipts, and disbursements, and to keep such records and report what other information may be required by the Commissioner, with the approval of the Secretary.

The amendment specifically exempts certain of such exempt organizations from the annual return requirement of the subsection. These include religious organizations exempt from taxation under paragraph (6) of section 101 and organizations similarly exempt under such paragraph which are operated, supervised, or controlled by or in connection with such religious organizations; educational institutions also exempt under such paragraph, which normally maintain a regularly organized faculty, curriculum, and student body in attendance at the places where their educational activities are regularly carried on; charitable organizations and organizations for the prevention of cruelty to children or animals, likewise exempt under paragraph (6), which are supported wholly or partially by Federal or State funds or which are supported primarily by contributions of the general public as distinguished from a few contributors or donors or from related or associated persons. Similarly exempted are fraternal beneficiary societies, orders, or associations exempt from taxation under paragraph (3) of section 101; corporations exempt under paragraph (15) of section 101 where such corporations are wholly owned by the United States or by any agency or instrumentality thereof or which are wholly owned subsidiaries of such corporations.

The provisions specifically relating to organizations for the prevention of cruelty to children or animals, fraternal beneficiary societies, orders or associations and corporations exempt under paragraph (15) were not contained in the House bill. Your committee also changed the House provision with respect to the exemption of educational organizations from the annual return requirement by extending the exemption to those cases in which a regular faculty, curriculum and student body are "normally" maintained. This is intended to make the exemption applicable to any such organizations which may have been compelled to curtail or temporarily discontinue their normal and regular activities due to war conditions and the absence of faculty members or students engaged in war work or in the armed forces.

Your committee has also eliminated the provisions in paragraphs (1), (2), (3), and (4) of the House amendment relating to rulings of the Commissioner. In view of existing regulations requiring all organizations exempt from taxation under section 101 to obtain such rulings, the language was deemed to be superfluous.

The insertion of this subsection, as well as the exclusion of the above specified organizations from its operation, so far as it relates to the filing of annual returns, does not impair the powers the Commissioner now exercises or otherwise has with respect to requiring such returns, by duly prescribed and approved regulations.

SECTION 113. PENALTIES IN CONNECTION WITH ESTIMATED TAX

This section, for which there is no corresponding provision in the House bill, amends section 294 of the Internal Revenue Code (relating to additions to the tax in case of nonpayment) by striking out subsection (a) (3), (4), and (5), containing provisions with respect to the estimated tax, and inserting subsection (d), also relating to the estimated tax. Rearrangement is made in the interest of clarity so that the term "the tax" as used in section 294 (d) (which is the tax imposed by chapter 1 of the Internal Revenue Code after credits for tax withheld at source) may not be confused with the expression "tax shown on return".

Under existing law, in the case of failure to make and file a timely declaration of estimated tax, the addition to the tax is 10 percent of the tax, and in the case of failure to pay a timely installment of the estimated tax the addition to the tax is $2.50 or 2½ percent of the tax, whichever is the greater, for each installment with respect to which such failure occurs. Under section 294 (d), as added by your committee bill, in the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to be due to reasonable cause, the addition to the tax is 5 percent of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 percent of the installment for each month or fraction thereof during which the installment remains unpaid. It is specifically provided that for the purposes of this addition to the tax each installment shall be considered to be one-fifth of the tax. It is also provided that in the case of a failure to pay an installment of the estimated tax within the time prescribed, unless such failure is shown to be due to reasonable cause, the addition to the tax is 5 percent of the unpaid installment, and in addition 1 percent of such unpaid amount for each month or fraction thereof during which such amount remained unpaid. The addition to the tax for failure to pay an installment of the estimated tax shall not apply with respect to any period with respect to which the addition to the tax for failure to make and file a declaration is applicable. In no event shall the aggregate addition to the tax for failure to file a declaration or pay an installment of estimated tax exceed 10 percent of the unpaid amount of the installment or installments due but unpaid.

Under existing law if 80 percent of the tax (determined without regard to the credits for tax withheld at source), in the case of individuals other than farmers exercising an election under section 60 (a) of the code, or 66⅔ percent of such tax so determined in the case of such farmers, exceeds the estimated tax (increased by credits for tax withheld at source), the addition to the tax is an amount equal to such excess, or equal to 6 percent of the amount by which such tax so determined exceeds the estimated tax so increased, whichever is the lesser, and it is also provided that this addition to the tax shall not

apply to the taxable year in which falls the death of the taxpayer. Under section 294 (d), as added by your committee bill, it is further provided that, under regulations prescribed by the Commissioner with the approval of the Secretary, this addition to the tax shall not apply to the taxable year in which the taxpayer makes a timely payment of estimated tax within each quarter of such year (or in the case of farmers exercising an election under section 60 (a), within the last quarter) in an amount at least equal to an amount computed on the basis of the net income of the taxpayer shown on his return for the preceding taxable year at the rates applicable to the taxable year.

A technical amendment is made to section 60 (b) of the code (relating to the application of declarations of estimated tax to short taxable years) because of the rearrangement of section 294 of the code.

The amendments made by section 113 are to be applicable with respect to taxable years beginning after December 31, 1942.

Section 114. Election as to Recognition of Gain in Certain Corporate Liquidations

This section, for which there is no corresponding section in the House bill, would, with some modifications, reenact section 112 (b) (7) of the Revenue Act of 1938 (relating to election by shareholders as to the recognition of gain upon the complete liquidation of a domestic corporation). The effect of the section is in general to postpone the recognition of that portion of a qualified electing shareholder's gain on the liquidation which would otherwise be recognized and which is attributable to appreciation in the value of certain corporate assets distributed in complete liquidation.

The provisions of the 1938 act applied to liquidations made in pursuance of a plan adopted after the date of enactment of that act if such liquidation was completed in the month of December 1938. Under that act gain in the case of a shareholder entitled to the benefits of the provision was recognized only to the extent of the greater of the following: (1) The shareholder's ratable share of the earnings and profits accumulated since February 28, 1913, or (2) the sum of the money received by him and the fair market value of any stock or securities received which were acquired by the corporation after April 9, 1938. There was excluded from the benefits of the section a corporate shareholder which at any time between April 9, 1938, and the date of the adoption of the plan of liquidation, both dates inclusive, was the owner of stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote upon the adoption of such plan of liquidation.

The section as modified applies only to a liquidation made in pursuance of a plan of liquidation adopted after the date of enactment of the Revenue Act of 1943, if such liquidation is thereafter completed within some one calendar month in 1944. The section also substitutes "December 10, 1943," for "April 9, 1938," wherever the latter appeared in the corresponding provisions of the 1938 act. For the purpose of determining the amount of the gain to be recognized as a dividend, the earnings and profits of the corporation accumulated after February 28, 1913, are to be determined as of the close of the month in which the liquidation occurred. The unrealized appreciation in value of the corporate assets existing immediately prior to the

liquidation, the recognition of the gain attributable to which it is the purpose of the section to postpone is not to be regarded as increasing such earnings and profits. In the computation of such earnings and profits, the section as modified specifically provides for the inclusion of all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed. Under existing law the computation of accumulated earnings and profits is made consistently with the accounting method and time applicable in the computation of net income under section 41, so that items increasing or decreasing earnings and profits are brought into account at the same time as they are brought into account under sections 42 and 43. Since the computation of earnings and profits under this section of the bill is a final one representing the closure of the account upon the completion of the liquidation, it seemed appropriate under this provision (whether or not a determination has been made under section 41 that a proper reflection of the net income, in the case of a corporation using a cash method of accounting, requires the inclusion in the net income account in the final year of liquidation of all previously unaccrued items) to bring into account all items of accrued expense or accrued income. All such items are represented in the computation of realized gain to the shareholders, and if not represented in the computation of earnings or profits, distortion results as well as discrimination between shareholders of cash basis corporations and those of accrual basis corporations.

Subsection (b) of this section of the bill amends section 113 (a) (18) (relating to basis of property received in certain corporate liquidations) of the code to make that section applicable to property (other than money) acquired by a qualified electing shareholder upon a liquidation under the proposed section 112 (b) (7), as well as under section 112 (b) (7) of the 1938 act.

Section 115. Reorganization of Certain Insolvent Corporations

This section, for which there is no corresponding section in the House bill, amends existing law to provide equality of tax treatment for all corporations undergoing insolvency reorganization under court supervision. The tax treatment provided includes the rules with respect to gain or loss and basis of assets which shall be used both for the determination of depreciation and gain or loss on subsequent sale, and for the determination of credit for excess profits tax purposes. Rules applicable to the determination of gain or loss, and basis of new securities to shareholders and creditors participating in the reorganization are likewise provided.

Under existing law great confusion and uncertainty exist with respect to the tax consequences, both for the income and the excess profits taxes, of certain insolvency reorganizations which are effected under a plan of reorganization ordered by a court having jurisdiction of the corporation which is being reorganized. The United States Supreme Court in *Helvering* v. *Alabama Asphaltic Limestone Co.* (315 U. S. 179) and *Helvering* v. *Southwest Consolidated Corp.* (315 U. S. 194) and related cases held that upon an insolvency reorganization, where creditors of the reorganizing corporation succeed to the

equity interests in the corporation, the test of continuity of interest is sufficiently met so that if the transaction otherwise falls within the definition of reorganization provided in section 112 (g) (1), or the corresponding provision of earlier revenue acts, the transaction is one with respect to which no gain or loss is to be recognized, and the basis of the assets in the hands of the corporation as reorganized is the same as that in the hands of the predecessor corporation. In a subsequent case, namely, *Helvering* v. *Cement Investors, Inc.* (316 U. S. 527), the Supreme Court held that even though the definition of reorganization is not met by the transactions which take place, nevertheless there may still be no gain or loss recognizable to creditors who, upon succeeding to the equity interests in the assets of the corporation, join in a transfer of these assets to a successor corporation in return for stock and securities in the new corporation. The question of the basis of the assets in the hands of the new corporation in a transaction of this character was not before the court and has not, therefore, been judicially determined.

In the Revenue Act of 1942 certain amendments were made to section 112 of the code to provide the rule for determination of some of the problems existing with respect to the reorganization of insolvent railroad corporations.

The amendments made by this section are designed to cover the reorganization transactions not only of railroad corporations but of all insolvent corporations and to resolve the remaining doubts and uncertainties which result from existing law as construed in the Supreme Court decisions. Subsection (a) of this section, by amending section 112 (b) (9) which at present contains the provisions applicable to railroad corporations, provides the rule with respect to nonrecognition of gain or loss upon the transfer of property of a reorganizing corporation in a taxable year commencing after December 31, 1933. It is provided that no gain or loss shall be recognized upon the transfer of the property in pursuance of an order of the court having jurisdiction of the corporation in a receivership, foreclosure, or similar proceeding or in a proceeding under section 77, 77B, or chapter X of the Bankruptcy Act, to a corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation. This provision describes the form of transactions to which all the amendments apply. It is intended that only an actual reorganization of a corporation will be covered as distinguished from a liquidation in a bankruptcy proceeding and sale of property to either new or old interests supplying new capital and discharging the obligations of the old corporation. In other words, the type of transaction which was held not to be a reorganization under section 112 (g) (1) in the *Mascot Store Co.* case (120 F. (2d) 153) or in *Templeton Jewelers Inc.* (126 F. (2d) 251) would likewise not be covered under these amendments. It is also intended that the business purpose test enunciated in *Gregory* v. *Helvering* (293 U. S. 465), shall likewise apply to transactions under these amendments.

Although the usual plan of reorganization of an insolvent corporation utilizes a new corporation to which the assets of the insolvent corporation are transferred, in some rare instances it is possible to employ the existing corporate entity and to make adjustments in the capital and debt structure to effect the reorganization. Where

the corporation is insolvent, this type of adjustment is generally not possible for the reason that under the absolute priority rule stockholders may no longer have an interest in the corporation and, therefore, may not participate in the corporation as reorganized. In order to use the old corporate structure to effect the reorganization, it is usually necessary that amendments to the articles of incorporation be made. Where the stockholders do not participate in the corporation as reorganized, it is more often than not impossible to obtain the vote of a sufficient number of shares to amend the articles. In some few States, however, the State laws provide that the trustee in bankruptcy or receivership proceedings may vote the shares of an insolvent corporation. Under laws such as this, it is somewhat easier to reorganize through the use of the existing corporate entity. In order that no different tax treatment be afforded in reorganizations where the old corporate entity is utilized, and in order to provide a rule for the determination of the excess profits tax credit in such cases, subsection (a) provides, as a second portion of the gain or loss provisions applicable to corporations, the rule that where a corporation is reorganized by the adjustment of the capital and debt structure of an existing corporation, then the reorganized corporation shall be deemed to be a new corporation organized to effectuate the plan of reorganization, and its assets shall be considered to have been acquired upon reorganization solely for stock or securities or for stock or securities plus an assumption of liabilities. This paragraph is not applicable to transactions where more than 50 percent of the total combined voting power of all classes of stock after reorganization exists in persons who were shareholders of the corporation immediately before the reorganization by reason of a continuing equity in the assets of the corporation attributable to such shareholders solely by reason of their ownership of stock. Thus, under the amendment, cases which might truly and properly be deemed recapitalizations, since shareholders have sufficient equity in the assets of the corporation to remain in voting control, are left to be governed by the provisions of existing law. The amendment provides, however, that where the provisions of section 112 (b) (9) apply to a transaction no other paragraph of section 112 (b) shall apply.

In subsection (c) corollary rules are provided with respect to basis of property acquired on reorganization transactions described in the amendments to section 112 (b) (9). Section 113 (a) (20) of the code, which at present relates to the basis of property acquired on a railroad reorganization, is amended to provide that if property is acquired by a corporation upon a transfer to which section 112 (b) (9) is applicable, then notwithstanding the provisions of section 270 of the Bankruptcy Act, the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, adjusted to reflect any gain recognized upon the acquisition. Subsection (f) of section 115 provides the effective dates to which the amendments apply. In this subsection the amendments with respect to gain or loss of the reorganizing corporation and basis of its property are made retroactive as if they were part of the law back through the Revenue Act of 1934. For reasons of administration, however, the subsection goes on to provide that tax liability only for years beginning January 1, 1940, and thereafter will be directly affected by the amendments made. Thus, for example, although the amendments to basis will have an indirect

effect in that depreciation of assets for the taxable year 1940 and subsequent years will be computed as if the assets had been carried and depreciated at the transferor's basis throughout the intervening years, 1940 will be the first year under this amendment in which the transferor's basis adjusted for theoretical depreciation sustained in intervening years, would properly constitute the reorganized corporation's basis for depreciation.

Section 115 (b) of the bill adds new subsection (1) to section 112 of the code, and section 112 of the Revenue Acts of 1932, 1934, 1936, and 1938, effective as of the date of enactment of each of such acts, to provide for the recognition of gain or loss to participating shareholders and creditors in a reorganization described in new section 112 (b) (9).

Subsection (1) provides for the recognition of gain or loss upon an exchange of stock, securities, or other obligations of the old corporation for stock or securities in the new corporation. In order to provide uniform treatment in all cases regardless of the form of the particular transaction, the section provides that the acquisition of stock or securities in the new corporation and the relinquishment or extinguishment in connection therewith of stock, securities, or other obligations in the old corporation shall be deemed to be an exchange for the purposes of the subsection. Thus the reorganization may take the form of a transfer of the property of the old corporation to its bondholders upon surrender of the bonds, and a subsequent transfer of the property to the new corporation in exchange for stock of such corporation, or the bonds may be transferred to the new corporation in exchange for stock of such corporation, and subsequently surrendered by the latter in exchange for the property of the old corporation. In either event, the net effect to the participating security holders is an exchange of securities of the old corporation for securities of the new corporation and the transaction is so considered by subsection (1).

An exception to the general rule is provided in those cases in which the exchange described in subsection (1) occurred in a taxable year beginning prior to January 1, 1943. For such cases the recognition or nonrecognition of gain or loss upon the exchange is made to depend (1) if the tax liability for such taxable year has been finally determined, upon the treatment accorded such transaction in such final determination, or (2) if the tax liability for such taxable year has not been finally determined, upon the position last maintained by the taxpayer relative to the recognition or nonrecognition of gain or loss upon such transaction.

For the purpose of the application of the exception provided in clause (A) of subsection (1) there is a final determination in any case in which further change in the tax liability for the taxable year is prevented by reason of a decision of a court or the Board of Tax Appeals, or a closing agreement, or the expiration of the statutory period of limitation upon the making of a claim for refund or the issuance of a statutory notice of deficiency. The fact that the taxable year may be reopened for the purpose of the application of the provisions relating to carry-backs, or the application of a special statute of limitations as in the case of bad debts, or under a provision such as section 3801 or 734, does not prevent a determination from becoming

final within the meaning of this section. The statute applies, however, only in the case of a determination which becomes final before the ninetieth day after date of the enactment of the Revenue Act of 1943. This provision affords the taxpayer a reasonable opportunity to assert a position with respect to the recognition or nonrecognition of gain or loss on the transaction before a determination is deemed final.

Clause (B) of subsection (1) relates only to taxable years for which there has been no final determination within the meaning of clause (A). Under this clause the recognition or nonrecognition of gain or loss upon the exchange depends upon the latest treatment accorded such exchange by the taxpayer prior to December 15, 1943. For such purpose the treatment accorded the exchange means the position formally maintained by the taxpayer relative to the recognition or nonrecognition of gain or loss in his return or amended return for the taxable year, in a claim for refund, in a proceeding before a court or the Board of Tax Appeals, or in some formal action taken in connection with a proposed determination of his tax liability for such taxable year.

Subsection (c) of this section amends section 113 (a) to set out in paragraph (21) the basis applicable to stock or securities on an exchange described in subsection (1) of section 112. Where the general rule of subsection (1) applies and gain or loss is recognized on the exchange, the basis of the new securities in the hands of the creditor is cost under the provisions of 113 (a). Where, however, the exception in section 112 (1) is applicable in the case of securities acquired in taxable years beginning prior to January 1, 1943, to provide nonrecognition of gain or loss on the exchange or recognition only in part, the rule provided in this subsection states that the basis of such stock or securities acquired shall be determined as if paragraph (6) of section 113 (a) were applicable. Paragraph (6) is the present rule of existing law applicable to exchanges of stock or securities on a tax-free exchange under 112 (b) (2) (3) or (5).

Subsection (d) of this section contains a number of technical amendments necessary to make applicable existing provisions of law with respect to receipt of other property or money in connection with an exchange on which gain or loss is not recognized. A further technical amendment makes applicable section 112 (k) which provides that an assumption of indebtedness does not affect a nonrecognized transaction. There is also a technical amendment which enlarges the existing section 22 (b) (10), relating to discharge of indebtedness of a railroad corporation, to cover appropriate transactions under section 112 (b) (9).

Section 116. Gain From Sale or Exchange of Property Pursuant to Orders of Federal Communications Commission

The Federal Communications Commission, in pursuance of the policy of eliminating common ownership of directly competing radio facilities, may condition applications for renewal of licenses or other applications upon the elimination of such common control and disposition of some of the facilities or property. This section, for which there is no corresponding provision in the House bill, provides that a sale or exchange of property required by order of the Commission or required as a condition of granting certain applications

shall at the election of the taxpayer be treated as an involuntary conversion of property. The taxpayer may thus elect to have the benefits of section 112 (f). If the property is converted into property similar or related in service or the entire proceeds forthwith expended in the acquisition of such property or in the establishment of a proper replacement fund, no gain is recognized. Gain, if any, is recognized to the extent of the money which is not so expended. This section provides that the part of the gain, if any, which is recognized after the application of section 112 (f) shall not be recognized to the extent that it is applied to reduce the basis of depreciable property remaining in the hands of the taxpayer immediately after the sale, or acquired by the taxpayer in the taxable year in which the sale occurred. Where all of the proceeds of a sale or exchange is not invested in similar property the reduction in the basis of the remaining assets shall be as of the date of such sale or exchange. The manner and amount of such reduction of basis is to be determined under regulations. The section provides that the taxpayer's election shall be made on his tax return, except that for the taxable years beginning before January 1, 1944, it may be made by a statement filed within 6 months after the effective date of the Revenue Act of 1943. Gain, if any, will be recognized to the extent remaining after the application of section 112 (f) and application to the reduction of basis of depreciable property.

The section is applicable with respect to taxable years after December 31, 1942.

SECTION 117. PERCENTAGE DEPLETION FOR FLAKE GRAPHITE, VERMICULITE, POTASH, BERYL, FELDSPAR, MICA, TALC, LEPIDOLITE, AND SPODUMENE

This section is substantially similar to section 114 of the House bill but differs in some respects as hereinafter discussed.

Subsection (a) of this section amends the heading and the first sentence of section 114 (b) (4), relating to percentage depletion for coal, fluorspar, ball and sagger clay, rock asphalt, and metal mines, and sulphur, so as to include among the mines or deposits entitled to percentage depletion flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, and potash. The provision relating to talc was not in the House bill. In the case of flake graphite, vermiculite, potash, beryl, feldspar, mica, talc, lepidolite, and spodumene mines, the allowance for depletion shall be 15 percent of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. This allowance is subject to the further limitations contained in the existing provisions of section 114 (b) (4). The provision in the House bill fixing the allowance in the case of potash at 23 percent has been eliminated.

Subsection (b) amends section 114 (b) (2) relating to discovery value of certain mines, so as to debar the use of the discovery value as the basis for depletion in the case of flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, and potash mines. As noted above, talc was not included in the House bill provision.

Subsection (c), which was not in the House bill, adds a new subparagraph (B) to section 114 (b) (4) of the code to define for the purposes of section 114 (b) (4) the term "gross income from the property." For such purposes the term "gross income from the property" means the gross income from mining. The term "mining" shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. It is further provided that the term "ordinary treatment processes," as so used, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (2) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (3) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (4) in the case of lead, zinc, copper, gold, silver, or fluor spar ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The costs of any process or service which does not constitute an "ordinary treatment process" shall be excluded in the determination of such gross income from mining. Provision is also made that the principles of this subparagraph shall be applicable in determining gross income attributable to mining for the purposes of section 731 of the code (relating to corporations engaged in mining of strategic minerals) and section 735 of the code (relating to nontaxable income from certain mining and timber operations).

Subsection (d) provides that the amendments made by subsections (a) and (b), insofar as they apply to flake graphite mines, shall be applicable to taxable years beginning after December 31, 1942.

Subsection (e) of the House bill provides that the amendments made by subsections (a) and (b) and the amendments made to section 114 of the code by section 145 of the Revenue Act of 1942, providing percentage depletion for fluor spar, ball and sagger clay, and rock asphalt, shall not be applicable to any taxable year beginning on or after the date of the termination of hostilities. Your committee has amended this subsection to provide that the termination date applicable to the minerals specified in subsections (a) and (b) shall not be applicable in the case of potash. Your committee has also provided that the amendment made by subsection (e) of this section shall be effective as if it were a part of the Internal Revenue Code and the Revenue Acts of 1938, 1936, 1934, and 1932, as of the effective date of the code and as of the date of enactment of each of the respective acts.

SECTION 118. EXCLUSION FROM GROSS INCOME OF CERTAIN COST-OF-LIVING ALLOWANCES PAID TO CIVILIANS AND OFFICERS AND EMPLOYEES OF THE GOVERNMENT STATIONED OUTSIDE CONTINENTAL UNITED STATES

This section, for which there is no corresponding provision in the House bill, amends section 116 of the Internal Revenue Code (relating to exclusions from gross income) by adding at the end thereof subsection (j) which provides for the following three new classifications which are to be considered as exclusions from gross income (1) in the case of a clerk or employee in the Foreign Service of the United States, amounts received as cost-of-living allowances under authority of section 3, as amended, of the act of February 23, 1931; (2) in the case of an ambassador, minister, diplomatic, consular, or Foreign Service officer, amounts received as post allowances under the authority of section 12, as amended and renumbered, of the act of May 24, 1924; and (3) in the case of other civilian officers or employees of the Government of the United States stationed outside continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President.

SECTION 119. LOSS ON SALE OR EXCHANGE OF SECURITIES OF CERTAIN RAILROAD COMPANY SUBSIDIARIES

This section, for which there is no corresponding provision in the House bill, amends section 117 (a) (1) of the Internal Revenue Code (defining "capital assets") by inserting at the end thereof a provision limiting the definition of "capital assets" so as not to include stock or securities of any other corporation subject to part I of the Interstate Commerce Act, provided the same are held by the taxpayer pursuant to due authorization by public authority if and so far as such authorization is required by law. This limitation is applicable only in case the taxpayer is (A) a corporation whose principal business is that of a common carrier by railroad or (B) a corporation the assets of which consist principally of stock in such corporations and which does not of itself operate a business other than that of a common carrier by railroad. In order to determine whether the principal business of a corporation is that of a common carrier by railroad, the amendment provides that the business of receiving rents for railroad properties shall be considered as the business of a common carrier by railroad if a common carrier by railroad has leased its railroad properties and such properties are operated as such by another common carrier by railroad.

SECTION 120. ALTERNATIVE TAXES RELATING TO CAPITAL GAINS AND LOSSES OF CORPORATIONS

This section, for which there is no corresponding provision in the House bill, amends the first sentence of section 117 (c) (1), (relating to the alternative tax upon corporations whose net long-term capital gain for a taxable year exceeds its net short-term capital loss for such year) so as to provide that the alternative tax provided by section 117 (c) (1) shall be in lieu of the declared value excess profits tax imposed by section 600, as well as in lieu of the tax imposed by sections 13

14, 15, 204, 207 (a) (1) or (3), and 500. Under the provision, the net long-term capital gains subjected to the alternative tax at capital gain rates will in effect not be included in the income subject to declared value excess profits tax.

SECTION 121. GAIN OR LOSS UPON THE CUTTING OF TIMBER

This section, for which there is no corresponding provision in the House bill, adds a new subsection (k) to, and makes a complementary technical amendment to subsection (j) of, section 117 of the code so as to provide that certain timber which is cut shall be considered to have been sold or exchanged; that timber so cut and certain other timber disposed of shall be considered property used in the trade or business of the taxpayer; and that certain income considered to arise from such dispositions shall be subject to the special treatment provided in section 117 (j) (relating to gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business).

Under section 117 (k) (1) of the code, as added by this section, a taxpayer which owns or has a contract right to cut timber, which ownership or contract right has existed for a period of more than 6 months prior to the beginning of a taxable year, may elect in his return for such year to treat the cutting of such timber during such year as a sale or exchange of such timber. In such event such timber shall be considered "property used in the trade or business" of the taxpayer within the meaning, and for the purposes, of section 117 (j). If such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber as of the first day of the taxable year in which such timber is cut. Such fair market value shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor, as, for example, for purposes of the inclusion in closing inventory for the year in which such timber has been cut if during such year such timber was not sold and for purposes of determining the basis of such timber upon subsequent sale. Income derived from subsequent disposition of such cut timber is not subject to the provisions of section 117 (k) (1), except insofar as it provides the basis to be used in connection with such disposition. An election made by a taxpayer under section 117 (k) (1) shall be applicable with respect to all timber owned by the taxpayer or which the taxpayer has a contract right to cut, and shall be binding upon the taxpayer for the taxable year for which the election is made and for all subsequent years unless the Commissioner, on showing of undue hardship, permits the taxpayer to revoke his election. Such revocation shall preclude any further elections under section 117 (k) (1) except with the consent of the Commissioner.

Under section 117 (k) (2) as added by this section, in the case of timber which has been disposed of by the owner, who has held it for more than 6 months prior to such disposal, under any form or type of contract by virtue of which the owner retains an economic interest in such timber, the difference between the amount received for such timber and the adjusted basis for depletion of such timber in the hands of the owner, shall be considered as though it were a gain or

loss, as the case may be, upon the sale of such timber. Such timber shall be considered "property used in the trade or business" of the owner within the meaning, and for the purposes, of section 117 (j).

Subsection (b) of this section amends section 117 (j) (1) of the code by including within the definition of "property used in the trade or business," timber as provided in section 117 (k). Thus gain or loss arising from the cutting of timber with respect to which an election has been made under section 117 (k) (1), and from timber which has been disposed of, as provided in section 117 (k) (2), shall be considered, or shall not be considered, as gains or losses from the sales or exchanges of capital assets under the provisions of section 117 (j), depending upon the operation of such section in the case of the taxpayer.

Subsection (c) of this section provides that the amendments made by subsections (a) and (b) of this section to the extent that they relate to the disposal of timber by the owner under section 117 (k) (2) of the code, and section 117 (j) of the code as amended by subsection (b) of this section, to the extent that it relates to such disposal, shall be effective as if such amendments and such section 117 (j) were a part of the Internal Revenue Code and of each prior revenue law on the date of its enactment.

Section 122. Acquisitions to Avoid or Evade Income or Excess-Profits Tax

This section corresponds to section 115 of the House bill which added a new section 129 to chapter 1 under which a deduction, credit, or allowance is disallowed (or allowed only in part in a manner consistent with the prevention of tax avoidance) in any case in which any person or persons acquire, on or after October 8, 1940, an interest in or control of a corporation or property, if the Commissioner finds that one of the principal purposes for which such acquisitions was made or availed of is the avoidance of Federal income or excess profits tax by securing the benefit of such deduction, credit, or other allowance.

Under the amendment proposed by your committee, section 129 disallows a deduction credit or allowance in any case in which any person or persons acquire, on or after October 8, 1940, control (more than 50 percent) of a corporation, if the principal purpose for which such acquisition was made is evasion or avoidance of Federal income taxes by securing the benefit of a deduction, credit, or allowance.

The objective of the section, as stated in the report on the House bill, is to prevent the distortion through tax avoidance of the deduction, credit, or allowance provisions of the code, particularly those of the type represented by the recently developed practice of corporations with large excess profits (or the interests controlling such corporations) acquiring corporations with current, past, or prospective losses or deductions, deficits, or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes. The House report also recognizes that the legal effect of the section is, in large, to codify and emphasize the general principle set forth in *Higgins* v. *Smith* (308 U. S. 473), and in other judicial decisions, as to the ineffectiveness of arrangements distorting or perverting deductions, credits, or allowances so that they no longer bear a reasonable business relationship to the interests or enterprises which produced them and for the benefit of which they were provided.

Your committee recognizes these facts and is in agreement with these objectives. Your committee also recognizes the difficulty of formulating a proper general provision which will be helpful in administration and decision in distinguishing between business conduct which effectuates the basic purposes of the deduction, credit, and allowance provisions of the code and arrangements which distort, pervert, and defeat such basic purposes.

Your committee was of the opinion that the section would more effectually secure its objectives if its scope were limited to cases in which the control (more than 50 percent) of a corporation was acquired on or after October 8, 1940. Such acquisitions are clearly those in which the opportunities for distortion and perversion are largest, both in method and result. Controlled groups are already subject to an express avoidance rule under existing law; and, under your committee amendment, persons acquiring control of a corporation are subjected to the same express rule.

The older types of avoidance scheme which aer excluded under your committee's amendment from the scope of section 129, if not within the scope of section 45, will be governed by the principles which have been stated, more fully than elsewhere, in *Higgins* v. *Smith* (308 U. S. 473), and which, in an increasing number of specific situations, have been applied. *Gregory* v. *Helvering*, 293 U. S. 465; *Griffiths* v. *Commissioner*, 308 U. S. 355; *U. S.* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Moline Properties* v. *Commissioner*, 319 U. S. 436; *Interstate Transit Lines* v. *Commissioner*, 63 Sup. Ct. 1279; *National Securities*, C. C. A. 3d., cert. den. December 6, 1943; and *J. D. & A. B. Spreckels Co.* v. *Commissioner*, 41 B. T. A. 370. As a result, the law applicable to the older types of avoidance, has acquired a definiteness which the law applicable to the newer types involving the acquisition of the control of a corporation, has not. By thus recognizing these different types (which types must necessarily be broad and which must necessarily overlap) your committee believes that the effectiveness of section 129 will be increased, not only in the prevention of avoidance schemes which defeat the basic policies of the several provisions of the income and excess profits tax law, but also in assisting and facilitating bona fide business transactions in accord with and effectuating such basic policies.

The House bill made section 129 operative only upon an express finding by the Commissioner. Your committee has eliminated the necessity for an express finding. Since the section is retroactive to taxable years beginning after December 31, 1939, as a result the procedural position of the taxpayer will not be retroactively changed in any way.

The House bill made section 129 operative if one of the principal purposes was tax avoidance. Your committee believes that the section should be operative only if the evasion or avoidance purpose outranks or exceeds in importance, any other one purpose.

The House bill made section 129 dependent upon the purpose for which the acquisition was made or availed of. Your committee eliminated "availed of" from the requirement. The determination of the purpose for which the acquisition was made necessarily requires a scrutiny of the entire transaction, or course of conduct, with all its surrounding circumstances.

Section 129, under your committee's amendment, as under the House bill, recognizes that any attempt to encompass tax evasion and avoidance problems by a specific description of the tax avoidance schemes will catch within its net both intended transactions and those not intended and will fail to catch both those intended to be caught and those not intended. Further, the specific description tends to center attention upon the form and technical character of the scheme, and to let the substance of the tax avoidance escape. To determine what transactions constitute the condemned evasion or avoidance, section 129 must be read in its context and background. It is superimposed on the several existing provisions of the income and excess-profits-tax law, the basic policies of which contemplate the bona fide conduct of business in the ordinary way. Basic to the deduction, credit, and allowance provisions is a continuing enterprise so conducting its affairs. A substantial number of the code provisions, like sections 112, 113, and 141, are especially designed to remove tax impediments from such business transactions. It is nonconformity to the basic policies of these provisions of the code which is denoted by tax avoidance in section 129, and it is in the light of these basic policies that section 129 would necessarily have to be applied and administered. Such is also the case under section 45 and under the principles applied in the absence of the explicit statutory language. The *National Securities* and *Spreckels cases* cited above aptly illustrate such nonconformity, violating in those cases the basic policies of the deduction provisions, and in the *Spreckels case*, the consolidated returns provisions. The test of this nonconformity is, as was indicated in *Higgins* v. *Smith*, whether the transaction or a particular factor thereof "distorts the liability of the particular taxpayer" when the "essential nature" of the transaction or factor is examined in the light of the "legislative plan" which the deduction or credit is intended to effectuate.

Section 129, under the committee amendment, applies only if there is, on or after October 8, 1940, an acquisition of control of a corporation for tax evasion or avoidance purposes. If a controlled or affiliated group existed on October 8, 1940, transfers thereafter within the group could not amount to the acquisition of such control by the parent or its controlling interest. Control once acquired could not be again acquired, unless the group was in some way broken. A mere shift in the form of control—from direct to indirect, from indirect to direct, or from one form of indirect to another form of indirect—cannot, therefore, amount to the acquisition of control within the meaning of section 115 of the bill.

A transfer within a controlled or affiliated group frequently occurs by a section 112 (b) (6) liquidation or by a tax-free exchange under the reorganization or consolidated returns provisions of law. A liquidation cannot occur unless there is an 80-percent control of the section 112 (b) (6) liquidated corporation. If this 80-percent control exists, there exists also control of each corporation of which the liquidated corporation owned a controlling interest of 50 percent or more. Hence while a section 112 (b) (6) liquidation would change the form of control into a more direct form, it could hardly result in the acquisition of control under section 129. Transfers within a controlled or affiliated group under the reorganization or consolidated returns provisions of law are more often than not precisely the same as section 112 (b) (6) liquidations in this respect.

If instead of shifting the stock of a subsidiary nearer the parent as in a section 112 (b) (6) liquidation, it is transferred farther down the chain of subsidiaries it is clear that these subsidiaries farther down the chain (but not the parent or the subsidiaries up the chain) do acquire control of the shifted subsidiary. If the shift were principally for evasion or avoidance purposes, section 129 would apply. So would section 45 of existing law; so that in these cases section 129 does not change existing law.

Subsection (a) provides for the disallowance in its entirety of the deduction, credit or allowance which was the objective of the tax avoidance and evasion devices, but in order that the disallowance may be consistent with the purpose and appropriate scope of the section, subsection (b) authorizes the allowance of such part of the deduction, credit, or allowance as will not result in the avoidance or evasion of taxes sought by the acquisition. A proper result can be simply reached under paragraph (1) of subsection (b) in the more widely advertised schemes by reflecting in the deductions, credits, and allowances the purchase in substance by the acquiring interests of the assets which it was the design of the scheme so artfully to conceal. The more complex cases may require the allocation or distribution of any deduction, credit, or allowance between or among the corporations or properties involved. Due to the complex and varied form in which transactions of this character may be cast, the apportionment problems involved will require the specialized knowledge and experience of the Commissioner and his staff. Accordingly, section 129 (b) grants the Commissioner broad authority (of the same kind as that now exercised by him under sections 45 and 141) commensurate with the task of determining such proper allowance. Thus, the consideration passing upon the acquisition or the income of the corporations or properties involved, both prior to and after the acquisition, may, in appropriate cases, be an important factor in determining a proper credit, deduction, or allowance.

To prevent any implication that section 45 was or is intended in a narrower sense than the new section 129, the amendment made by subsection (b) of this section conforms the phrase used in section 45 to that used in section 129. It is believed that the amendment makes no change in existing law.

Subsection (c) of this section makes the provisions of this section applicable to taxable years beginning after December 31, 1939. Under the applicability clauses in chapter 2 (such as sections 508, 603, 702, and 729), the provisions of the section become applicable to each of the taxes imposed under chapter 2, including, of course, the excess profits tax.

Section 123. Disallowance of Certain Deductions Attributable to Business Operated by Individual at Loss for 5 Years

This section, for which there is no corresponding section in the House bill, adds a new section 130 to the code, which would limit in the case of individuals the amount of deductions attributable to a trade or business which are otherwise allowable in any given taxable year. If the deductions attributable to a trade or business carried on by an individual exceed the gross income from such business for each of 5

consecutive taxable years, the net income of such individual for each of such years is to be recomputed. In recomputing the net income for each of such years, deductions attributable to such trade or business shall be allowed only to the extent of $20,000 plus the gross income attributable to such trade or business. In making such recomputations, the net operating loss deduction provided in section 23 (s) of the code shall not be allowed. In determining the amount of any net operating loss carry-over or carry-back from any year which falls within the provisions of this section to any year which does not fall within such provisions, the net operating loss shall be the excess of the deductions as allowed by this section over the gross income.

For purposes of section 130, a given taxable year may be part of two or more different periods of 5 consecutive taxable years. Thus, if the deductions attributable to a trade or business carried on by an individual exceed the gross income from such business for each of 6 consecutive taxable years, the fifth year of such 6 consecutive taxable years shall be considered to be a part both of a 5 year period beginning with the first and ending with the fifth taxable year and of a 5 year period beginning with the second and ending with the sixth taxable year.

The tax imposed by chapter 1 of the code is to be recomputed for each taxable year subject to the provisions of this section upon the basis of the net income recomputed in the manner described above. Any excess of tax resulting solely from such recomputation over the tax previously determined shall be assessed and collected as a deficiency. Notwithstanding the normal period of limitation for the assessment of a deficiency, any such deficiency for a taxable year preceding the fifth taxable year in the above period of 5 consecutive taxable years may be assessed within 1 year after the expiration of the time prescribed by law, including any extensions thereof, for the assessment of a deficiency for such fifth taxable year.

The amendments made by this section are applicable to taxable years beginning after December 31, 1938, but no deficiency shall be assessed or collected thereunder for any taxable year beginning prior to January 1, 1944.

Section 124. Foreign Tax Credit

This section, for which there is no corresponding section in the House bill, would amend subsections (b) and (f) of section 131 of the code relating to the credit for taxes of foreign countries and possessions of the United States. Subsection (a) of section 116 amends subsection (b) of section 131 so as to provide, in the case of corporations, a formula of general application measuring the amount of the normal tax and the surtax borne by the foreign income subject to such tax. The formula provided in existing law in the case of corporations results in a credit in an amount which equals that proportion of the chapter 1 tax which the taxpayer's net income from the foreign sources bears to the sum of the normal-tax net income and the credit for adjusted excess profits net income provided in section 26 (e) of the code. Normally, the application of such formula produces a correct result. However, in any case in which a domestic corporation (a) receives foreign dividends, (b) is subject to the chapter 2 E excess

profits tax, and (c) computes its excess profits tax credit under the invested capital method (namely, under sec. 714) the foreign dividend is included in full in the numerator of the limitation fraction (because such dividend is not subject to the ch. 2 E excess profits tax, sec. 711 (a) (2) (A) of the code) while the denominator of the fraction contains income which has been subjected to the chapter 2 E tax and, hence, is not subject to the normal tax and the surtax (sec. 13 (a) (2) of the code). However, all of such income is included in the denominator of the limiting fraction in section 131 (b). The effect of this in such case is to dilute, or spread the normal tax and the surtax over a larger income than the income upon which such tax is actually computed.

Thus a domestic corporation has the following income and tax for the taxable year 1943:

Net income	$300,000
Less foreign dividends	50,000
Excess profits net income	250,000
Excess profits credit under sec. 714	175,000
Adjusted excess profits net income	75,000
Foreign tax paid on foreign income	25,000
Normal tax and surtax (40 percent of $225,000)	90,000

The credit is such case, under section 131 (b) (1) as it now stands is

$$\frac{50}{225+75} \text{ or } \frac{50}{300} \times \$90{,}000 \text{ or } \$15{,}000$$

In such case, however, only $225,000 is subject actually to normal tax and surtax and such tax on the foreign income is actually

$$\frac{50}{225} \times \$90{,}000 = \$20{,}000$$

which amount measures the correct amount of credit in such case. The larger the amount of the adjusted excess profits net income the smaller the amount of normal-tax net income and, hence, the larger distortion in such cases produced by the formula now found in section 131 (b). Likewise in some other cases the relation between numerator and denominator may be incorrect because of adjustments made in arriving at adjusted excess profits net income.

In the proposed amendment, including the new paragraph (3) added to subsection (b) of section 131, there will be included in the numerator the foreign income, or the portion thereof, subject to the normal tax and the surtax and there will be included in the denominator of such fraction the amount of income actually subject to such tax, thus producing an appropriate measure of the amount of such tax borne by the foreign income.

Subsection (b) of section 116 amends subsection (f) of section 131. The latter subsection provides that a domestic parent corporation of a foreign subsidiary corporation which has paid dividends to its parent corporation during the taxable year shall be deemed to have paid that proportion of the foreign tax actually paid by the subsidiary which the amount of the dividend bears to the accumulated profits of the subsidiary out of which such dividends have been paid. The subsection,

however, as it now stands, goes further and provides that the amount so deemed to have been paid shall not exceed the same proportion of the chapter 1 tax (that is the corporate normal tax and surtax) which the dividend bears to the amount of the normal-tax net income. This has the effect of confining the credit of the tax deemed to have been paid to the chapter 1 tax and preventing such tax being made available in part, as a credit against any chapter 2 E tax for which the parent corporation may be liable. Such effect, it is believed, is not in keeping with the fundamental purpose of the credit for foreign tax provisions which is the avoidance of double taxation. To reach such objective, it is suggested that the amount of tax thus deemed to have been paid, should, when added to the foreign taxes actually paid by the parent corporation, be available as a basis of credit to the parent corporation, first, against its chapter 1 tax, and the remainder, if any, to fall under section 729 (c) as a credit against the chapter 2 E tax subject, of course, to the limitations provided in section 729 (d) of that chapter. In view of the extremely high rates of taxation now imposed by Canada and Great Britain, from which countries a considerable portion of the dividends here involved arises, the restriction now found in existing law has serious effects in the case of some of the corporations concerned.

Accordingly subsection (b) of section 116 eliminates from subsection (f) of section 131 the proviso found therein, and reading as follows:

"* * * *Provided*, That the amount of the tax deemed to have been paid by such domestic corporation under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the normal-tax net income of the domestic corporation in which such dividends are included. * * *"

The amendments made by subsection (a) of section 116 will be effective for taxable years beginning after December 31, 1941; the amendment made by subsection (b) of section 116 will be effective for taxable years beginning after December 31, 1939.

Section 125. Extension of Consolidated Returns Privilege to Certain Corporations

This section, for which there is no corresponding provision in the House bill, adds a new paragraph to section 141 (c) of the code (relating to the definition of includible corporations which are members of an affiliated group which may elect to file consolidated returns). Under existing law, personal service corporations, as defined in section 725, may elect under certain conditions to be exempt from the excess profits tax; however, if such corporation is a member of an affiliated group of corporations filing consolidated returns, it is not so exempt. Likewise, under existing law, corporations exempt from the excess profits tax under section 727 of the code are not so exempt if they are members of an affiliated group of corporations filing consolidated returns, unless they are excluded from the definition of an includible corporation within the provisions of section 141 (c) of the code. The only corporations described in section 727 which are includible corporations within the provisions of section 141 (c) are personal holding companies as defined in section 501 (section 727 (c)), domestic corporations satisfying certain conditions specified in section 727 (g), and certain corporations subject to the provisions of title IV of the

Civil Aeronautics Act of 1938 (section 727 (h)). In order to preserve the exemption otherwise granted personal service corporations and corporations listed in section 727 (c), (g), and (h), the amendment made by this section provides that corporations described as in subsection 725 (a) and as in subsections 727 (c), (g), and (h), but not including such a corporation which has made and filed a consent for the taxable year or any prior taxable year beginning after December 31, 1943, to be treated as an includible corporation, shall not be considered to be includible corporations. It is further provided that such consent shall be made and filed at such time and in such manner as may be prescribed by the Commissioner, with the approval of the Secretary.

SECTION 126. ALIENS BROUGHT INTO THE UNITED STATES UNDER AUTHORITY OF THE WAR MANPOWER COMMISSION

This section amends section 143 (b) of the code, relating to withholding of tax at source in the case of nonresident aliens. Section 143 (b) provides generally for withholding at the rate of 30 percent upon the amount of payments made to nonresident aliens of such items as constitute gross income from sources within the United States, including amounts representing compensation for personal services. With respect to such items of income as dividends, interest, and the like, withholding at the 30 percent rate usually coincides with the final tax liability, which, in the case of most nonresident aliens, is also computed at the flat rate of 30 percent without allowance for credits or deductions. However, a nonresident alien performing personal service within the United States is not subject in determining his final tax liability to the flat rate of 30 percent but is subject to the normal tax, the surtax, and the Victory tax after the application against his income of the personal exemption appropriate to such cases, and, in the case of residents of contiguous countries, the credit for dependents.

Under the program of the War Manpower Commission, looking to alleviation of the critical manpower shortage, it is contemplated bringing to the United States for a portion of each year residents of Puerto Rico and other points outside the United States. Such persons are treated in the same manner as nonresident aliens for withholding purposes and are within the term "nonresident aliens" as used in this section. Such aliens are generally unskilled laborers and it is anticipated that their wages for the portion of the taxable year during which they will be in the United States will ordinarily be such that to subject them to withholding at the flat rate of 30 percent upon the gross amount would mean withholding an amount substantially in excess of the true tax liability. Such withholding would definitely discourage, if not actually prevent, the importation of such aliens. To promote the objective of the War Manpower Commission and at the same time to collect an amount which will closely approximate the actual tax, this section reduces the rate of withholding at the source to 10 percent of the gross amount of the wages of nonresident alien individuals brought into the United States under the authority of the War Manpower Commission for temporary employment essential to the war effort. Regulations relating to proration of the personal exemption now in

operation in the case of certain nonresident aliens will not be applicable to nonresident aliens coming within the scope of this section. This section does not affect any exemption from withholding of any nonresident alien under existing law, regulations, or ruling.

SECTION 127. RELIEF IN THE CASE OF EXCESS DEDUCTIONS OF ESTATES AND TRUSTS

This section, for which there is no corresponding provision in the House bill, adds a new paragraph to section 162 (d), which was inserted in the code by section 111 of the Revenue Act of 1942. Through the application of section 162 (d) (2) and (3) (A) it is possible in some cases that the amount of the deductions allowed in computing the net income of an estate or trust, and required to be included in the net income of the legatees, heirs, or beneficiaries, will exceed the net income of the estate or trust for its taxable year. Your committee believes that such excess deductions result in a form of double taxation which should be remedied. Therefore, paragraph (4) has been added to section 162 (d). Under this paragraph, in cases where the deductions to an estate or trust allowed under section 162 (b) or (c) for any income which becomes payable to a beneficiary, and which would not otherwise constitute a deduction except by reason of the operation of the rules prescribed by section 162 (d) (2) and (3) (A), exceed the net income of the estate or trust, computed without such deductions, the amount equal to such excess shall be excluded from the net income of the beneficiary. For the purposes of determining such excess, the net income of the estate or trust shall be computed in accordance with the provisions of section 162 and other applicable provisions of the code, except that the deductions arising solely from the operation of section 162 (d) (2) and (3) (A) shall not be taken in reduction of such net income; however, the net income shall be reduced through the operation of section 162 (d) (1) to the same extent that deductions are required under that paragraph with the operation of section 162 (d) (3) (A). In cases where such amounts of income become payable during the taxable year of an estate or trust to more than one beneficiary, the amount to be excluded from the net income of each beneficiary shall be determined in accordance with the ratio which the amount of such income paid to each beneficiary bears to the aggregate of such income paid to all the beneficiaries.

Application of the above is illustrated by the following example: A trust in 1942 had net income, before allowance of any deductions under section 162, of $8,000. The deductions required under section 162 (computed with the deductions required by subsection (d)) amount to $13,000 by reason of the following payments to beneficiaries:

$6,000 was paid to A on April 1, 1942; $5,000 as his share of the trust income during the last 9 months of 1941, and $1,000 as his share of the trust income during the first 3 months of 1942.

$2,000 was paid to A on December 31, 1942, as the balance of his share of trust income for 1942.

$3,000 was paid to B on January 5, 1943, as his share of trust income for 1942.

$4,000 was paid on April 1, 1942, to C, an annuitant, of which only $2,000 is allowed as a deduction to the trust under subsection (d) (1).

The amount of the above payments which is to be excluded in computing the net income of the above beneficiaries is computed as follows:

(*a*) Without the application of subsection (d) (2) and (3) (A), the following deductions would not have been taken by the trust:

$5,000 of the $6,000 paid to A on Apr. 1, 1942	$5,000
Amount paid to B on Jan. 5, 1943	3,000
Total	8,000

(*b*) The net income, for the purposes of subsection (d) (4), is computed without applying subsection (d) (2) and (3) (A) except in arriving at the deduction allowed under subsection (d) (1), as follows:

(1) Net income before any deductions under section 162		$8,000
(2) Less:		
$1,000 of the $6,000 paid to A on Apr. 1, 1942	$1,000	
Income paid to A on Dec. 31, 1942	2,000	
$2,000 of the $4,000 paid to C, the annuitant	2,000	
		5,000
(3) Net income for the purposes of subsection (d) (4)		3,000

(*c*) The deductions of $8,000 (from (*a*) above) exceed the net income of $3,000 (from (*b*) (3) above) by $5,000. Such excess deductions are excluded from the net income of A and B (beneficiaries receiving the income in (*a*) above) in the following proportions:

$\frac{5,000}{8,000}$ of $5,000 is excluded from A's income.

$\frac{3,000}{8,000}$ of $5,000 is excluded from B's income.

While this section of the bill would relieve taxpayers from the more serious type of double taxation resulting from the application of section 162 (d) (2) and (3) (A) in certain cases, your committee believes that further study should be given to the operation of section 162 (d). Your committee is in accord with the purposes for which section 162 (d) was inserted into the law by section 111 of the Revenue Act of 1942, but it is of the opinion that the method adopted by the 1942 Act to attain such purposes has given rise to considerable difficulty in administration, particularly with regard to the application of the 65 day rule. Therefore, the technical staffs have been instructed to examine this problem further for the purpose of suggesting a means of attaining the objectives of the 1942 Act in a manner simpler of operation.

Section 128. Trusts for Maintenance or Support of Certain Beneficiaries

This section is identical with section 116 as passed by the House, except for certain technical changes made by your committee.

Under existing law the income of a trust which is created in order to maintain or support a beneficiary whom the grantor is legally obligated to maintain or support is taxable to the grantor (*Douglas* v. *Willcuts*, 296 U. S. 1 (1935)). In accordance with the settled principle of *Douglas* v. *Willcuts* it has been held that if income of a trust may, in the discretion of persons lacking a substantial adverse interest, be applied in discharge of the same obligation, the income is taxable to the grantor regardless of whether or not it is actually so applied (*Helvering* v. *Stuart*, 317 U. S. 154 (1942)). This decision has, in effect, overruled G. C. M. 18972, C. B. 1937–2, page 231, which for reasons of administrative convenience had adopted the rule that in cases of such discretionary trusts the income is taxable to the grantor only to the extent that it is actually applied in discharging his obligation of maintenance or support. In view of various administrative difficulties created by a strict application of the decision in *Helvering* v. *Stuart*, your committee has deemed it desirable to return to the rule approved in G. C. M. 18972 and has amended section 167, relating to trust income which is attributed to the grantor, in order to accomplish this result.

Subsection (a) of this section adds a new subsection (c) to section 167 of the code, so as to provide that income shall not be taxable to the grantor under section 167 (a) of the code or any other provision of chapter 1 thereof merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary, such as the wife or child of the grantor, whom he is legally obligated to support, except to the extent that such income is actually so applied or distributed. It is further provided that in those cases where the amounts so applied or distributed are paid out of corpus or out of other than income, such amounts are to be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor. Thus, if the trust provides for the annual payment of income to the grantor's adult son whom he is no longer legally obligated to support in an amount not exceeding $7,000, and the application of the remaining income or principal, in the trustee's discretion, to the support of the grantor's minor daughter, and if out of the entire income for the taxable year aggregating $12,000, of which $3,000 is taxable to the grantor under section 166, the trustee pays $7,000 to the son, and applies the remaining $5,000 as well as principal in the sum of $1,000 to the support of the daughter, the grantor is taxable under subsection (c) with respect to $2,000 of trust income. The applicability of subsection (c) is not affected by the fact that the income of the trust may also be applied or distributed for purposes other than the maintenance or support of a beneficiary whom the grantor is legally obligated to support. Subsection (c) is not applicable if discretion to apply or distribute the trust income for support, maintenance, or education rests solely in the grantor or in the grantor in conjunction with other persons unless the grantor has such discretion as trustee.

Subsection (c) does not affect the present scope of sections 22 (k) and 171 of the code. Nor does subsection (c) alter the principles governing the taxability of trust income to the grantor under some other provision of law. For example, trust income remains taxable

to the grantor under section 22 (a) of the code if the terms of the trust, not excluding the discretionary power to apply trust income, and all the circumstances attendant on its creation and operation indicate that the grantor has retained a control of the trust so complete that he is still, in practical effect, the owner of its income. The grantor of a trust continues to be taxable under section 167 with respect to such income as may, in the discretion of persons lacking a substantial adverse interest, be applied in discharge of his obligations other than his obligation of support and maintenance falling within the amendments made by subsection (c). Thus if the grantor creates a trust the income of which may, in the discretion of a person lacking a substantial adverse interest, be applied in the payment of his debts, such income is taxable to the grantor regardless of whether it is actually so applied.

The Treasury Department has already provided in I. T. 3609 that the decision in the *Stuart case* will not be applied retroactively because of difficulties which would otherwise arise. While this action adequately provides for prior years, any limitation of the amendments made by this section to future years might cause some misunderstanding as to the tax liability for prior years and it has accordingly been provided in subsection (b) of this section for the retroactive application of the amendments.

Subsection (b) (1) of this section provides that the amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1942, unless a taxable year of the trust beginning in 1942 ends within a taxable year of the grantor beginning in 1943, in which case (except as provided in subsection (b) (2)) the amendments shall not be applicable to such taxable year of the grantor. Thus, if the trust is on a fiscal year ending June 30, and the grantor is on a calendar year, the amendments will be effective with respect to the trust commencing with its fiscal year beginning July 1, 1943. Since the grantor's return for the calendar year 1943 includes the income of the trust's fiscal year beginning on July 1, 1942, and ending on June 30, 1943, the amendments will first be applicable, with respect to the grantor, to his calendar year 1944.

Paragraph (2) of subsection (b) provides that the amendments made by subsection (a) shall apply retroactively if there are filed with the Commissioner (in accordance with regulations prescribed by him with the approval of the Secretary) at such time and by such persons as may be prescribed under such regulations, signed consents that there shall be paid, at such time as the Commissioner may prescribe, all of the taxes under chapter I of the Internal Revenue Code or under the corresponding provisions of prior revenue laws which would have been paid for the taxable years concerned if such amendments had been a part of the revenue laws applicable to such taxable years. Paragraph (3) of subsection (b) provides that such subsection does not change any provision or rule of law limiting the allowance of refund or credit with respect to overpayments of the grantor. It is contemplated that the regulations prescribed by the Commissioner will not authorize the filing of consents with respect to any taxable year of the grantor unless there are filed with the Commissioner consents for all taxable years of the grantor with respect to which the period allowed to him for filing claim for credit or refund has not expired. If consents are filed within the period in which claim for

credit or refund may be filed by the grantor, the period within which such claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, with respect to any overpayment by the grantor resulting from the consents shall include 1 year immediately after the date of the filing of the consents. It is further provided that with respect to any deficiency resulting from consents filed, the period of limitations for making assessment and the beginning of distraint or a proceeding in court for collection shall include 1 year immediately after the date such consents are filed, and such assessment and collection may be made notwithstanding any provision of the internal revenue laws or any rule of law which bars such adjustment (such as a prior judicial determination of the tax for the taxable period of the person signing the consent). No interest is to be allowed or paid on any refund or credit to the grantor, and no interest shall be assessed on any deficiency, resulting from the filing of the consents.

Section 129. Mutual Fire-Insurance Companies Issuing Perpetual Policies

This section, for which there is no corresponding provision in the House bill, provides for the taxability of fire-insurance companies exclusively issuing perpetual or refundable single premium policies under section 204 of the code, relating to stock insurance companies other than life and mutual marine insurance companies, instead of as at present under the provisions of section 207 of the code, relating to mutual insurance companies other than life or marine.

Section 207, as amended by the Revenue Act of 1942, affects companies issuing perpetual and single premium policies in a discriminatory manner. The 1942 amendments were designed to obtain a suitable tax base for mutual companies as a class. The most important group were the companies issuing the usual type of renewable short-term policies. Generally speaking, the tax imposed by section 207 is levied either on investment income at regular corporate rates, or on the gross amount of income from interest, dividends, rents, and net premiums (less certain deductions) at the rate of 1 percent, whichever tax is greater. No deductions are allowed from investment income for losses or general business expenses. The plan works equitably for companies issuing the ordinary type of short-term policies, since their main income is from premiums and their losses and expenses are paid out of this income which is taxed only at the 1 percent rate. The perpetual companies, however, derive by far the largest portion of their income from investments, and meet their losses and expenses from that fund. The denial of deductions for such losses and expenses results in an overstatement of their true income. This is corrected by applying to these companies the provisions of section 204 with slight adjustments. Principally these adjustments consist of excluding from gross income of such companies single deposit premiums received (but not payments of quotas or assessments), and of disallowing any deduction for dividends paid to policyholders.

SECTION 130. TREATY OBLIGATIONS

This section, which is the same as section 117 of the House bill, provides that no amendment made by title 1 of the bill shall apply in any case where its application would be contrary to any treaty obligations of the United States.

TITLE II—EXCESS PROFITS TAX AND POST-WAR REFUND OF EXCESS PROFITS TAX

PART I—EXCESS PROFITS TAX AMENDMENTS

SECTION 201. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE

This section, which is identical with section 201 of the House bill, provides that the excess profits tax amendments made by this title of the bill shall be applicable only with respect to taxable years beginning after December 31, 1943, except as otherwise expressly provided.

SECTION 202. INCREASE IN EXCESS PROFITS TAX RATE

With the exception of an additional amendment made by your committee to section 710 (a) (1) (B) of the code, this section is identical with section 202 of the House bill.

Subsection (a) of this section amends section 710 (a) (1) (A) of the code by increasing the 90-percent rate specified therein to 95 percent.

Subsection (b), which was not in the House bill, amends section 710 (a) (1) (B) of the code to provide that in computing corporation surtax net income, for purpose of applying the 80 percent limitation provided in such section, 80 percent of the credit provided in section 26 (h), relating to credit for dividends paid on the preferred stock of public utilities, shall be disregarded. This amendment is to correct a technical error in drafting whereby a public utility subject to the 80 percent limitation would have its total income and excess profits tax liability reduced by an amount equal to 80 percent of the dividends which it paid on its preferred stock during the taxable year. The credit provided in section 26 (h) was intended, however, as a credit only for purposes of the surtax. By providing that corporation surtax net income shall be computed for purposes of the 80 percent limitation without regard to 80 percent of the credit provided in section 26 (h), your committee has made the necessary correction, and at the same time has provided that a public utility which is subject to the 80 percent limitation shall receive the same tax advantage as a result of paying dividends on its preferred stock as a public utility which is not subject to such limitation. Subsection (d) of this section provides that the amendment made by this subsection is applicable with respect to all taxable years beginning after December 31, 1941.

Subsection (c) amends section 26 (c) of the code, which provides for the credit for income subject to excess profits tax to be used in the computation of normal-tax net income and corporation surtax net income, by providing that in the case of any corporation which computes its excess profits tax under section 721 (relating to abnormalities

in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations with income from long-term contracts), the credit for income subject to the excess profits tax shall be the amount of which tax imposed by subchapter E of chapter 2 is 95 percent, instead of 90 percent.

SECTION 203. CERTAIN FISCAL YEAR TAXPAYERS

This section is identical with section 203 of the House bill.

Under section 710 (a) (3), as added by section 203 of the Revenue Act of 1942, special rules were provided for the computation of the excess profits tax under subchapter E of chapter 2 in the case of taxable years beginning in 1941 and ending after June 30, 1942. This tax is the sum of the prorated portions of two tentative taxes. The first tentative tax is computed under the law applicable to the taxable year beginning in 1941 and at the rates (or in the amounts of tax) specified for such a taxable year but without regard to the provisions of section 710 (a) (3). The second tentative tax is computed under the law applicable to the taxable year beginning in 1941, but with certain modifications relating to certain deductions and credits in the base for computing the tax, and at the rates (or in the amounts of tax) specified for a taxable year beginning in 1942. The second tentative tax is to be computed without regard to the provisions of section 710 (a) (3), except insofar as certain provisions of the code are made applicable by such section.

In computing the second tentative excess profits tax under section 710 (a) (3) (B) the 80 percent limitation provided by section 710 (a) (1) (B) might be applicable. Under this limitation the excess profits tax cannot exceed an amount which when added to the tax imposed under chapter 1 equals 80 percent of the corporation surtax net income (computed without regard to the credit provided in section 26 (e) relating to income subject to excess profits tax imposed by subchapter E of chapter 2). If such limitation is applicable, it becomes necessary to ascertain the amount of the tax under chapter 1 for the taxable year. It was the intention that in computing the second tentative excess profits tax under section 710 (a) (3) (B) the amount of the tax under chapter 1 to be used in computing the 80 percent limitation should be the second tentative normal and surtax computed under subparagraph (B) of section 108 (a) (1). That section provides for a tax computation similar to that of section 710 (a) (3) in computing normal tax and surtax. However, because of a technical inadvertence, no specific provision was inserted in section 710 (a) (3) providing that the total tax computed under section 108 (a) (1) should be disregarded, and that only the second tentative tax computed under section 108 (a) (1) (B) should be used in the computation of the 80 percent limitation. Moreover, this technical omission might give rise to a circular computation in cases in which the 80 percent limitation is applicable since the first tentative normal and surtax to be used in computing the total normal tax and surtax under section 108 (a) (1) (A) is based upon the allowance of the excess profits tax as a deduction in computing net income, and since the portion of such excess profits tax under

the 80-percent limitation could not be ascertained until the total normal tax and surtax had been first computed under 108 (a) (1) (A).

The regulations promulgated by the Commissioner under section 710 (a) (3) give expression to the computation intended to be prescribed by section 710 (a) (3) which would require a parallel computation of the first tentative excess profits tax under section 710 (a) (3) (A) and the first tentative normal tax and surtax under section 108 (a) (1) (A), and a parallel computation of the second tentative excess profits tax under section 710 (a) (3) (B) and the second tentative normal tax and surtax under section 108 (a) (1) (B). Inasmuch as an amendment to section 710 to relate to taxable years beginning in 1943 and ending in 1944 was required in any event, your committee have made an exception to the decision to postpone to next year clarifying changes required as a result of the provisions added by the Revenue Act of 1942, and has therefore amended section 710 (a) (3) and section 108 (a) (1), retroactively, so as to remove any technical ambiguity which might have inhered in such sections as added by the Revenue Act of 1942, to clarify their provisions, and to give express statutory approval to the regulations issued by the Commissioner.

This section also adds a new paragraph (6) to section 710 (a) of the code to provide for the computation of the excess profits tax in the case of taxable years beginning in 1943 and ending in 1944. This computation is similar to that provided with respect to the computation of normal and surtax under section 108 (b), as amended by section 104 of this bill.

The new paragraph provides that in the case of a taxable year beginning in 1943 and ending in 1944, the excess profits tax imposed by subchapter E of chapter 2 shall be an amount equal to the sum of (a) that portion of a tentative tax (computed as if the law applicable to taxable years beginning on January 1, 1943, were applicable to such taxable year) which the number of days in such taxable year prior to January 1, 1944, bears to the total number of days in such taxable year, plus (b) that portion of a tentative tax (computed as if the law applicable to taxable years beginning on January 1, 1944, were applicable to such taxable year) which the number of days in such taxable year after December 31, 1943, bears to the total number of days in such taxable year.

Section 204. Increase in Specific Exemption

This section is identical with section 204 of the House bill. It amends section 710 (b) (1) (relating to specific exemption), section 729 (b) (2) (relating to excess profits tax return requirement), and section 141 (c) (relating to the computation of tax in case consolidated returns are filed), to increase the specific exemption applicable in the computation of adjusted excess profits tax net income from $5,000 to $10,000.

Section 205. Reduction of Excess Profits Credit Based on Invested Capital in Certain Brackets

This section is substantially the same as section 205 of the House bill, with one major exception. Section 205 of the House bill amends section 714 of the code, relating to the excess profits credit based on

invested capital, by reducing by 1 percent the existing percentages of the invested capital taken as the invested capital credit with respect to amounts of invested capital over $5,000,000. Under existing law the invested capital credit is computed as 8 percent of the first $5,000,000 of the invested capital, 7 percent of the next $5,000,000, 6 percent of the next $190,000,000, and 5 percent of the balance over $200,000,000. The House bill provides for a credit determined as 8 percent of the first $5,000,000 of invested capital, 6 percent of the next $5,000,000, 5 percent of the next $190,000,000, and 4 percent of the balance over $200,000,000.

The House bill has been amended by striking out the provision for an invested capital computation of 4 percent over $200,000,000. As thus amended section 714 provides for a credit determined as 8 percent of the first $5,000,000 of invested capital, 6 percent of the next $5,000,000, and 5 percent of the balance over $10,000,000.

Section 206. Publicity of Relief Granted Under Section 722

This section, except for certain technical changes, and except for the fact that an applicability subsection has been added, is identical with section 206 of the House bill.

This section adds a new subsection (g) to section 722 to provide for publicity of certain salient facts with respect to relief granted under section 722 of the code. The amendment provides that the Commissioner shall compile for each fiscal year beginning after June 30, 1941, a list, arranged alphabetically and according to internal revenue districts, of all cases in which relief has been allowed pursuant to section 722 during such year either by the Commissioner or The Tax Court of the United States. This compilation shall contain the name and address of each taxpayer to which relief has been allowed, the business in which the taxpayer is engaged, the amount of the excess profits credit of the taxpayer before such allowance, the increase in such excess profits credit claimed and the increase in such credit allowed, and the amount of the gross reduction in the excess-profits tax and of the gross increase in the tax under chapter 1, which results from the operation of section 722. In the case of relief allowed by The Tax Court the Commissioner shall also set forth the data previously reported pursuant to this subsection with respect to relief previously allowed in such case by the Commissioner. This compilation shall be published in the Federal Register. It is contemplated that the Commissioner will compile a list of all cases in which relief has been allowed prior to the first fiscal year ending after enactment of the Revenue Act of 1943 in the Federal Register during such first fiscal year.

This section has been further amended by the addition of subsection (b) which provides that the compilation of cases required to be published in the Federal Register shall not be limited to cases relating to taxable years beginning after December 31, 1943.

Section 207. Strategic Minerals

This section is identical with section 207 of the House bill. It amends section 731 of the code relating to the exemption from excess profits tax of the portion of the adjusted excess profits net income

attributable to the mining in the United States of certain strategic minerals so as to extend the benefits of such section to corporations mining fluorspar, flake graphite, and vermiculite. The portion of the adjusted excess profits net income attributable to strategic mining is determined according to detailed regulations as contemplated by the section. As in the House bill, the amendment made with respect to flake graphite is applicable to taxable years beginning after December 31, 1942.

SECTION 208. NONTAXABLE INCOME OF CERTAIN INDUSTRIES WITH DEPLETABLE RESOURCES

With the exception of certain amendments relating to lessors, coal and iron mines and timber blocks not in operation during the base period, and certain natural gas companies, this section is similar to section 208 of the House bill.

This section amends sections 711 (a) (1) (I), 711 (a) (2) (K), and various paragraphs of section 735 so as to exempt from excess profits tax a certain portion of the income of a lessor of mineral property or a timber block, of new coal and iron mines and timber blocks not in operation during the base period, and of certain natural gas companies.

Under existing law a lessor is not included within the definition of a producer of minerals or a producer of logs or lumber from a timber block which is entitled to exclude from its excess profits net income the amount of nontaxable income from exempt excess output. Sections 711 (a) (1) (I), 711 (a) (2) (K), and 735 (a) (1) are amended by this section to permit a lessor to exclude from excess profits net income nontaxable income from exempt excess output as defined in section 735 (b). In the House bill the term "lessor" has been defined to mean a corporation which owns an economic interest in a mineral property or a timber block, and is paid in accordance with the number of mineral units or timber units recovered therefrom by the producer to which such property or block is leased by the lessor. Your committee has changed the definition of "lessor" to mean a corporation which owns an economic interest in a mineral property or a timber block, and is paid in accordance with the number of mineral units or timber units recovered therefrom by the person to which such property or block is leased. By changing the word "producer" to "person" and by deleting the words "by the lessor", it is made explicit that subleases are included within the purview of section 735 as respects lessors. Section 711 (a) (1) (I) and (a) (2) (K) are amended so as not to authorize a lessor to exclude from excess profits net income any amounts of royalties which could be claimed to represent a distribution by the lessee producer of nontaxable bonus income derived from bonus payments made by any agency of the United States Government pursuant to section 735 (c).

The present provisions of section 735 extend no relief to coal mining or iron mining properties or timber blocks which were not in operation during the base period. Subsection (c) of this section of the bill adds a new paragraph to section 735 (b) which provides that for any taxable year, the nontaxable income from exempt excess output of a coal mining or iron mining property or a timber block, which was not in operation during the base period, shall be an amount equal to one-half of the net income for such taxable year (computed with

the allowance for depletion) from the coal mining or iron mining property or from the timber block, as the case may be. Under the House bill, such amount was equal to one-sixth of such net income.

Section 735 (a) (8) (relating to the definition of "timber block") has also been amended so as to strike out the prohibition that an operation unit acquired after December 31, 1941, would not be included in the composition of a timber block.

In addition, this section of the bill extends to natural gas companies relief similar to the relief granted under the present law with respect to coal mining and iron mining properties and timber blocks. Under the House bill, in the case of natural gas companies, the nontaxable income from exempt excess output is to be computed with respect to net income derived from the withdrawal, storage, and transportation by pipe line, of natural gas, but is not to include any income attributable to the distribution of such gas. In order to make the relief extended to natural gas companies more nearly correspond to that extended to coal mining and iron mining properties and timber blocks, your committee has provided that relief shall be granted to natural gas companies only with respect to net income derived from the withdrawal of natural gas from natural gas properties in which the natural gas company owns an economic interest, and shall not be extended to any income attributable to storage, transportation, or distribution of such gas. The relief extended to a natural gas company is applicable only with respect to natural gas properties in which such company owns an economic interest during the taxable year and only if such company is engaged in the withdrawal of natural gas from a natural gas property in which it owns an economic interest and which was in operation during the base period.

Therefore section 711 (a) (1) (I) and (a) (2) (K) is amended to include natural gas companies within the scope of those corporations entitled to exclude nontaxable income from exempt excess output in the computation of excess profits net income. Section 735 (a) (1) is amended by including the term "natural gas company," which means a corporation engaged in the withdrawal of natural gas from a natural gas property in which it owns an economic interest and which was in operation during the base period; under the House bill a "natural gas company" was defined as a corporation engaged in the withdrawal, or transportation by pipe line, of natural gas. Section 735 (a) (2) and (3) (relating to the definition of a "mineral unit" and "timber unit") are consolidated into section 735 (a) (2), and this section is expanded to include the term "natural gas unit," which means a unit of natural gas withdrawn from a natural gas property; under the House bill a "natural gas unit" was a unit of natural gas sold by a natural gas company. Section 735 (a) (4) (relating to the definition of "excess output") is renumbered section "735 (a) (3)" and is amended to include "natural gas units." Section 735 (a) (5) (relating to the definition of "normal output") is renumbered section "735 (a) (4)," and is amended to include the determination of normal output in the case of a natural gas company. In such case, the term "normal output" means the average annual natural gas units withdrawn in the base period (the base period having been defined for the purposes of section 735 by a technical amendment made in section 735 (a) (4) to mean the taxable years beginning after December 31, 1935, and not beginning after December 31, 1939) of the person owning the natural

gas property (whether or not the taxpayer). In the House bill the term "normal output" is defined as the average annual natural gas units sold in such base period. The remaining provisions of section 735 (a) (4), as renumbered, are amended to include, along with mineral units and timber units and mineral property and timber blocks, natural gas units and natural gas properties.

A new paragraph (5) is added to section 735 (a) to define the term "natural gas property" which means a gas well, the development and plant necessary for the withdrawal of natural gas therefrom, and so much of the surface of the land as is necessary for such withdrawal, excluding any part of such property which is an emergency facility under section 124. In the House bill a "natural gas property" was defined as the property of a natural gas company used for the withdrawal, storage, and transportation by pipe line, of natural gas, excluding any part of such property which is an emergency facility within the provisions of section 124.

Section 735 (a) (12) (relating to the definition of "unit net income") is amended to provide that in respect of a natural gas property, the term "unit net income" means the amount ascertained by dividing the net income, computed in accordance with regulations prescribed by the Commissioner, with the approval of the Secretary, from such property during the taxable year by the number of gas units withdrawn from such property in such year. In the House bill the divisor is the number of gas units sold by the taxpayer in such year. It is contemplated that the Commissioner, with the approval of the Secretary, will issue under this section appropriate regulations providing rules for the allocation of items of income, costs, expenses, and other deductible amounts between the natural gas property and the other property (or activities) of the natural gas company, and for the elimination of any duplication of benefits which might result from the application of this section providing for nontaxable income and any other section providing for allowable deductions which are also attributable to the natural gas property or which would effect a reduction in the income from such property.

Subsection (c) of this section adds a new paragraph (5) to section 735 (b) to provide for the computation of nontaxable income from exempt excess output in the case of natural gas companies. It prescribes that in the case of a natural gas company, the nontaxable income from exempt excess output for any taxable year shall be an amount equal to the excess output for such year from natural gas properties in which it owns an economic interest multiplied by one-half of the unit net income for such year. This computation is to be made with respect to all natural gas properties in which a natural gas company owns an economic interest, regardless of whether such properties were in operation during the base period or whether, if in operation, the natural gas company owned an economic interest in such properties during the base period, provided that the natural gas company fulfills the requirements of section 735 (a) (1). As added by the House bill, paragraph (5) provides that in the case of a natural gas company any of the natural gas property of which was in operation during the base period, the nontaxable income from excess output for any taxable year shall be an amount equal to the excess output for such year multiplied by one-half of the unit net income for such year.

Your committee has changed the effective date provision of this section as contained in the House bill by making all the amendments made by this section applicable to taxable years beginning after December 31, 1941.

PART II—POST-WAR REFUND OF EXCESS PROFITS TAX

SECTION 250. POST-WAR REFUND OF EXCESS PROFITS TAX

This section, which with the exception of subsection (a) is substantially the same as section 250 of the House bill, amends sections 780 and 781 of the code, relating to post-war refunds of excess profits tax imposed by subchapter E of chapter 2 of the code.

Under existing law the Secretary of the Treasury is authorized and directed to establish a post-war credit, for each of certain specified taxable years, to the account of each taxpayer subject to the excess profits tax. In general, the post-war credit is equal to 10 percent of the excess profits tax imposed for the taxable year, but it is subject to limitations under which it may not exceed the amount by which the amount of the excess profits tax paid exceeds the amount of excess profits tax that would be payable at an 81 percent rate. Special provision is made in the case of fiscal year corporations subject to section 710 (a) (3) of the code and in the case of corporations to which the 80-percent limitation under section 710 (a) (1) (B) of the code applies. Bonds of the United States in the amount of the post-war credit are required to be issued in the name of the taxpayer generally within 3 months (with the exception of bonds for a taxable year beginning or ending in 1942) after the tax is paid in full. Since the post-war credit is tentatively determined on the basis of the excess profits tax shown on the return, provision is made for upward adjustments of the post-war credit and bonds in case of the payment of a deficiency in respect of the excess profits tax for a taxable year for which a post-war credit is provided, and for downward adjustments of the post-war credit and bonds in case a refund or credit is made of an overpayment of the excess profits tax for a taxable year for which a post-war credit is provided.

Subsection (a) of this section of the bill, which was added by your committee to the House bill, amends the last sentence of section 780 (a) of the code. Such sentence in existing law provides that, for the purposes of part III of subchapter E of chapter 2 of the code (comprising sections 780 to 783, inclusive), in the case of a taxpayer whose tax is determined under section 710 (a) (3) of the code, the term "tax imposed under this subchapter" means the excess of the tax imposed by section 710 (a) (3) over the tax that would be imposed if such section were not applicable. Section 710 (a) (3), as in existing law and as retroactively amended by section 203 of this bill, contains special rules for the computation of the excess profits tax in the case of taxable years beginning in 1941 and ending after June 30, 1942. This tax is the sum of the prorated portions of two tentative taxes. The first tentative tax, which is determined under section 710 (a) (3) (A), is computed under the law applicable to a taxable year beginning in 1941 and at the rates (or in the amounts of tax) specified for such a taxable year. The second tentative tax, which is determined under section 710 (a) (3) (B), is computed under the law

applicable to a taxable year beginning in 1941 with certain modifications, but at the rates (or in the amounts of tax) specified for a taxable year beginning in 1942. For a more complete explanation of section 710 (a) (3), as amended, see the explanation under section 203 of this bill. Under existing law the amount of the post-war credit in the case of a taxable year beginning in 1941 and ending after June 30, 1942, is, except as otherwise limited by section 781 (d), 10 percent of the amount of the excess of the tax imposed by section 710 (a) (3) over the tax that would be imposed if such section were not applicable. The amendment made by subsection (a) of this section of the bill provides that for the purposes of part III of subchapter E of chapter 2 of the code, in the case of a taxpayer whose tax is determined under section 710 (a) (3), the term "tax imposed under this subchapter" means the portion of the tentative tax determined under section 710 (a) (3) (B). Thus, under the amendment the amount of the post-war credit in the case of a taxable year beginning in 1941 and ending after June 30, 1942, will, except as otherwise limited by section 781 (d), be 10 percent of the amount of the prorated portion of the tentative tax determined under section 710 (a) (3) (B).

Subsection (b) of this section of the bill amends section 780 (c) of the code, relating to the terms and maturity of the bonds. The present section 780 (c) provides, in part, that the bonds shall not be transferable by sale, exchange, assignment, pledge, hypothecation, or otherwise, on or before the date of cessation of hostilities in the present war. The effect of the amendment is to permit the transfer of the bonds, on or before the date of cessation of hostilities in the present war, to the successor of the taxpayer in such cases as the Secretary of the Treasury may by regulations authorize. Thus, the Secretary may authorize the transfer of the bonds to a successor of the taxpayer in connection with certain liquidations, dissolutions, or reorganizations, or in case of certain transfers by operation of law, where the transfer would appear not to violate the purpose of the general provision that the bonds are not to be transferable on or before the date of cessation of hostilities. The prohibition on the transferability of the post-war credit or bonds should not be permitted to prevent a corporate liquidation, dissolution, merger, consolidation, reorganization, or other similar change in corporate structure which is consummated in good faith and not for the purpose of realizing on the post-war credit or bonds so that the proceeds thereof may be used on or before the date of cessation of hostilities in the present war.

The present section 780 (d) of the code provides that the proceeds of the bonds upon redemption shall not be included in gross income. Subsection (c) of this section of the bill amends section 780 (d) so as to limit this exemption to the taxpayer.

Subsection (d) of this section of the bill adds subsections (f) and (g) to section 780 of the code. Subsection (f) provides that subject to, and to the extent provided in, regulations prescribed by the Secretary of the Treasury, a successor of the taxpayer shall succeed to all the rights and liabilities of the taxpayer under part III of subchapter E of chapter 2 of the code, comprising sections 780 to 783, inclusive. Among other things, this subsection authorizes regulations under which transfer of the post-war credit, as well as the bonds, will be permitted in proper cases. The rights of the Government can be safeguarded in those cases where transfers are permitted by imposing on the successor

the liabilities of the taxpayer to the extent deemed necessary. Under this subsection in appropriate cases the tax exemption accorded the taxpayer under section 780 (d) may be extended by regulations to a successor of the taxpayer. Subsection (g) defines the term "successor" to mean such person or persons who succeed, either directly or through one or more other persons, to ownership of property of the taxpayer, as the Secretary of the Treasury may by regulations prescribe. The requirement of regulations prescribed by the Secretary will be satisfied by regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary.

Subsection (e) of this section of the bill amends section 781 (b) of the code, relating to the effect on the post-war credit or bonds, of a refund or credit of an overpayment of the excess profits tax for a taxable year for which a post-war credit is provided. Under existing law the outstanding post-war credit in favor of the taxpayer is first reduced by the amount of the post-war credit attributable to the overpayment of the excess profits tax; and in case the outstanding post-war credit is less than the amount by which it is required to be reduced, or if there is no such credit existing in favor of the taxpayer, the excess of such amount over the amount of the outstanding post-war credit, if any, is carried forward as a charge against the taxpayer to be applied in reduction of a subsequent post-war credit; and if no such subsequent post-war credit is made in favor of the taxpayer, the taxpayer is required to pay the amount of such charge to the United States or the amount of the bonds previously issued to the taxpayer is reduced by the amount of such charge. The amendment provides that in case of an overpayment of the excess profits tax for any taxable year for which a post-war credit is provided, the outstanding post-war credit for such taxable year in favor of the taxpayer shall be reduced by an amount equal to the post-war credit attributable to such overpayment; and that if the outstanding post-war credit for such taxable year is less than the amount by which it is required to be reduced, or if there is no such post-war credit existing in favor of the taxpayer, the excess of such amount over the amount of such post-war credit, if any, shall constitute a charge against the taxpayer to be applied in reduction of the amount of the bonds previously issued to the taxpayer with respect to such taxable year; or, if such bonds are not made available for that purpose or the amount of such bonds so made available is less than the amount of such charge, such charge or the excess of such charge over the amount of such bonds so made available, as the case may be, shall be applied at the time of the credit or refund (or as of the time of the maturity of the bonds with respect to such taxable year, if that time is earlier) in reduction of the amount of the credit or refund of the overpayment of the excess profits tax.

If such reduction in the amount of the credit or refund of the overpayment for a taxable year for which a post-war credit is provided is effected on or before the maturity date of the bonds for such year, the interest on the overpayment is to be computed on the amount of the overpayment before such amount is reduced by the charge attributable to such overpayment. For example, assuming that on December 15, 1943, the taxpayer overpays its excess profits tax for the calendar year 1942 by $100; the bonds for 1942 mature on December 31, 1947; the overpayment is refunded on December 15, 1944; at that time the taxpayer has no outstanding post-war credit for 1942; and no bonds

are made available for adjustment; the amount of the refund is $96, computed as follows: overpayment of $100 plus interest thereon for 1 year at 6 percent, making a total of $106, minus $10, the charge attributable to the overpayment.

In case the reduction in the amount of the credit or refund of the overpayment for a taxable year for which a post-war credit is provided is made after the maturity date of the bonds for such year, such reduction will, for the purpose of computing the interest on the overpayment, be made as of the date of the maturity of the bonds. For example, assuming that on December 31, 1943, the taxpayer overpays its excess profits tax for the calendar year 1942 by $100; the bonds for 1942 mature on December 31, 1947; the overpayment is refunded on December 31, 1948; at that time the taxpayer has no outstanding post-war credit for 1942; and no bonds are made available for adjustment; the amount of the refund is $119.40, computed as follows: $24, being the interest on the overpayment of $100 at 6 percent from December 31, 1943, to December 31, 1947 (the maturity date of the bonds for the taxable year), and $5.40, being the interest on $90 (overpayment of $100 less charge of $10) at 6 percent from December 31, 1947, to the date of the refund, plus $90, being the overpayment of $100 less the charge of $10.

The present section 781 (d) of the code provides, in part, that the post-war credit for any taxable year shall not be greater than the excess of the amount of the excess profits tax paid (and not credited or refunded under the internal revenue laws) in respect of such year over the amount of the tax which would be payable if the excess profits tax rate were 81 percent. Subsection (f) of this section of the bill amends section 781 (d), first, by substituting 85½ percent for 81 percent to give effect to the increase in excess profits tax rate from 90 to 95 percent, second, by adding additional rules for the computation of the limitation upon the post-war credit in the case of taxable years beginning in 1941 and ending after June 30, 1942, and, third, by adding additional rules for the computation of the limitation upon the post-war credit in the case of taxable years beginning in 1943 and ending in 1944, the excess profits tax for which will be computed under section 710 (a) (6), as added by section 203 of this bill.

In the case of a taxable year beginning in 1941 and ending after June 30, 1942, the post-war credit shall not be greater than the excess of the excess profits tax paid to the United States for such taxable year (and not credited or refunded under the internal revenue laws) over the sum of (1) the portion of the tentative tax determined under section 710 (a) (3) (A) for such taxable year, and (2) the portion of the tentative tax determined under section 710 (a) (3) (B) for such taxable year reduced by 10 percent.

In the case of taxable years beginning in 1943 and ending in 1944, the excess profits tax is the sum of the prorated portions of two tentative excess profits taxes computed under section 710 (a) (6). The amount of the post-war credit is the sum of the prorated portions of each of the post-war credits which would be computed upon the basis of each of the tentative excess profits taxes provided by section 710 (a) (6) (A) and (B). Thus, in the case of a taxable year beginning in 1943 and ending in 1944, the post-war credit shall be not greater than the excess of the excess profits tax paid to the United

States for such taxable year (and not credited or refunded under the internal revenue laws) over the amount which would be payable to the United States if (a) in the computation of the first tentative excess profits tax under section 710 (a) (6) (A), the excess profits tax rate were 81 percent, or if the 80-percent limitation of section 710 (a) (1) (B) is applicable, if the amount determined under section 710 (a) (1) (B) were reduced by 10 percent; and (b) in the computation of the second excess profits tax under section 710 (a) (6) (B), the excess profits tax rate were 85½ percent, or if the 80-percent limitation of section 710 (a) (1) (B) is applicable, if the amount determined under section 710 (a) (1) (B) were reduced by 10 percent.

Subsection (g) of this section of the bill provides that the amendments made by subsections (b), (c), and (d), and the amendment made by subsection (e) (except with respect to credits or refunds made on or prior to the date of enactment of this act) shall be effective as if made by section 250 of the Revenue Act of 1942; that the amendment made by subsection (a), and the amendment made by subsection (f) inserting a new paragraph (2) of section 781 (d), shall be applicable with respect to fiscal years beginning in 1941 and ending after June 30, 1942; and that the amendment made by subsection (f) inserting a new paragraph (3) of section 781 (d) shall be applicable with respect to taxable years beginning in 1943 and ending in 1944.

Section 251. Technical Amendment to Credit for Debt Retirement

This section, which was added by your committee to the House bill, amends section 783 (b) (2) of the code, relating to one of the limitations on the credit for debt retirement.

Section 783 of the code provides for credit against the excess profits tax for debt retirement in the case of certain taxable years. Such credit is equal to 40 percent of the amounts paid by the taxpayer during the taxable year in repayment of the principal of indebtedness, subject to certain limitations. Such limitations are imposed by section 783 (b). The credit with respect to any taxable year may not exceed the lesser amount determined under the applicable limitations. Under section 783 (b) (1) such credit may not exceed an amount equal to 10 percent of the excess profits tax imposed for the taxable year. Section 783 (b) (3) imposes an additional limitation in the case of a taxable year in which September 1, 1942, falls. Section 783 (b) (2) imposes an additional limitation in the case of a subsequent taxable year—namely, that the credit for such year may not exceed an amount equal to 40 percent of the amount by which the smallest amount of indebtedness during the period beginning September 1, 1942, and ending with the close of the preceding taxable year exceeds the amount of indebtedness as of the close of the taxable year.

This section of the bill would change such limitation under section 783 (b) (2) by providing that the credit for debt retirement shall not exceed an amount equal to 40 percent of the amount by which (1) the amount of indebtedness as of September 1, 1942, or (2) the smallest amount of indebtedness as of the close of any preceding taxable year ending after September 1, 1942, whichever amount is the lesser, exceeds the amount of indebtedness as of the close of the taxable year. This

change would be applicable to taxable years beginning after December 31, 1942.

TITLE III—EXCISE TAXES

SECTION 301. EFFECTIVE DATE OF THIS TITLE

This section, which is identical with section 301 of the House bill, fixes the effective date of title III, which relates to excise taxes. Since the excise taxes are paid monthly and covered by monthly returns, it is desirable that changes with respect thereto shall take effect on the first day of a selected month. It is also desirable that there shall be reasonable opportunity for preparation by taxpayers, as well as by the Bureau of Internal Revenue, for compliance with the new requirements. Accordingly section 301 provides that title III shall take effect on the first day of the first month which begins more than 10 days after the date of enactment of the act.

SECTION 302. INCREASES IN RATES

Section 302 (a) of the bill as passed by the House amends chapter 9A of the code to increase the rates of various excise taxes, impose certain new excise taxes, and make various administrative provisions relative thereto. Your committee has made a number of changes in the amendments made by this section as follows:

Section 1650 of the code, as amended by the House bill, increased the rates of numerous excise taxes. The rates fixed by present law, by the House, and by your committee are as follows:

Description of tax	Present tax rates	Tax rates approved by House	Tax rates approved by committee
Admissions	1 cent for each 10 cents or fraction thereof.	2 cents for each 10 cents or fraction thereof.	1 cent for each 5 cents or fraction thereof.
Permanent use or lease of boxes or seats.	11 percent	20 percent	20 percent.
Sales of tickets outside box office.	do	do	Do.
Cabarets, roof gardens, etc.	5 percent	30 percent	Do.
Dues or membership fees	11 percent	20 percent	Do.
Initiation fees	do	do	Do.
Jewelry	10 percent	do	20 percent (except as respects watches selling at retail for not more than $65 and alarm clocks selling at retail for not more than $5, the rate on which will remain at 10 percent.)
Furs	do	25 percent	20 percent.
Toilet preparations	do	do	20 percent.
Distilled spirits	$6 per gallon	$9 per gallon	$9 per gallon.
Imported perfumes containing distilled spirits.	do	do	Do.
Still wines:			
(1) Not over 14 percent of alcohol.	10 cents per gallon	15 cents per gallon	15 cents per gallon.
(2) Over 14 percent and not over 21 percent of alcohol.	40 cents per gallon	60 cents per gallon	60 cents per gallon.
(3) Over 21 percent and not over 24 percent of alcohol.	$1 per gallon	$2 per gallon	$2 per gallon.
Sparkling wines, liqueurs, and cordials:			
(1) Champagne or sparkling wine.	10 cents per half-pint or fraction thereof.	15 cents per half-pint or fraction thereof.	15 cents per half-pint or fraction thereof.

Description of tax	Present tax rates	Tax rates approved by House	Tax rates approved by committee
Sparkling wine, liqueurs and cordials—Con.			
(2) Artificially carbonated wine.	5 cents per half-pint or fraction thereof.	10 cents per half-pint or fraction thereof.	10 cents per half-pint or fraction thereof.
(3) Liqueurs, cordials, etc.	do	do	Do.
Fermented malt liquors	$7 per barrel	$8 per barrel	$8 per barrel.
Billiard and pool tables and bowling alleys.	$10 per year per table or alley.	$20 per year per table.[1]	$20 per year per table or alley.
Electric light bulbs and tubes	5 percent	25 percent	15 percent.
Telephone, long-distance	20 percent	do	25 percent.
Telegraph, cable, or radio dispatches:			
(1) Domestic	15 percent	do	Do.
(2) International	10 percent	15 percent	10 percent.
Leased wires, etc	15 percent	20 percent	25 percent.
Wire and equipment service	5 percent	7 percent	8 percent.
Local telephone service	10 percent	15 percent	15 percent.
Transportation of persons	do	do	Do.
Seats, berths, etc	do	do	Do.

[1] The tax on bowling alleys was suspended in the House bill in view of the action of the House imposing a tax on amounts paid for the privilege of bowling.

The increased rates, except as otherwise provided by section 302 (b) of the bill, are applicable with respect to the period beginning with the effective date of title III of the bill, as fixed by section 301, and continuing until the first day of the first month beginning 6 months or more after the date of termination of hostilities in the present war. This general provision with respect to the effective period of the rate increases was contained in the House bill and no change in such provision has been made by your committee.

Section 1651, added to the code by the House bill, imposes a tax on enumerated articles of the general class of travelers' luggage, purses, wallets, key cases, toilet cases, and other containers sold at retail. The rate of tax fixed by the House was 25 percent of the sale price. Your committee has reduced the rate to 15 percent.

Section 1652 (section 1654 in the House bill), added to the code, relates to the taxability of installment payments made under leases, contracts of sale, conditional sales, etc., made prior to the effective date of the title. The effect of the section is to confer exemption from the retailers' excise tax, or from increases in rates of existing manufacturers' and retailers' excise taxes, imposed by the bill in those cases in which the taxes are within the scope of sections 2405 and 3441 (c) of the code, with respect to installment payments made on or after the effective date of the title under contracts made prior to such date. The section also contains an existing contracts provision applicable to the excise tax imposed by section 1651 (on luggage, etc., sold at retail) and the increased rates of excise taxes imposed by section 1650 on sales of various articles. The provision is in all respects comparable to that set forth in section 553 of the Revenue Act of 1941 (sec. 3453 of the code). Liability for the tax or the increased rate of tax is shifted from the vendor to the vendee in the case of sales made pursuant to contracts executed before the effective date of the title, but consummated after that date, where the contract does not provide for the addition by the vendor to the sales price of the new tax or increased rate of tax but does not, however, prohibit such addition. Section 1652 (a) imposes the condition not included in section 1654 (a) of the House bill that, in order for exemption from the rate increases

to obtain in the case of installment payments made on or after the effective date of the title under a contract made prior to such date, a part of the consideration under such contract must have been paid prior to such date. The House bill required only that delivery under the contract be made before the effective date. The change made by your committee brings the conditions which must be met in the case of installment contracts for the sale of articles with respect to which existing tax rates have been increased, as provided in subsection (a) of the code section, into harmony with those which must obtain in the case of articles not previously subject to tax, as provided in subsection (b) thereof.

Section 1653 is identical with section 1655, added to the code by the House bill, except for the necessary renumbering of the section. The section deals with the situation of an article classifiable under more than one section of the code taxing articles sold at retail, namely, sections 2400, 2401, and 2402 of chapter 19, relating respectively to jewelry, furs, and toilet preparations, and section 1651 of chapter 9A added by section 302 (a) of the bill, relating to luggage. Section 1653 provides that if in such a case the rates of tax differ, the highest shall prevail. The same rule applies where an article consists of several parts subject, when taken separately, to different rates of tax. In that case, the entire article is subject to the highest rate to which any one of the parts, taken separately, would be subject. For example, a fitted traveling case containing an article classifiable as jewelry under section 2400 would be taxable in its entirety at the 20-percent rate even though the traveling case without that article would otherwise be taxable at a 15-percent rate. Thus, the luggage and the fittings and accessories are always subject to the same rate of tax.

Section 1654, added to the code by the committee bill, contains a limitation on the effective period of the retailers' tax on luggage which is identical with the limitation on the effective period of this tax appearing in section 1656, added to the code by the House bill. The section provides that the tax imposed by section 1651 (relating to luggage, etc.) shall not apply with respect to the period commencing on the first day of the first month beginning 6 months or more after the date of the termination of hostilities in the present war.

Section 1655 is identical with section 1657, added to the code by the House bill, except for the necessary renumbering of the section. The section defines the term "date of the termination of hostilities in the present war," as used in sections 1650 and 1654, added to the code, as meaning the date proclaimed by the President as the date of such termination, or the date specified in a concurrent resolution of the two Houses of Congress, as the date of such termination, whichever is the earlier.

Section 302 (b) of the bill, as passed by the House, made exceptions from the general rule established by section 301 relative to the effective date of the new taxes and the increases in the rates of existing taxes provided for in section 302 (a). As provided in section 302 (b) (1) of the House bill, the increase in the cabaret tax becomes applicable at 10 a. m., prevailing local time, on the first day of the first month which begins more than 10 days after the date of enactment of the act. No change in the effective date of this tax has been made by your committee. Section 302 (b) (2) of the House bill provided that the increase in the tax imposed by section 3268 of the code with

respect to billiard and pool tables should become applicable with the year beginning July 1, 1944. Your committee has made this provision applicable to the increase in the rate of tax on bowling alleys as well. Your committee has also provided that the increased rate on billiard and pool tables and bowling alleys shall continue through June 30 next following the first day of the first month which begins 6 months or more after the date of the termination of hostilities in the present war. This is administratively desirable because the tax with respect to billiard and pool tables and bowling alleys is an annual tax which becomes due on July 1 of each year. If the termination of the increased rate were made subject to the general provision governing the termination of the other rate increases, as provided in section 302 (a) of the bill, the increase might terminate on the first day of any month within the year, and thus might require a refund of that portion of the increase attributable to the month or months remaining until the next following July 1.

Section 302 (b) (3) of the House bill provided that the increases in the taxes imposed by section 3465 (a) (1) with respect to telephone toll calls and telegraph, cable, or radio dispatches or messages shall be applicable to amounts paid for services rendered on or after the effective date of the title; that the increases in the taxes imposed by section 3465 (a) (2) and (3) with respect to leased wires, wire and equipment service, and local telephone service shall be applicable only to amounts paid pursuant to bills rendered on or after the effective date of the title for services for which no previous bill was rendered; and that where bills rendered on or after the effective date of the title include charges for services previously rendered, the increased rates shall not apply to such services as were rendered more than 2 months before the effective date of the title. That part of the House provision which relates to the effective date of the increases in the taxes imposed by section 3465 (a) (1) with respect to telephone toll calls and telegraph, cable, or radio dispatches or messages has been retained. In order, however, to afford the companies a sufficient time to adjust their billing practices to the increased rates with respect to local telephone service, leased wires, and wire and equipment services, your committee has amended this subsection to provide that the increases in these taxes shall apply only to amounts paid pursuant to bills rendered on or after the first day of the first month beginning after the effective date of the title for services for which no previous bill was rendered, and that where bills rendered on or after such first day include charges for services previously rendered, the increased rates shall not apply to such services as were rendered more than 2 months before such first day.

Section 303. Furs

This section, which is the same as section 303 of the House bill, amends section 2401 of the code to meet a practice which has become somewhat prevalent whereby a person desiring to have a taxable fur article made for his own use procures and provides the fur himself, and thus avoids the tax on the article made from the fur. To put a check on tax avoidance by such means, it is provided that where a person who is engaged in the business of dressing or dyeing fur skins, or manufacturing, selling, or repairing fur articles, produces a taxable

fur article for the use of a customer from fur on the hide or pelt furnished, directly or indirectly, by the customer, the transaction shall be deemed to be a sale at retail and the person producing the article shall be deemed to be the person selling the article at retail for the purposes of the tax. The tax is, in this case, to be computed and paid by such person upon the fair retail market value, as determined by the Commissioner, of the finished article.

SECTION 304. SUSPENSION OF MANUFACTURERS' EXCISE TAX ON LUGGAGE

This section, which is identical with section 304 of the House bill, amends section 3406 (a) (2) of the code, which imposes a tax on luggage sold by the manufacturer, producer, or importer, to suspend such tax during the period of application of the tax imposed by section 1651, added to the code by section 302 (a) of the bill, on luggage, etc., sold at retail.

SECTION 305. EXEMPTION OF BILLIARD AND POOL TABLES IN HOSPITALS FROM TAX

This section, which was not contained in the House bill, amends section 3268 (a) of the code, which imposes a tax on bowling alleys and billiard and pool tables, to provide that the tax imposed under such code section shall not apply with respect to a billiard table or pool table in a hospital if the persons using such table are permitted to do so without charge. The amendment made by the section is effective with respect to the period beginning July 1, 1944.

SECTION 306. TECHNICAL AMENDMENT OF MANUFACTURERS' EXCISE TAX ON TIRES AND INNER TUBES

This section is the same as section 306 of the House bill. It amends section 3400 of the code which taxes tires and inner tubes made wholly or in part of rubber, to define "rubber" as including synthetic or substitute rubber. This is to insure that the tax shall be applicable to tires and tubes made entirely without natural rubber.

SECTION 307. TERMINATION OF CERTAIN GOVERNMENTAL EXCISE TAX EXEMPTIONS

Section 307 of the bill, as passed by the House, removed many excise tax exemptions now existing with respect to articles sold or services rendered to the United States. In general, the taxes affected by the section are the retailers' excise taxes, the manufacturers' excise taxes, and the taxes applicable to telegraph, telephone, radio, and cable facilities, and the transportation of persons and property. The result of the House provision would be that these taxes would apply with respect to articles sold or services rendered to the United States. The bill as passed by the House, however, continues the present exemptions with respect to articles sold to the United States pursuant to contracts entered into prior to the date on which sales of such articles to the United States became taxable. The House bill also provides that a credit or refund otherwise allowable under section 3443 (a) (1) (A) (i) of the code to a manufacturer, producer, or importer, with respect to

an article resold by any person to the United States, shall continue to be allowable with respect to a sale made to the United States prior to the date on which sales of the article to the United States become taxable or pursuant to a contract entered into prior to such date.

As provided in the House bill, certain of the exemptions will be terminated in the near future, while the termination of others will be postponed until approximately 6 months after the termination of hostilities in the present war. Under the House bill, the exemptions will terminate and the taxes will, accordingly, apply with respect to articles sold and services rendered to the United States (except as they may otherwise be exempt) as follows:

(*a*) In the case of the retailers' and manufacturers' excise taxes (except the manufacturers' excise taxes applicable to sales of pistols and revolvers, firearms, shells and cartridges, and radio-receiving sets, phonographs, phonograph records, and musical instruments), to sales made on or after the first day of the first month which begins 3 months or more after the date of the enactment of the act.

(*b*) In the case of the manufacturers' excise taxes applicable to sales of pistols and revolvers, firearms, shells and cartridges, radio-receiving sets, phonographs, phonograph records, and musical instruments, to sales made on or after the first day of the first month which begins 6 months or more after the date of the termination of hostilities in the present war.

(*c*) In the case of the taxes applicable to telephone toll calls and telegraph, cable, or radio dispatches or messages, to calls, messages, and dispatches originating on or after the first day of the first month which begins 3 months or more after the date of the enactment of the act.

(*d*) In the case of the taxes applicable to leased wires, wire and equipment service, and local telephone service, to amounts paid pursuant to bills rendered on or after the first day of the first month which begins 3 months or more after the date of enactment of the act for service for which no previous bill was rendered.

(*e*) In the case of the taxes applicable to the transportation of persons and property, to amounts paid on or after the first day of the first month which begins 3 months or more after the date of enactment of the act.

Your committee has made additional amendments to such provisions as follows: Code section 3466 (a) amended by section 307 (a) (7) of the House bill, section 3469 (f) (1) amended by section 307 (a) (8) of the House bill, and section 3475 (b) amended by section 307 (a) (9) of the House bill are further amended to continue the exemption from the taxes applicable to telegraph, telephone, radio, and cable facilities, and the transportation of persons and property, which exists under present law, with respect to services rendered to the American National Red Cross, a quasi governmental agency created by act of Congress to act in matters of relief under the Treaty of Geneva of August 22, 1864.

Section 307 (b) (1) and (2) are amended to insure that those provisions of subsection (b) of the section which continue the exemption with respect to radio receiving sets, phonographs, phonograph records, musical instruments, and parts and accessories therefor, until 6 months after the date of the termination of hostilities in the present war, apply to the tax on the use of such articles imposed under section

3444 of the code as well as to the tax on the sale thereof levied under section 3404.

Section 307 (b) (1) and (2) are further amended and section 307 (b) (3) is likewise amended to extend the exemption applicable to articles sold to the United States pursuant to preexisting contracts to articles sold pursuant to any agreement or change order supplemental to any such contract and bearing the same Government contract number.

Section 307 (b) (3) is also amended to correct a technical error in the House bill which refers to section 3443 (a) (1) (A) (i) instead of 3443 (a) (3) (A) (i).

Another amendment made by your committee to this section adds thereto a new subsection (c) which provides that notwithstanding the termination of the exemptions with respect to articles sold or services rendered to the United States, the Secretary of the Treasury may authorize exemption from the taxes imposed by chapter 19, 29, or 30 of the code as to any particular articles or services, to be purchased for the exclusive use of the United States, if he determines that the imposition of any of such taxes will cause substantial burden or expense which can be avoided by granting tax exemption and that the full benefit of such exemption, if granted, will accrue to the United States. The amendment also provides that, for the purposes of this provision, the sections of the code amended by section 307 of the bill as in force on the day preceding the effective date of the title shall remain in full force and effect, and that the provision shall not be applicable to any contract entered into on or after the first day of the first month which begins 6 months or more after the date of the termination of hostilities in the present war.

Section 308. Floor-Stocks Taxes

This section, which is identical with section 308 of the House bill, amends sections 2800 and 3150 of the code and adds section 3194 to the code so as to impose equalizing floor-stocks taxes on tax-paid distilled spirits and tax-paid wines held for sale or for use in the manufacture of any article intended for sale on the date the increased rates become effective, and on all tax-paid fermented malt liquors held for sale on the date the increased rate becomes effective. Provisions similar to those contained in the Revenue Act of 1942 are made for the filing of floor-stocks tax returns and for the payment of the taxes.

Section 309. Drawback on Distilled Spirits

Subsection (a) of section 309, which is identical with the subsection as passed by the House, amends section 2887 of the code, which provides for the allowance of drawback (refund) of taxes paid in respect of distilled spirits which are exported. The section provides at the present time that the rate of drawback which is allowed shall equal the rate of tax paid, but contains a limitation that such drawback shall not exceed the rate of $6 per proof gallon. This rate in the limitation has been raised from time to time as the rate on the distilled spirits has been increased so that if the taxpayer pays the higher rate of tax he may recover it. The limitation in figures

representing a money value serves no good purpose, since the section already provides that only the rate paid may be allowed in drawback. Therefore, the limitation has been stricken out.

Subsection (b) increases the rate of drawback authorized by section 3250 (l) (5) of the code. This section of the code authorizes the allowance of drawback of distilled spirits taxes, under certain circumstances, to persons who use fully tax-paid distilled spirits of domestic production in the manufacture of certain nonbeverage products which are sold or otherwise transferred for use for other than intoxicating beverage purposes. The rate of drawback under existing law is $3.75. The rate, raised to $5 by the House bill, has been increased by your committee to $6 with respect to the period in which the war tax rates specified by section 1650 of the code are in effect. Under the subsection the drawback will revert to the rate of $3.75 immediately upon the expiration of 6 full calendar months following the termination of hostilities in the present war.

Subsection (c), which is the same as the subsection as passed by the House, provides that the amount of tax per proof gallon paid on the distilled spirits covered by timely claims under section 3250 (l) (5) of the code shall govern the rate of drawback; i. e., if the tax was properly paid at only the $6 rate the drawback shall be at the $3.75 rate, and if the tax was properly paid at the $9 rate (basic tax of $9 or present tax of $6 plus floor stocks tax of $3) the drawback shall be at the $6 rate.

Subsection (d) has been added by your committee to amend paragraph 1 of section 3250 (l) of the code relating to eligibility for drawback on fully tax-paid domestic distilled spirits used in the manufacture of certain nonbeverage products. The amended paragraph dispenses with one of the present requirements of eligibility, i. e., that such products be "sold or otherwise transferred for use for other than beverage purposes." Use of the spirits in the manufacture of the products, payment of the special tax (required by paragraph (2) of section 3250 (l)), and conformity with requirements "hereinafter provided for" are continued as conditions of eligibility for the drawback. Under the amended paragraph eligibility for the drawback is acquired as of the time the spirits are used in conformity with the statute.

Section 310. Repeal of Manufacturers' Excise Tax on Vacuum Cleaners

This section, which has been added to the bill as passed by the House, amends section 3406 (a) (3) of the code so as to exempt vacuum cleaners from the manufacturers' excise tax on electric, gas, and oil appliances.

TITLE IV—POSTAL RATES

Section 401. Effective Date

This section is the same as section 401 of the House bill. It provides that the increased postal rates provided by title IV shall take effect on the thirtieth day after the date of the enactment of the act.

SECTION 402. FIRST-CLASS MAIL

Section 402, which is identical with section 402 of the House bill, increases the rate of postage on all mail matter of the first class mailed for local delivery or for delivery wholly within a county which is entirely within a corporate city and the population of which exceeds 1,000,000 (except postal cards and private mailing or post cards, and except other first-class matter on which the rate of postage under existing law is 1 cent for each ounce or fraction thereof) by 1 cent for each ounce or fraction thereof. The section also increases the rate of postage on air mail by 2 cents for each ounce or fraction thereof.

SECTION 403. FOURTH-CLASS MAIL

Section 403 is identical with section 404 of the House bill, except for the necessary renumbering of the section. It increases the rate of postage on all mail matter of the fourth class by an amount equal to 3 percent of the rate provided by existing law, or by 1 cent, whichever is the greater. It is further provided that if the additional 3 percent amount results in a fractional part of a cent, such fractional part shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

SECTION 404. MONEY ORDERS

This section, except for the necessary renumbering the same as section 405 of the House bill, increases the fees for domestic money orders by 66⅔ percent, computed in each case, if the amount of such increase is not a multiple of 1 cent, to the nearest multiple of 1 cent above such amount.

SECTION 405. REGISTERED MAIL

This section which is identical with section 406 of the House bill, except for the necessary renumbering of the section, increases the registry fees for registered mail by 33⅓ percent, computed in each case to the nearest multiple of 5 cents, and the additional fees for registered mail by 33⅓ percent, computed in each case, if the amount of such increase is not a multiple of 1 cent, to the multiple of 1 cent next above such amount.

SECTION 406. INSURED MAIL

Section 406, aside from the necessary renumbering, is the same as section 407 of the House bill. It increases the fees for insurance on mail matter in each case by an amount equal to the fee provided by existing law.

SECTION 407. RECEIPTS ON REGISTERED MAIL AND INSURED MAIL

Section 407, except for the necessary renumbering the same as section 408 of the House bill, increases the fees for obtaining receipts for registered mail and insured mail in each case by 33⅓ percent, computed in each case, if the amount of such increase is not a multiple of 1 cent, to the multiple of 1 cent next above such amount.

SECTION 408. COLLECT-ON-DELIVERY SERVICE

This section is identical with section 409 of the House bill, except for the necessary renumbering of the section. Subsection (a) of the section increases the fees for collect-on-delivery service with respect to domestic third- and fourth-class mail in each case by an amount equal to the fee provided by existing law. Subsection (b) increases the fee for services in effecting delivery of collect-on-delivery mail upon terms differing from those originally stipulated at the time of mailing by an amount equal to the fee provided by existing law. Subsection (c) increases the demurrage charges on collect-on-delivery parcels in each case by an amount equal to the charge provided by existing law.

SECTION 409. ADDITIONAL FEE FOR DELIVERY OF REGISTERED, INSURED, AND COLLECT-ON-DELIVERY MAIL TO ADDRESSEE ONLY

Section 409, aside from the necessary renumbering, is the same as section 410 of the House bill. It increases the additional fee for effecting the delivery of domestic registered, insured, and collect-on-delivery mail, the delivery of which is restricted to the addressee only, or to the addressee or order, by an amount equal to the fee provided by existing law.

SECTION 410. TERMINATION OF INCREASES

Section 410 is the same as section 411 of the House bill, except for the necessary renumbering of the section. Subsection (a) of the section provides that the increases in the postal rates, fees, and charges made by the title shall cease to be in effect on and after the first day of the first month which begins at least 6 months after the termination of hostilities in the present war. Subsection (b) defines the term "termination of hostilities in the present war" as used in subsection (a) of this section as meaning the date proclaimed by the President as the date of such termination, or the date specified in a concurrent resolution of the two Houses of Congress as the date of such termination, whichever is the earlier.

TITLE V. MISCELLANEOUS ESTATE TAX AND GIFT TAX AMENDMENTS, AND OTHER MISCELLANEOUS AMENDMENTS AND PROVISIONS

SECTION 501. CERTAIN DISCRETIONARY TRUSTS IN CONNECTION WITH GIFT TAX

This section, which adds a new subsection (e) to section 1000 of the code and a new subsection (c) to section 501 of the Revenue Act of 1932, corresponds to section 502 of the bill as passed by the House and is designed to prevent inequities in certain instances affected by the decisions of the United States Supreme Court in *Estate of Sanford* v. *Commissioner* (308 U. S. 39), and *Rasquin* v. *Humphreys* (308 U. S. 54 (Nov. 6, 1939)). The Supreme Court held in these cases that where a grantor of a trust retained a power to change the beneficiaries or their interests therein but reserved no power to revest the property in himself, the gift was incomplete, and that the gift would be completed and the gift tax would apply upon the relinquishment of such retained

power. Prior to these decisions a number of grantors assumed that in such cases the gift was completed for purposes of the gift tax when the trust became irrevocable, either at the time it was created if the grantor then retained no power to revest the property in himself, or, if he retained the power to revest the property in himself, at any subsequent time when such power was relinquished.

Many persons established trusts prior to the aforementioned Supreme Court decisions, retaining the power to change the beneficial interests but without reserving the power to revest the property in themselves, believing that gifts were thereby consummated and that no gift tax liability would thereafter result upon the relinquishment of such retained power. Likewise, if a trust had been previously created under which the grantor had reserved a power to revoke or amend, and prior to the Supreme Court decisions the grantor relinquished the right to revoke and revest the property in himself but retained the power to change the beneficiaries or their interests, it was assumed that such action completed the gift. Your committee believes it inequitable to impose a tax in such instances upon the subsequent relinquishment of the power to change the beneficiaries or their interests, unless the grantor is allowed an opportunity within a specified period to release such power without a resulting tax liability. This section accordingly makes relief available until January 1, 1945, with respect to property placed in trust prior to January 1, 1939, where the grantor on and after such date no longer could revest title to such property in himself through the exercise of a power exercisable by the grantor alone, or by the grantor in conjunction with any other person not having a substantial adverse interest in the disposition of such property or the income therefrom.

However, this section does not authorize any exemption from gift tax where the property was transferred to an irrevocable trust, or the grantor relinquished his power to revest the property in himself, during a period in which a gift-tax statute was in effect (June 2, 1924, to December 31, 1925, inclusive, and after June 6, 1932), unless the liability then considered applicable under the statute was discharged. Thus, if a trust was established in 1938, the grantor retaining a power to change the beneficial interests but not reserving a power to revest the property in himself, the grantor would incur a gift-tax liability upon the relinquishment of such power in 1944, unless, (1) in accordance with the requirements of the Bureau of Internal Revenue then in force, gift tax had been paid with respect to the 1938 transfer, and not credited or refunded, or, the value of the property disclosed in a gift-tax return timely filed for 1938, including such trust property, did not exceed the amount of the deductions and exclusions claimed, and (2) the grantor consents to treat such 1938 transfer, with respect to 1938 and all subsequent calendar years, as a gift for the purposes of the gift-tax law. Thus if the grantor utilized the specific exemption, in whole or in part, the amount so utilized reduces the amount of the exemption otherwise allowable in subsequent calendar years. If, for example, the grantor claimed an exclusion to which he was not entitled or claimed a deduction for a gift to charity which was not allow-

able, the transfer shall be considered as otherwise complete and the Commissioner may redetermine the tax if assessment thereof is not barred by limitations or by any rule of law.

The provisions of this section would apply to a case where under the terms of the trust instrument a power to change the beneficial interests reposes in the trustee, and the grantor, who is also the trustee, relinquishes such power by resigning from the office of trustee. The relinquishment by the grantor of his power with respect to the distribution of the trust property is the precise event which completes the gift in accordance with the aforementioned Supreme Court decisions, and since in the case of a grantor-trustee, where under the terms of the trust instrument such power is held by the trustee, such relinquishment is effected by the grantor resigning as trustee and not by the appointment of a new trustee or by the vesting of the power in the new trustee, your committee has reworded the provisions of this section, as passed by the House, so as to eliminate any unnecessary reference to appointments of other trustees and their subsequent exercise of discretion. Inasmuch as the retention of powers of administration does not render a gift incomplete, it has not been deemed necessary to include any provisions with respect to the relinquishment of such powers. This section does not affect the present law governing the taxability of powers of appointment received from another person.

Section 502. Use of Commissioners in Cases Before The Tax Court of the United States

This section amends section 1114 by adding a new subsection (b), to permit the appointment of commissioners in cases before The Tax Court of the United States. Such commissioners are to be attorneys from the legal staff of the court, designated to act in particular cases, by written order of the presiding judge. Commissioners so designated shall proceed under such rules and regulations as may be promulgated by the court. They shall be entitled to receive the same travel and subsistence allowance as may be received by commissioners of the Court of Claims.

Section 503. Retroactivity of 7-Year Statute of Limitations Relating to Bad Debts

This section, for which there is no corresponding provision in the House bill, amends section 169 (c) of the Revenue Act of 1942, relating to the retroactive effect of section 322 (b) (5) of the code. Section 322 (b) (c), which was added to the code by section 169 (a) of the Revenue Act of 1942, provides for a special period of limitation of 7 years with respect to overpayments resulting from deductions for bad debts and worthless securities. Section 169 (c) of the Revenue Act of 1942 provides that such special period of limitation is applicable to overpayments made with respect to taxable years beginning after December 31, 1938. The amendment changes the effective date provision to make such special 7-year period of limitation applicable to overpayments made with respect to taxable years beginning after December 31, 1937.

SECTION 504. EXTENSION OF TIME IN CONNECTION WITH RELEASE OF POWERS OF APPOINTMENT

This section amends section 403 (d) (3) of the Revenue Act of 1942, as amended by section 10 of the Current Tax Payment Act of 1943, to provide that the release of a power of appointment created on or before October 21, 1942, is not subject to estate tax if such release is effected prior to January 1, 1945. The gift-tax law is similarly amended with respect to such powers of appointment.

SECTION 505. REPEAL OF CERTAIN PROVISIONS OF THE CURRENT TAX PAYMENT ACT OF 1943 RELATING TO INCREASED INCOME

This section, for which there is no corresponding provision in the House bill, repeals section 6 (c) of the Current Tax Payment Act of 1943 (relating to additional increase in 1943 tax where income is substantially increased in comparison with income for the base year), as well as section 6 (d) (4) of such act (relating to section 107 income attributed to base year), section 6 (d) (5) of such act (relating to partnership business formerly operated as corporation), and section 6 (e) (2) of such act (relating to extension of time for payment of increase in 1943 tax under section 6 (c) of such act). In addition this section effects certain technical amendments to section 6 (d) of the Current Tax Payment Act of 1943 (relating to rules for the application of subsections (a) and (b) of section 6 of such act). In order to obviate all doubt as to the joint and several liability for the increase in 1943 tax under section 6 (a) of such act in the case of taxpayers filing a joint return for either of the taxable years 1942 or 1943 (whether or not joint returns are filed for both years) it is specifically provided that the liability in such case shall be joint and several.

The amendments made by this section are to be effective with respect to taxable years beginning after December 31, 1942, and before January 1, 1944.

TITLE VI—FEDERAL UNEMPLOYMENT TAXES

SECTION 601. CREDITS AGAINST FEDERAL UNEMPLOYMENT TAXES

This section, which is the same as section 601 of the House bill, amends section 1601 of the code, relating to credits against the Federal unemployment tax for the calendar year 1939 and subsequent calendar years. The present section 1601 permits full credit against the Federal tax (but not, however, to exceed 90 percent of such tax) for contributions with respect to the taxable year paid into a State unemployment fund on or before the due date of the Federal return for such year. Credit is also permitted under existing law for contributions paid after the due date of the Federal return but on or before June 30 next following the due date, but this credit is not to exceed 90 percent of the amount which would have been allowable as credit on account of such contributions had they been paid on or before the due date of the Federal return. Under the present section 1601 no credit, except in special cases, is permitted against the Federal tax for a taxable year for contributions paid after June 30 next following the due date of the Federal return for such year.

The amendment to section 1601 (a) (3), made by subsection (a) of section 601, removes the time limitation for payment of State contributions but preserves the 90 percent limitation on the amount of the credit applicable under existing law to contributions paid to a State fund after the due date of the Federal return. However, the allowance of the refund or credit of the Federal tax, which has been collected but with respect to which credit is allowable under section 1601 of the code, is subject to the 4 year period of limitation prescribed by section 3313 of the code. The special rule under existing law applicable to those cases where the assets of the taxpayer are in the custody or control of a court at any time beginning with the due date of the Federal return and ending with the next following June 30, both dates inclusive, has been eliminated. With the removal of the time limitation for payment of State contributions, this special rule does not appear to be warranted except as to past taxable years.

Subsection (b) of section 601 repeals the present section 1601 (a) (5) of the code, relating to refunds of the Federal tax based on any credit allowable under section 1601 of the code. The provisions of the present section 1601 (a) (5) are incorporated in the new section 1601 (d).

Section 1601 (d) of the code, as added by subsection (c) of section 601, provides for refund or credit of the Federal tax which has been collected but with respect to which the credit allowable under section 1601 of the code has not been taken. The law (including statutes of limitations or other time limitations) applicable in the case of erroneous or illegal collection of the tax will apply to such refunds or credits. Thus, all claims for refund or credit of the Federal tax, based on any credit allowable under section 1601, must be filed within 4 years next after the payment of the tax. In addition, the amount of the refund or credit of the Federal tax (including penalty and interest, if any), based on any credit allowable under section 1601, will be limited to the portion of the tax, penalty, or interest paid during the 4 years immediately preceding the filing of the claim for refund or credit, or if no claim was filed, then during the 4 years immediately preceding the allowance of the refund or credit. No interest will be paid on any such refund or credit.

The amendments made by section 601 will be applicable retroactively to taxable years beginning after December 31, 1938.

Section 602. Credit Against Federal Unemployment Taxes for Years 1936 to 1942

This section, which is the same as section 602 of the House bill, liberalizes the conditions of allowance of credit against the Federal unemployment tax imposed by title IX of the Social Security Act for the calendar years 1936, 1937, and 1938. It also continues without curtailment, for purposes of credit against the tax imposed by the Federal Unemployment Tax Act for the calendar years 1939 to 1942, both inclusive, the special treatment accorded under existing law in those cases where the assets of the taxpayer were in the custody or control of a court during the specified periods.

Under subsection (a), paragraph (1), credit is allowable against the tax for 1936, 1937, or 1938, imposed by title IX of the Social Security Act, for contributions paid into a State unemployment fund at any

time, subject in the case of a refund or credit of the tax to the 4 year period of limitation prescribed by section 3313 of the code. Section 1601 (a) (3), as amended by section 601 of the bill, contains comparable provisions with respect to the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939 and subsequent calendar years. If the contributions are paid after December 6, 1940, the credit against the tax for 1936, 1937, or 1938 on account of such contributions is limited to 90 percent of the amount which would have been allowable if they had been paid before the due date of the Federal return. Paragraphs (2) and (3) of subsection (a) provide in special cases for the allowance of credit, which is not subject to the foregoing limitation. These paragraphs continue without curtailment the relief heretofore granted in these cases by section 902 (a) (2) and (3) of the Social Security Act Amendments of 1939, section 701 (a) (2) and (3) of the Second Revenue Act of 1940, and section 701 (a) (2) and (3) of the Revenue Act of 1941.

The existing law provides, with respect to the credit against the tax imposed by the Federal Unemployment Tax Act for the calendar year 1939 or any subsequent calendar year, that in those cases where the assets of the taxpayer are in the custody or control of a court during the respective period specified in the present section 1601 (a) (3) of the code or section 701 (b) (2) of the Revenue Act of 1941 the taxpayer may pay the contributions to the State at any time and obtain full credit against the Federal tax for such year (but not, however, to exceed 90 percent of such tax). The allowance of refund or credit of the tax in such cases is subject to the 4 year period of limitation prescribed by section 3313 of the code. Subsection (b) continues this special treatment without curtailment for the calendar years 1939 to 1942, both inclusive.

Subsection (c), paragraph (1), provides for refunds and credits, without interest, based on the credit allowable under subsections (a) and (b). The law (including statutes of limitations or other time limitations) applicable in the case of erroneous or illegal collection of the tax will apply to such refunds or credits.

Paragraph (2) of subsection (c) permits refunds and credits of the tax imposed by section 901 of the Social Security Act or section 1600 of the Federal Unemployment Tax Act, based on credit for contributions allowable under this section or section 1601 of the Federal Unemployment Tax Act, as amended, in those cases where by virtue of the disallowance of a claim for refund or credit prior to the date of the enactment of this act the allowance of such claim would otherwise be considered erroneous under section 3774 (b) or 3775 (b) of the code at the time such claim is allowed. No interest will be allowed or paid on the amount of any such credit or refund.

Paragraph (3) of subsection (c) permits refunds, credits, and abatements, without interest, based on the credit allowable under this section or section 1601 of the Federal Unemployment Tax Act, as amended, in those cases where an offer in compromise with respect to the tax (or penalty or interest in connection therewith) imposed by section 901 of the Social Security Act or section 1600 of the Federal Unemployment Tax Act has been accepted prior to the date of the enactment of this act. This provision permits the reopening of cases compromised prior to the above-mentioned date so as to allow refunds, credits, and abatements based on credit allowable under the new law

which was not allowable under the law in force when the compromise offer was accepted. The law (including statutes of limitations or other time limitations) applicable in the case of erroneous or illegal collection of the tax will apply to such refunds or credits. Under paragraph (3) the amount of the refund, credit, or abatement will be determined as though an offer in compromise had not been accepted, except that any amount paid by the taxpayer under the compromise agreement will be treated as a payment on account of the tax (including penalty and interest in connection therewith, if any).

Paragraph (4) of subsection (c) provides that on and after the date of the enactment of this act no refund, credit, or abatement shall be allowed which is based on any credit allowable under prior relief legislation, that is, under section 701 of the Revenue Act of 1941. The relief granted under such legislation is continued without curtailment by this section and section 1601 of the code, as amended by section 601 of this bill.

DETAILED DISCUSSION OF THE RENEGOTIATION PROVISIONS

I. Reduction of the Area of Renegotiation

Amendments made by the House bill to the existing law governing renegotiation of war contracts considerably reduced the area of renegotiation. Your committee bill still further reduces this area by the exemption of certain contracts and subcontracts with common carriers or public utilities; by the exemption of construction contracts competitively awarded; and by the exemption of certain contracts and subcontracts for articles made or furnished under directive of the War Production Board.

In addition, the discretionary exemption of contracts and subcontracts for standard commercial articles in the House bill is made mandatory by your committee.

Finally, the list of agricultural commodities exempt from renegotiation under the House bill is enlarged to include canned, bottled, packed, or processed dairy products or products of which the principal ingredients are dairy products.

Existing law exempts from renegotiation contracts between a contracting department and another department, bureau, agency, or governmental corporation of the United States or with any Territory, possession, or State or any agency thereof; also any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined, or treated beyond the first form or state suitable for industrial use.

These exemptions are retained in both the House and the committee bill but the existing authority of the Secretaries of the contracting Departments to define, interpret, and apply the exemption of the latter class of contracts is transferred to the War Contracts Price Adjustment Board.

Both the committee and the House bill continue the existing discretionary exemption of contracts or subcontracts to be performed outside the territorial limits of the continental United States or Alaska; contracts or subcontracts under which, in the opinion of the Board (of the Secretary, under existing law), the profits can be determined with

reasonable certainty when the contract price is established, such as certain classes for agreements for personal services, for the purchase of real property, perishable goods, or commodities the minimum price for the sale of which has been fixed by a public regulatory body, of leases or license agreements, and of agreements where the period of performance under such contract or subcontract will not be in excess of 30 days; and any contract or subcontract or performance thereunder during a specified period or periods, if in the opinion of the Board (under the existing law of the Secretary), the provisions of the contract are otherwise adequate to prevent excessive profits.

The amendment by the House to subsection (a) (1), retained in the committee bill, adds the War Shipping Administration to the list of departments, contracts with which are renegotiable; this amendment, however, should not result in any enlargement of the volume of renegotiable business, inasmuch as the provisions of the statute are already applicable to the War Shipping Administration by Executive order.

1. INCREASE OF THE SPECIFIC EXEMPTION TO $500,000

[Subsec. (c) (6)]

Of the amendments reducing the area of renegotiation, the increase of the existing specific exemption of $100,000 to $500,000 is of major importance. The $500,000 exemption of the House bill, which is approved by your committee, goes to all contracts and subcontracts (other than so-called war broker contracts, described in subsection (a) (5) (A)), regardless of their date, to the extent of the amounts received or accrued thereunder by the contractor or subcontractor (and all persons under the control of or controlling or under common control with him), in any fiscal year ending after June 30, 1943. If the fiscal year is one of less than 12 months, the amount of the exemption is proportionately reduced. The fiscal year of the contractor or subcontractor is his taxable year for Federal income tax purposes. For the purpose of the exemption, amounts received or accrued from contracts or subcontracts exempt from renegotiation, either by authorization or mandate of the statute, are included with amounts received or accrued from nonexempt contracts or subcontracts.

The existing specific exemption of $25,000 relating to so-called war broker contracts remains unchanged in either the House or the committee bill.

2. DEFINITION OF SUBCONTRACT

[Subsec. (a) (5)]

The field of operation of the renegotiation statute is further reduced by the definition of "subcontract" in the House bill. Your committee has made no change in this definition. Under it, the term "subcontract" means any purchase order or agreement (other than a contract with a department) to make or furnish, or to perform any part of the work required for the making or furnishing of, a contract item or a component article. A "contract item" is defined to mean any article, work, services, building, structure, improvement, or facility contracted for by a department; and a "component article" is defined to mean any article which is to be incorporated in or as a part of a contract item. The term "article" is defined in subsection (a) (6) to

include any material, part, assembly, machinery, equipment, or other personal property.

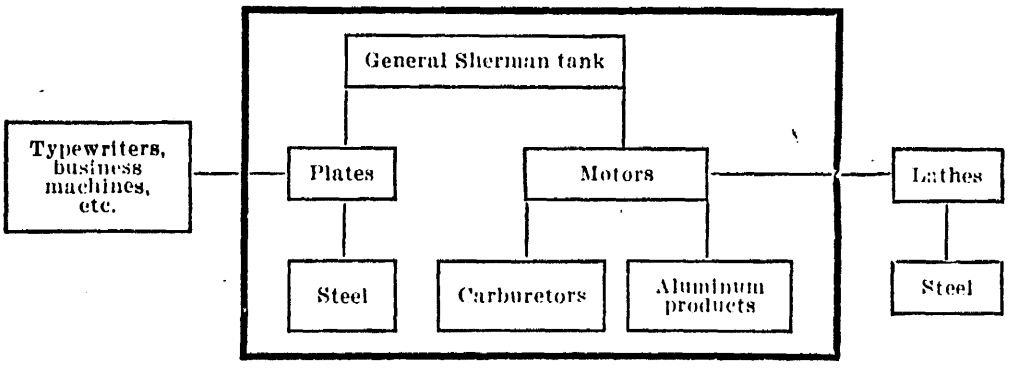
To illustrate the above definition of a subcontract, suppose the War Department contracts with X for 1,000 airplanes. X, finding he cannot produce 1,000 planes in the time required, subcontracts with Y to furnish 500 of the airplanes complete for delivery, which X delivers, as produced by Y, to the War Department. Y's subcontract is renegotiable as a contract item.

Under the new definition, however, factory supplies such as tools or equipment, typewriters, business machines, etc., are exempt from renegotiation.

The following example will illustrate the scope of the articles coming within the new definition of component article. Assume that the War Department contracts with A for the purchase of a General Sherman tank. A contracts with B to furnish the plates, and with C to furnish the motors. B contracts with D to furnish the steel and C contracts with E to furnish the carburetors for the motors. C also contracts with F for the aluminum products to be used in the construction of the motors.

Subcontracts for the purchase of all of these articles are subject to renegotiation because they are incorporated in or as a part of the contract item which is the General Sherman tank. If C, who has contracted to furnish the motors, contracts with G for lathes to be used in making parts of the motor, C's contract with G is not renegotiable, for the reason that it is not a contract for an article to be incorporated in or as a part of a contract item. For the same reason, if G contracts with H for some steel for the lathes, G's contract with H is not renegotiable. Also, if B, who contracts to furnish steel plates to A, contracts with I for typewriters and business machines, that contract is not subject to renegotiation. In other words, only an end product or products which will enter into an end product will be subject to renegotiation.

The chart below will illustrate this:



NOTE.—Contracts and subcontracts within the large enclosure are subject to renegotiation; subcontracts outside are not subject to renegotiation.

3. SUBCONTRACTS UNDER EXEMPT CONTRACTS OR SUBCONTRACTS

[Subsec. (i) (1) (I) of the Finance Committee bill; (i) (1) (E) of the House bill]

Under existing law, considerable confusion results from the fact that a subcontract may be subject to renegotiation even though the prime

contract or any intermediate subcontract may not be so subject. The House bill exempted such contracts as were directly or indirectly under an exempt contract or subcontract.

The exemption in the House bill went to contracts and subcontracts exempted from the provisions of the renegotiation section and to those to which that section was inapplicable by reason of paragraph (1) of subsection (i). Under the committee bill, the exemption is restricted to contracts and subcontracts to which the renegotiation section is made inapplicable by the paragraph.

There is an important difference between the House and the committee bill in this respect, further, in that the committee bill makes the exemption retroactive to April 28, 1942. The House exemption applied only to amounts received or accrued under such contracts or subcontracts in fiscal years of the contractor or subcontractor ending after June 30, 1943.

4. CONTRACTS WITH CERTAIN ORGANIZATIONS EXEMPT FROM INCOME TAX

[Subsec. (i) (1) (D)]

There are some instances of contracts or subcontracts with religious, charitable, educational, and other organizations of the type described in section 101 (6) of the Internal Revenue Code, which are exempt from income tax.

The exemption by the House of contracts and subcontracts with such organizations is retained by your committee, but is made retroactive to April 28, 1942.

5. EXEMPTION OF AGRICULTURAL COMMODITIES

[Subsec. (i) (1) (C)]

The existing law provides for no exemption from renegotiation of agricultural commodities as such. The House bill expressly makes the amended provisions inapplicable to contracts or subcontracts for such commodities in their raw or natural state or (in the case of commodities not customarily sold or having an established market in their raw or natural state) in the first form or state beyond the raw or natural.

The definition of agricultural commodities in the House bill is broad, including not only products of the soil but also saps and gums of trees; animals such as cattle, hogs, poultry, and sheep; fish and marine life; products of live animals, such as wool, eggs, milk, and cream. The same definition appears in the committee bill, except for the addition of "natural resins" in subparagraph (ii), for purposes of clarification.

As in the House bill, contracts or subcontracts for canned, bottled, or packed fruits, or vegetables (or their juices), which are customarily canned, bottled, or packed in the season in which they are harvested, are also exempt. Your committee adds to the exempt list contracts or subcontracts for canned, bottled, packed, or processed dairy products or any product of which the principal ingredient is a dairy product.

This exemption was not retroactive under the House bill; your committee has made it retroactive to April 28, 1942.

6. EXEMPTION OF STANDARD COMMERCIAL ARTICLES

[Subsec. (i) (1) (F) of the Finance Committee bill; (i) (4) (D) of the House bill]

The House bill authorized the War Contracts Price Adjustment Board (created under subsection (d) (1), as amended) to exempt from renegotiation any contract or subcontract for the making or furnishing of a standard commercial article if, in its opinion, normal competitive conditions affecting the sale of such article existed.

The committee bill makes the exemption mandatory and removes the condition relating to competitive conditions.

Your committee also changed the definition of "standard commercial article" by eliminating the first test, provided by subsection (a) (7) (A), which read "which is not specially made to specifications furnished by a Department or by another contractor or subcontractor". It is believed that this test, in view of the others set forth in the definition, serves no useful purpose, and that its elimination will not appreciably broaden the scope of the definition.

Accordingly, a "standard commercial article" is defined in subsection (a) (7) of the committee bill as an article—

> "(A) which is identical in every material respect with an article which was manufactured and sold, and in general civilian, industrial, or commercial use prior to January 1, 1940,
>
> "(B) which is identical in every material respect with an article which is manufactured and sold, as a competitive product, by more than one manufacturer, or which is an article of the same kind and having the same use or uses as an article manufactured and sold, as a competitive product, by more than one manufacturer, and
>
> "(C) for which a maximum price has been established and is in effect under the Emergency Price Control Act of 1942, as amended, or under the Act of October 2, 1942, entitled 'An Act to amend the Emergency Price Control Act of 1942, to aid in preventing inflation, and for other purposes', or which is sold at a price not in excess of January 1, 1941, selling price."

An article made in whole or in part of substitute materials but otherwise identical in every material respect with the article with which it is compared under subparagraphs (A) and (B) is to be considered as identical in every material respect with such article with which it is so compared.

7. EXEMPTION OF COMPETITIVELY PRICED ARTICLES GENERALLY

[Subsec. (i) (4) (D) of the Finance Committee bill; (i) (4) (E) of the House bill]

Under the House bill, discretionary authority was given the War Contracts Price Adjustment Board to exempt contracts or subcontracts for articles other than standard commercial articles if, in the opinion of the Board, competitive conditions affecting the making of such contract or subcontract were such as were likely to result in effective competition with respect to the price.

In view of the transfer of contracts and subcontracts for standard commercial articles by the committee bill from the discretionary to

the mandatory exemption list without regard to the existence of competitive conditions, a clerical amendment has been made to eliminate the reference to standard commercial articles.

8. EXEMPTION OF SUBCONTRACTS WHERE PROFITS OTHERWISE RENEGOTIABLE CANNOT BE SEGREGATED

[Subsec. (i) (4) (E) of the Finance Committee bill; (i) (4) (F) of the House bill]

Under the House bill, discretionary authority is also given the Board to exempt any subcontract or group of subcontracts not otherwise exempt from renegotiation if, in its opinion, it is not administratively feasible to segregate the profits attributable thereto from profits attributable to nonrenegotiable business.

The committee bill retains this provision without change.

9. EXEMPTION OF CONSTRUCTION CONTRACTS

[Subsec. (i) (1) (G)]

Your committee has added to paragraph (1) of subsection (i), as amended by the House bill, a new subparagraph (G), under which the provisions of the section are not to apply to—

any contract with a Department, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility.

The renegotiation of such contracts has been found especially troublesome in certain cases and it is the opinion of the committee that construction work has reached the stage where the freedom of new contracts from the provisions of the statute will not be prejudicial to the public interest.

10. EXEMPTION OF CONTRACTS WITH COMMON CARRIERS OR PUBLIC UTILITIES

[Subsec. (i) (1) (E)]

Your committee has also added to paragraph (1) of subsection (i), as amended by the House bill, a new subparagraph (E), which adds to the list of contracts and subcontracts not subject to renegotiation—

any contract or subcontract with a common carrier for transportation, or with a public utility for gas or electrical energy, when made in either case at published rates or charges filed with, or fixed, approved, or regulated by, a public regulatory body, State, Federal, or local.

It is believed that possible conflict between Federal and State or local authority in these fields, as well as between different Federal departments or agencies, should be avoided.

11. EXEMPTION OF CONTRACTS MADE UNDER DIRECTIVE OF THE WAR PRODUCTION BOARD

[Subsec. (i) (1) (H)]

Subsection (i) (1) (H), another new provision in the committee bill, adds to the list of exempt contracts and subcontracts—

any contract or subcontract for an article made or furnished in obedience to a directive of the War Production Board, and at or below a maximum price established and in effect under the Emergency Price Control Act of 1942, as amended.

It is the opinion of the committee that no sound reason exists for the subjection of contracts and subcontracts in this category to the requirements of the Renegotiation Act.

The exemption is made retroactive to April 28, 1942.

II. Determination of Excessive Profits

1. MANDATORY STATEMENTS OF COSTS

[Subsec. (c) (5) (A)]

The House bill (unchanged in this respect by your committee) requires every contractor and subcontractor holding contracts or subcontracts subject to the provisions of the statute to file with the War Contracts Price Adjustment Board, at such time or times and in such form and detail as the Board may by regulations prescribe, statements of actual costs of production and such other financial statements as it may by regulations prescribe. The willful failure or refusal to furnish such a statement or the filing of a false or fraudulent statement incurs liability to a fine of not more than $10,000 or imprisonment for not more than 2 years, or both.

2. ALLOWABLE COSTS

[Subsec. (a) (4) (B)]

War contract and subcontract profits are defined by both the committee and the House bill to mean the excess of the amount received or accrued under such contracts and subcontracts over the costs paid or incurred with respect thereto. To the extent that costs are unreasonable or not properly chargeable to the contract or subcontract, in the opinion of the Board or of the Court of Claims (under the House bill, The Tax Court of the United States), as the case may be, are disallowed.

Subject to these qualifications, items allowable as deductions or exclusions in computing net income for income and excess-profits tax purposes are, with the exception of taxes measured by income, allowable to the extent that they are allocable to such contracts or subcontracts. An amendment in the committee bill expressly provides that in the case of the recomputation of the amortization deduction and in the case of carry-overs and carry-backs, the consequent deductions and exclusions shall also be allowed, to the extent that they are allocable to the contracts and subcontracts involved. The House bill, it should be noted, confined the deductions and exclusions to be allowed in the determination of excessive profits for purposes of renegotiation to items "of the character" allowed as deductions and exclusions for income and excess-profits tax purposes.

Federal income taxes are not allowable as items of cost under either the House or the committee bill. After the excessive profits have been determined, however, credit is allowed, against any portion thereof required to be refunded, for any Federal income or excess-profits taxes paid with respect thereto.

State income taxes likewise are disallowed as an item of cost but the bill provides for a proper adjustment, in determining the amount of excessive profits to be eliminated, for such taxes attributable to

the nonexcessive portion of profits. For example, if the amount due on a contract is $1,000 and the cost is $800, the profit before adjustment for such tax is $200. Suppose that of the $200 profit, $90 is considered excessive before adjustment for the State tax. If in such case the State income tax on the remaining $110 is $11, then the $11 is to be applied against the $90, reducing to $79 the amount of excessive profit to be eliminated.

Under the House bill, any commission, percentage, brokerage, or contingent fee paid or payable to any person for, or in connection with, the soliciting or securing by any such person of a contract with a department, unless such person was a bona fide established commercial or selling agency maintained by the contractor for the purpose of securing business, was expressly disallowed as cost on any contract with a department. This provision is omitted from the committee bill, in consideration of the inequity, as well as the administrative difficulties, involved in conditioning the allowance upon the person being a bona fide established commercial or selling agency maintained by the contractor.

3. COSTS ALLOWED TO CERTAIN PROCESSORS

[Subsec. (i) (3)]

To insure the equitable treatment of contractors or subcontractors producing minerals, oil or gas, or timber, and who process, refine, or treat such products to or beyond the first form or state suitable for industrial use, or who produce agricultural products and process, refine, or treat them to or beyond the first form or state in which they are customarily sold or in which they have an established market, the Board is required by the House bill to prescribe such regulations as may be necessary to give the contractor or subcontractor a cost allowance substantially equivalent to the amount which would have been realized by him if he had sold such products in their first form or state.

This provision is retained in the committee bill, with a clarifying amendment substituting "and" for "or" in the House bill phrase "to or beyond".

4. AGGREGATION OF CONTRACTS

[Subsec. (c) (1)]

The committee bill makes no change in this provision of the House bill, which provides for the aggregation of all amounts received or accrued by a contractor or subcontractor under contracts or subcontracts during his fiscal year, for the purpose of determining whether they reflect excessive profits. Upon the request of the contractor or subcontractor, however, the Board may determine such excessive profits with respect to each contract or subcontract, separately or by groups.

5. STANDARDS

[Subsec. (a) (4) (A)]

The definition of excessive profits contained in the House bill sets forth certain factors to be taken into consideration in the determination of excessive profits. The standards there prescribed are: efficiency,

with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of raw materials, facilities, and manpower; reasonableness of costs and profits, with particular regard to volume of production and normal pre-war earnings; amount and source of public and private capital employed and net worth; risk assumed, including the risk incident to reasonable pricing policies; contribution to the war effort, including inventive and developmental contribution and cooperation in supplying technical assistance to the Government and to other contractors; character of business, including complexity of manufacturing technique, character and extent of subcontracting, and rate of turn-over; and such other factors the consideration of which the public interest and fair and equitable dealing may require.

Your committee bill retains these standards, modifying the second (relating to the reasonableness of costs and profits) to include a comparison of war and peacetime products. It also adds to the House bill list two additional standards, one of which requires taking into consideration financial problems in connection with reconversion, and the other, whether the profits remaining after attainment of estimated Federal income and excess profits taxes will be excessive.

6. APPLICATION OF THE SECOND WAR POWERS ACT, 1942

[Subsec. (c) (5) (B)]

The Board is granted by the committee, as well as by the House bill, for the purposes of renegotiation, the same powers with respect to any contractor or subcontractor that any agency designated by the President to exercise the powers conferred by title XIII of the Second War Powers Act, 1942, has with respect to any contractor to whom that title is applicable. The title cited confers upon the Chairman of the War Production Board, or any governmental agency or officer designated by the President, powers to inspect the plant and audit the books of any contractor with whom a defense contract has been placed at any time after the declaration of emergency on September 8, 1939, and before the termination of the present war. A defense contract is there defined to mean any contract, subcontract, or order placed in furtherance of the defense or war effort.

III. Renegotiation Procedure

1. "RENEGOTIATE" AND "RENEGOTIATION" DEFINED

[Subsec. (a) (3) (A)]

These terms, given new definition in the House bill, include the determination by agreement or order of the amount of excessive profits. The definition suggests (as is set forth in detail in later provisions of the section) that the determination of excessive profits may take the form of a bilateral agreement between the Government and the contractor or, in case such an agreement cannot be reached, of an order or unilateral determination.

Subsection (a) (3), as amended by the House bill, introduced a definition of the terms "reprice" and "repricing" to include a determination by agreement or order under the section of a fair price for performance under a contract or subcontract. In harmony with the

action of the committee with respect to the repricing authority of the Secretaries of the contracting departments, this definition has been eliminated in your committee bill.

2. NOTICE OF CONFERENCE

[Subsec. (c) (1)]

The renegotiation proceeding begins with a notice of conference given the contractor or subcontractor by the Board. Such a notice is to be given whenever, in the opinion of the Board, amounts received or accrued under contracts or subcontracts may reflect excessive profits. The mailing of the notice by registered mail constitutes the commencement of the renegotiation proceeding.

The House bill provision in this respect is retained without change in your committee bill.

3. AGREEMENTS AND ORDERS OF THE BOARD

[Subsec. (c) (1), (4)]

The conference between the contractor or subcontractor and the Board is for the purpose of arriving at a final or other agreement between them with respect to the elimination of excessive profits received or accrued and with respect to such other matters relating thereto as the Board deems advisable. Under the House bill, the excessive profits to be eliminated were those "realized or likely to be realized"; under the committee bill, the description of such excessive profits is "received or accrued."

In the event an agreement is not arrived at, the Board is required (under both the House and the committee bill) to issue and enter an order determining the amount of the excessive profits, if any. If the determination is by order, the Board must forthwith give notice thereof by registered mail to the contractor or subcontractor. In the absence of the filing of a petition with the Court of Claims, as provided in subsection (c) (1) of the committee bill (see below, under the heading "Redeterminations by the Court of Claims"), such an order is to be final and conclusive and not subject to review or redetermination by any other court or agency.

Under subsection (c) (4), as amended by the House bill, the Board was empowered to make final or other agreements with the contractor or subcontractor for the elimination of excessive profits and for the discharge of any liability therefor under the section. Such agreements could cover such past and future period or periods, might apply to such contract or contracts, and might contain such terms and conditions, as the Board deemed advisable. The language of your committee bill omits reference to the periods to be covered by such agreements and to their application, providing only that they may contain such terms and conditions as the Board deems advisable. Both the committee and the House bill provide that such an agreement is, for renegotiation purposes, to be conclusive according to its terms and that in the absence of fraud or malfeasance or a willful misrepresentation of a material fact it is not to be reopened or modified by the Government; and any such agreement or any determination made in

accordance therewith is not to be annulled, modified, set aside, or disregarded in any suit, action, or proceeding.

4. STATEMENT OF THE DETERMINATION

[Subsec. (c) (1)]

Upon a determination of the Board, whether by agreement or order, of the amount of excessive profits, the Board is required, at the request of the contractor or subcontractor, as the case may be, to prepare and furnish him with a statement of the determination, of the facts used as a basis therefor, and of the reasons for it. This provision of the House bill is retained without change by your committee.

Under the House bill, however, the statement could not be used as evidence or be otherwise considered by The Tax Court in connection with its determination of excessive profits. Your committee bill strikes out this restriction and provides that the statement cannot be used in the Court of Claims as proof of the facts or conclusions stated therein. (The substitution of the Court of Claims for The Tax Court is a clerical amendment in harmony with the committee amendment to subsection (c) (1), as amended by the House bill, substituting the Court of Claims for The Tax Court as the forum of petition for redeterminations of excessive profits.)

5. ELIMINATION OF EXCESSIVE PROFITS

[Subsec. (c) (2)]

After the making of an agreement as to the amount of excessive profits between the Board and the contractor or subcontractor; or the entry of an order by the Board with the Court of Claims determining the amount of excessive profits; or the entry of an order by the Court of Claims finally determining the amount of excessive profits, the next step in the renegotiation proceeding is the authorization and direction by the Board to the Secretaries (or any of them) of the contracting departments or department to eliminate such excessive profits.

Under the House bill, the elimination could be accomplished by reductions in the amounts otherwise payable to the contractor under contracts and subcontracts, or by other revision of their terms; by withholding from amounts otherwise due the contractor or subcontractor; by directing a contractor to withhold for the account of the United States from amounts otherwise due a subcontractor; by recovery from the contractor or subcontractor through repayment, credit, or suit; or by any combination of these methods deemed desirable by the Board. Amendments made by your committee prevent the elimination of excessive profits by reduction in amounts payable to the contractor under subcontracts, or by withholding by the United States from amounts due a subcontractor, or by recovery by the United States from a subcontractor by repayment, credit, or suit.

The filing of a petition with the Court of Claims (as was true under the House bill in the case of a petition filed with The Tax Court) does not operate to stay the execution of an order of the Board determining excessive profits.

Contractors and subcontractors are indemnified by the United States against all claims by any subcontractor on account of amounts

withheld from him pursuant to subsection (c). In view of the action of the committee in the matter of repricing, a clerical amendment is made to eliminate the reference to subsection (f).

6. REVIEW BY THE BOARD OF DECISIONS OF ITS DIVISIONS, OFFICERS, OR AGENCIES

[Subsec. (d) (5)]

Subsection (d) (5), in both the House and the committee bill, entitles any contractor or subcontractor aggrieved by an order of a division of the Board, or of any officer or agency to whom any of its powers, functions, or duties may have been delegated or redelegated in pursuance of subsection (d) (4), to a review thereof by the full Board. Such review may also be upon the Board's own motion and the Board is authorized to provide by regulations that in the absence of a request for review within a time to be fixed by the Board by regulation, the order of a division, officer, or agency shall be deemed the order of the Board.

Upon any such review, the Board may determine an amount of excess profits less than, equal to, or greater than the amount determined by the division, officer, or agency.

IV. REDETERMINATIONS BY THE COURT OF CLAIMS

One of the most important changes made by your committee to the Renegotiation Act as amended by the House bill was to substitute the Court of Claims for The Tax Court of the United States as the forum for review of orders of the Board determining the amount of excessive profits received or accrued by a contractor or subcontractor. Review by The Tax Court would constitute merely a further administrative review and therefore, in the opinion of the committee, would serve no useful purpose.

Your committee was unwilling, moreover, to jeopardize the existing satisfactorily current position of The Tax Court by imposing upon it the very heavy additional burden of reviewing renegotiation cases. Consideration of the probable influx of excess-profits tax cases in the near future, including those in respect to which relief is claimed under section 722, also influenced the committee in this decision.

While the committee is mindful of the heavy burden that may be placed upon the Court of Claims as the result of the committee action, it is believed that the public interest will be best served by granting that court jurisdiction of renegotiation cases.

1. DETERMINATIONS OF THE BOARD WITH RESPECT TO FISCAL YEARS ENDING AFTER JUNE 30, 1943

[Subsec. (e) (1)]

The House bill permitted any contractor or subcontractor aggrieved by an order of the Board determining the amount of excessive profits received or accrued by him or by an order of the Secretary determining a fair price to file a petition with The Tax Court for a redetermination thereof. The committee bill makes two amendments to this provision. One of these amendments is clerical, striking out the

reference to orders of the Secretary determining fair price, in line with the action of the committee with reference to repricing. The other amendment substitutes the Court of Claims for The Tax Court, and the reasons impelling your committee have already been stated.

As under the House bill, the petition may be filed at any time within 90 days after the mailing by registered mail of the notice of the order.

The jurisdiction of the court finally to determine the amount, if any, of excessive profits, is to be exclusive under the committee bill, as was the case with the jurisdiction of The Tax Court under the House bill, and that determination is not to be reviewed or redetermined by any court or agency.

As in the case of The Tax Court under the House bill, the court is permitted by the committee bill to determine as the amount of excessive profits an amount less than, equal to, or greater than that determined by the Board.

The committee bill also expressly provides, as did the House bill in the case of The Tax Court, that such a proceeding before the Court of Claims is not to be treated as a proceeding to review the determination of the Board, but as a proceeding de novo.

In consequence of the substitution of the Court of Claims for The Tax Court as the review body, the provisions of the House bill conferring powers and imposing duties upon The Tax Court for the purposes of review are stricken and in their stead appear provisions in the committee bill authorizing the court to prescribe such rules of practice and procedure as it deems necessary to the exercise of its new powers.

The amendment made by your committee, contains a provision, not expressly stated in the House bill relating to The Tax Court, requiring the Court of Claims, whenever it makes a determination with respect to the amount of excessive profits, to prepare and furnish the contractor or subcontractor, at his request, with a statement of the determination, of the facts used as basis therefor, and of the reasons for it. This is not a change of substance, however, since a like duty was imposed on The Tax Court by the House bill provision incorporating section 1117 (b) of the Internal Revenue Code by reference.

As stated above (item 5 under the heading "Renegotiation procedure"), the filing of a petition with the court for review of an order of the Board with reference to the elimination of excessive profits does not operate to stay the execution of the order.

The review granted by paragraph (1) of subsection (e) of the committee bill, as well as the House bill, goes to orders of the Board determining the amount of excessive profits received or accrued by the contractor or subcontractor in a fiscal year (that is, a taxable year for purposes of Federal income and excess-profits taxes) ending after June 30, 1943.

2. DETERMINATIONS OF A SECRETARY PRIOR TO ENACTMENT OF THE BILL AND WITH RESPECT TO FISCAL YEARS ENDING BEFORE JULY 1, 1943

[Subsec. (c)(2)]

Under the House bill, any contractor or subcontractor (other than a subcontractor described in subsection (a) (5) (B)) aggrieved by a determination of a secretary made prior to the date of the enactment of the bill, with respect to a fiscal year ending before July 1, 1943, as to the existence of excessive profits, whether or not such a determination is embodied in an agreement with the contractor or subcontractor, was permitted, within 90 days after the enactment of the bill, to file a petition with The Tax Court for a redetermination thereof. The committee bill retains this provision without other change than to substitute the Court of Claims for The Tax Court as the forum with which the petition is to be filed.

In the case of a determination by a secretary on or after the date of the enactment of the bill, with respect to any such fiscal year, as to the existence of excessive profits, which is not embodied in an agreement with the contractor or subcontractor, the House bill also permitted a petition for redetermination to be filed with The Tax Court within 90 days. This provision is retained in your committee bill, with the substitution of the Court of Claims for The Tax Court.

The jurisdiction, powers, and duties of the court in either case are to be subject, under the committee bill, to the same provisions as in the case of a petition filed with the court for a redetermination in respect of a fiscal year ending after June 30, 1943, except that amendments made to the Renegotiation Act by the bill which are made applicable as of April 28, 1942 (the date of the original enactment of the act), or to fiscal years ending before July 1, 1943, are not to be applicable. Under the House bill, the exception went to amendments (other than the amendment inserting subsection (c) (2)) made to the Renegotiation Act by the bill.

Under the House bill, in the event the determination of a secretary was embodied in an agreement with the contractor or subcontractor, neither the agreement nor the amount agreed upon as excessive profits was to be taken into consideration by The Tax Court in its determination of excessive profits. This provision is retained by your committee without change, except the necessary change by implication in the term "court" to refer to the Court of Claims.

V. PERIODS OF LIMITATION

1. ON COMMENCEMENT OF PROCEEDING

[Subsec. (c) (3)]

The House bill prohibited the commencement of any proceeding by the Board to determine the amount of excessive profits more than 1 year after the close of the fiscal year in which such profits were received or accrued, or more than 1 year after the statements of costs

of production and other financial statements required from the contractor or subcontractor had been filed with the Board, whichever date was the later, and if the proceeding was not commenced within that period, all liabilities of the contractor or subcontractor for excessive profits received or accrued during such fiscal year were thereupon to be discharged.

Your committee has amended this provision by striking out the references to the statements of costs of production and other financial statements. In the opinion of the committee, the fixing of the period of limitation by reference to the date of the filing of such statements might result in the inequitable treatment of the contractor or subcontractor in cases where such statements were not deemed acceptable by the contracting department. The extension of the period pending the receipt of such an acceptable statement or statements would result, your committee believes, in needless uncertainty for the contractor or subcontractor.

2. ON DETERMINATION OF EXCESSIVE PROFITS

Under both the committee and the House bill, if an agreement or order determining the amount of excessive profits is not made within 1 year following the commencement of the renegotiation proceeding, all liabilities of the contractor for excessive profits with respect to which the proceeding was commenced are thereupon to be discharged, except that if an order is made within such 1 year by the Secretary or by an officer or agency designated by him pursuant to his authority under subsection (d) (4) to delegate, such 1-year limitation shall not apply to review of the order by the Board. Provision is made, further, for the extension of the 1-year period by mutual agreement between the Board and the contractor.

VI. Disposition of the Proceeds of Renegotiation

1. EXCESSIVE PROFITS RECOVERED

[Subsec. (c) (2)]

As under existing law and the House bill, all moneys recovered by way of repayment or suit are to be covered into the Treasury as miscellaneous receipts.

2. EXCESSIVE PROFITS WITHHELD OR CREDITED

[Subsec. (c) (2)]

The House bill provided that upon the withholding of any amount of excessive profits or the crediting of any amount of such profits against amounts otherwise due a contractor, the amount so withheld or credited was to be transferred by the Secretary of the renegotiating department to the Treasury, to the credit of miscellaneous receipts, from the appropriations of the renegotiating department respectively available for the contract or subcontracts renegotiated.

To conform this policy to Treasury accounting procedure, a committee amendment requires the secretary of the renegotiating department to certify the amount withheld or credited to the Treasury and

the appropriations are to be correspondingly reduced. The amount of such reductions is to be transferred to the surplus fund of the Treasury.

3. CREDIT FOR FEDERAL INCOME AND EXCESS PROFITS TAXES

[Subsec. (c) (2)]

The House bill provided, as does existing law, that in determining the amount of any excessive profits to be eliminated the Secretary should allow the contractor or subcontractor credit for Federal income and excess profits taxes paid or accrued thereon, as provided in section 3806 of the Internal Revenue Code.

A clarifying amendment is made in the committee bill providing for this allowance in eliminating excessive profits.

VII. ADMINISTRATION

1. ESTABLISHMENT OF THE WAR CONTRACTS PRICE ADJUSTMENT BOARD

[Subsec. (d) (1), (2), (3)]

The committee bill retains without change, except to add a member (to be an officer or employee of the War Production Board and to be appointed by its Chairman), the provision of the House bill creating the War Contracts Price Adjustment Board. The Board is to consist of six members, of whom one is to be an officer or employee of the War Department, one of the Navy Department, one of the Treasury Department, one of the United States Maritime Commission or the War Shipping Administration, one of the Reconstruction Finance Corporation, and one of the War Production Board. The Chairman of the Board is to be elected from among those members and the Board is to have a seal which shall be judicially noticed.

The principal office of the Board will be in the District of Columbia, but the Board or any of its divisions may meet and exercise its powers at any other place within the United States. Such number of field offices as it may deem necessary to expedite its work may be established by the Board.

Four members of the Board (three under the House bill) are to constitute a quorum, and any power, function, or duty of the Board may be exercised or performed by a majority of the members present, if the members present constitute at least a quorum.

The committee bill retains without change the provision of the House bill, subsection (d) (3), authorizing the Board, subject to the civil-service laws and the Classification Act of 1923, as amended, to employ and fix the compensation of such officers and employees as it deems necessary to assist it in carrying out its duties under the Renegotiation Act as proposed to be amended. The Board may also, with the consent of the head of the department, agency, or instrumentality of the United States concerned, utilize the services of any officers or employees of the United States and reimburse such department, agency, or instrumentality for the services so utilized.

2. DELEGATION BY THE BOARD OF ITS POWERS, FUNCTIONS, AND DUTIES

[Subsec. (d) (4)]

Paragraph (4) of subsection (d), as amended by the House bill, is also retained without change by your committee. The paragraph authorizes the Board to delegate in whole or in part any of its powers, functions, or duties (except to review orders determining excessive profits) to the Secretary of a department and any such power, function, or duty may be delegated in whole or in part by him to such officers or agencies of the United States as he may designate. The Secretary may also authorize successive redelegations.

3. DIVISIONS OF THE BOARD

[Subsec. (d) (5)]

Paragraph (5) of subsection (d), as amended by the House bill, is also retained without change in the committee bill. Under this paragraph, the Board may be divided from time to time by its Chairman into divisions of one or more members and, in case of a division of more than one member, the Chairman may designate its chief. The Board is also empowered to determine, by regulations or otherwise, the character of cases to be conducted initially by the Board through an officer or officers of, or utilized by, the Board; the character of cases to be conducted initially by the various officers and agencies authorized to exercise its powers pursuant to paragraph (4) of the subsection; the character of cases to be conducted initially by the various divisions of the Board; and the character of cases to be conducted initially by the Board itself.

Review by the Board of an order of any of its decisions, officers, or agencies has been referred to above (item 6, under the heading "Renegotiation Procedure").

VIII. CONTRACT OBLIGATION FOR RENEGOTIATION

[Subsec. (b)]

The House bill authorized and directed the Secretary of each department to insert in each contract made by it 30 days or more after the date of the enactment of the bill, and not exempt or exempted under the provisions of subsection (i), a provision under which the contractor was to agree to repricing and to the elimination of excessive profits through renegotiation; to the retention by the United States from amounts otherwise due the contractor, or to the repayment to the United States, if paid to him, of any excessive profits; and to the insertion of similar provisions in each subcontract made by him.

In accordance with its action in the matter of repricing, your committee has stricken from subsection (b) the requirement of the contractor to agree to repricing or to insert such an agreement in subcontracts made by him.

The committee bill also contains amendments requiring the insertion of these provisions only in contracts or subcontracts (other than so-called war broker contracts) involving an estimated amount of more than $100,000. In the case of war broker contracts, the provision is not required to be inserted if the estimated amount involved is

not more than $25,000. These amendments, however, are not amendments of substance, inasmuch as the committee bill permits (as did the House bill) the incorporation by reference in any contract or subcontract of the required provision for renegotiation, but whether or not the contract or subcontract contains such a provision, it must be construed to have been made subject to it.

Notwithstanding the requirements relating to the inclusion, actually or by reference, of these provisions for renegotiation in the contract or subcontract, the contractor or subcontractor will be bound in any fiscal year thereby only if the aggregate amounts received or accrued by him under his contracts or subcontracts in that year exceed the applicable specific exemption.

IX. Effective Dates of Amendments

[Subsec. (c) (6) of the Renegotiation Act; sec. 701 (c) (3) (d) of the revenue bill]

In general, the amendments made by the committee bill to the Renegotiation Act, like the amendments made to it by the House bill, are to be effective only with respect to fiscal years ending after June 30, 1943.

Exceptions are made in the committee bill with respect to the exemption of agricultural commodities (and other articles enumerated in subsection (i) (1) (C)); to the exemption of contracts or subcontracts with organizations exempt from income tax under section 101 (6) of the Internal Revenue Code; to the exemption of contracts or subcontracts under directive of the War Production Board; to the exemption of subcontracts directly or indirectly under an exempt contract or subcontract; to the allowance of costs to contractors or subcontractors under subsection (i) (3) in processing, refining, or treating the products therein enumerated; to the amendment authorizing the citation of section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, as the Renegotiation Act; and to the definition of subcontract under subsection (a) (5) (A)—all of which amendments are to be effective as of April 28, 1942, the date of the enactment of the Sixth Supplemental National Defense Appropriation Act, 1942. Under the committee bill, further, the amendments creating the War Contracts Price Adjustment Board and the amendment relating to repricing are to become effective upon the date of the enactment of the bill.

Exceptions from the general effective date of the House bill were made in the case of the exemption of contracts and subcontracts for agricultural commodities and the amendment providing for the new citation—both these amendments, as under the committee bill, were to be effective as of April 28, 1942. The remaining exceptions under the House bill related to the repricing amendment, which, as under the committee bill, was to become effective upon the date of enactment; to the amendment authorizing the review of determinations of the Secretary prior to the enactment of the bill and with respect to fiscal years ending before July 1, 1943—which amendments, as under the committee bill were also to become effective on the date of enactment; and to the amendment of subsection (b), relating to the insertion in contracts and subcontracts of a provision agreeing to renegotiation, which amendment was to become effective 30 days after enactment.

Subsection (c), relating to renegotiable procedure, is made applicable by paragraph (6) thereof, both in the committee and the House bill, to all renegotiable contracts and subcontracts to the extent of amounts received or accrued thereunder in any fiscal year of the contractor or subcontractor ending after June 30, 1943.

X. Termination of Renegotiation

[Subsec. (h)]

Under existing law, the Renegotiation Act will remain in force during the present war and for 3 years thereafter. The termination date under the committee bill, as under the House bill, is the date of the termination of hostilities in the present war or the date specified in a concurrent resolution of Congress as the date ending the war, whichever is the earlier.

XI. Technical and Clerical Amendments

1. PROSECUTION OF CLAIMS AGAINST THE UNITED STATES

[Subsec. (j) of the House bill]

In the belief that the public interest might otherwise be seriously jeopardized, your committee has eliminated subsection (j), as amended by the House bill.

This subsection relaxed the existing prohibition upon any person leaving the employ of the Government from acting as counsel, agent, or attorney for prosecuting any claim against the United States. This prohibition goes to the prosecution of any claim arising from any matter directly connected with which the person is employed, or to such prosecution during the period of his engagement in intermittent and temporary employment in a department. The House changed the period mentioned in the second test to the period of employment in a department.

2. AUTHORITY OR DISCRETION OF A SECRETARY UNDER OTHER LAWS

[Subsec. (j) of the Finance Committee bill; subsec. (k) of the House bill]

The committee bill retains, without amendment other than of designation, the subsection added by the House bill to provide that nothing in the section is to be construed to limit any authority or discretion of a secretary of a department under the provisions of any other law.

3. CREDIT FOR DECLARED VALUE EXCESS PROFITS TAXES

[Sec. 701 (c) (2)]

Section 701 (c) (2) of both the House and the committee bill amends paragraphs (1) and (2) of section 3806 of the Internal Revenue Code by inserting the words "Chapter 2B" after the words "Chapter 2A", wherever they appear therein. The effect of the amendments is to include declared value excess profits taxes paid with those in respect of which a credit is allowed against recoverable excessive profits.

4. CLERICAL AMENDMENT TO I. R. C. 3806 (A) (1) (B), (C)

[Sec. 701 (c) (1)]

The House amendment, unchanged by the committee, striking out the words "by the Revenue Act of 1942" from these subparagraphs has the effect of extending the application of the definition of the term "excessive profits" to the renegotiation section as amended by the bill.

5. CITATION

[Subsec. (k)]

The committee bill, like the House bill, provides that the renegotiation section may be cited as the Renegotiation Act. The purpose of this amendment is to obviate the necessity of the long citation now necessary in documents pertaining to renegotiation; namely, section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942.

RENEGOTIATION OF WAR CONTRACTS

OUTLINE OF CHANGES MADE IN THE EXISTING STATUTE BY THE FINANCE COMMITTEE BILL

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(c) (5) (B)	6. Application of the Second War Powers Act, 1942	115	170

* Of the revenue bill.

TITLE IX—SOCIAL SECURITY TAXES

SECTION 901. AUTOMATIC INCREASE IN 1944 RATE NOT TO APPLY

This section, which was added by your committee to the House bill, postpones the increase in the rates of the taxes imposed by the Federal Insurance Contributions Act (subchapter A of chapter 9 of the code). Under existing law, the rate of the income tax on employees imposed by section 1400 increases from 1 percent to 2 percent on January 1, 1944; and the rate of the excise tax on employers of one or more employees imposed by section 1410 also increases from 1 percent to 2 percent on such date. In the case of each such tax the amendment provides that the 1 percent rate shall remain in force through the calendar year 1944, and that the 2 percent rate shall be applicable to wages paid and received during the calendar year 1945.

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THE REVENUE BILL OF 1943

JANUARY 6, 1944.—Ordered to be printed

Mr. WALSH of Massachusetts (for himself, Mr. LA FOLLETTE, Mr. CONNALLY, and Mr. LUCAS), from the Committee on Finance, submitted the following

MINORITY VIEWS

[To accompany H. R. 3687]

The renegotiation statute is strictly a war measure. It could not be defended in ordinary peacetimes. But in war, with its vast demand for munitions, with shortages of labor and materials, and with the absence of effective competition, some law such as the renegotiation statute is essential to protect the taxpayers against excessive profits. Even before the war, in 1934, when contracts for large naval vessels of necessity had to be made with a limited number of concerns, legislation had been adopted to limit profits on these contracts, and it was later extended to aircraft contracts. In 1939 and 1940, when the defense expansion of our Navy and aircraft facilities began on a large scale, this profit limitation upon the urgent request of the contractors themselves, was first relaxed and then suspended to expedite production. The excess-profits tax then became the sole restriction against unreasonable profits on war contracts. Thus the attempt to limit munitions profits through fixed limitations came to a close before the war began.

Then early in 1942, while the Senate Appropriations Committee was studying appropriations for the Army and Navy, it became apparent that many contracts were negotiated before either of the contracting parties had any accurate idea of the costs of producing the article on a mass-production basis. Contractors naturally sought a very high price in order to play safe. When the actual cost of making the article became known, some firms were found to be making excessive profits, which both the Government and the manufacturer desired to eliminate by reducing the contract price. This led to the enactment of section 403 of Public Law 528 (April 28, 1942) authorizing the procuring agencies to recapture excessive war profits and to adjust contract prices, whenever profits could be determined with reasonable certainty.

The renegotiation statute has provided an effective means of limiting war profiteering. Under it, war contractors have been allowed liberal profits on their war business, but inordinate profits have been eliminated. Already it has recovered for the Government over $5,000,000,000 in actual refunds and in reductions in current prices on existing contracts, which represents a net saving of about $1,500,000,000, after allowing for taxes. Through its operation the soldiers, the sailors, and the public have been given a measure of assurance that no group would make exorbitant profits during the war from munitions and war supplies. Thus the statute has protected industry as a whole from the stigma of war profiteering and has contributed to wartime morale.

The Finance Committee's bill amending the statute would largely destroy these benefits of renegotiation. Under the proposed bill large segments of war business would be excluded from renegotiation. They would be free to make exorbitant profits out of the war. Indeed, one large segment would not only be exempt for the future but would be entitled to refunds amounting perhaps to as much as one-half billion dollars—even through the contractors themselves have agreed that this money represents excessive war profits. For example, one machine tool company, which has agreed to a refund of its excessive profits, would probably receive from the Government a net refund (after taxes) of $1,300,000, swelling its wartime profits (after taxes) to four times their pre-war average.

The effects of these amendments are so sweeping and so serious that we feel bound to oppose them and to state the reasons for our views.

I. War Profiteering—World War I

In the First World War profiteering by war contractors and creation of war millionaires became a public scandal. Despite the excess-profits tax and other measures, 23,000 war millionaires were created in World War I out of the sacrifices of the American people. After the war, the investigations of committees of Congress, the War Policies Commission, and other agencies brought to light many cases of outrageous profits on war contracts.

The mass of the people—those who had borne the burdens and sacrifices of the war, who had paid the taxes to finance the war expenditures—joined with the returned soldiers to express their indignation over war profiteering.

So pronounced was this resentment that the American Legion, as one of its first principles, urgently demanded legislation to take the profits out of any future war. One of the principal planks of the 1924 platform of the Democratic Party was the following:

> In the event of war in which the manpower of the Nation is drafted, all other resources should likewise be drafted. This will tend to discourage war by depriving it of its profits.

Likewise, in the same year, the Republican platform contained the following declaration:

> We believe that in time of war the Nation should draft for its defenses not only its citizens but also every resource which may contribute to success. The country demands that should the United States ever again be called upon to defend itself by arms, the President be empowered to draft such material resources and such services as may be required, and to stabilize prices of services and essential commodities, whether utilized in actual warfare or in private activity.

The mistakes of the First World War must not be repeated in this war. In our opinion the repeal or the emasculation of the renegotiation law will inevitably result in widespread excessive profits from war business, profits so excessive that they are certain to create public bitterness and injure public morale.

II. Difficulties of Preventing War Profits

Experience shows that preventing excessive war profits is not easy. When war comes, the needed munitions and supplies must be procured with maximum speed. Soldiers must be put in the field and furnished with adequate equipment in the shortest possible time. The vital thing is to begin actual production at once. Contract pricing is subordinated to this primary objective. Furthermore, the nature of this production complicates the problem. Many of the weapons are new or in process of development, and experience in producing them and in estimating their costs of production is not at hand. In addition, many producers are forced to convert from normal peacetime products to the making of war munitions and supplies with which they are wholly unfamiliar. Finally, the quantity of munitions required so far exceeds any peacetime experience that the costs of production in such quantities cannot readily be predicted.

Under these circumstances, contracts cannot be effectively awarded by competitive bidding. Inadequate data and specifications alone would frequently prevent this, and even where these are available, there is not time for this procedure. Moreover, with the demand for munitions far exceeding the capacity of the available facilities, competitive bidding does not produce effective competition. Knowing that the entire production is needed, suppliers do not need to bid low in order to get contracts. When all possible sources, including the high bidders, must be used, all incentive for genuine competitive bidding disappears.

As the war progresses, these difficulties are reduced but they are not wholly eliminated. Strategic factors constantly alter the kinds and quantities of munitions needed. New weapons are developed and old weapons are constantly improved, or become obsolete. It is a lesson of warfare that the types and quantities of weapons supplied will constantly change.

With these fluctuations in production, costs and profits remain uncertain, both initially and during the continuance of the war, making adequate control of profits extremely difficult. Faced with such uncertainties, contractors seek to fix prices with sufficient allowances for contingencies to protect themselves against the unknown risks that may develop. When some of these contingencies do not happen, these allowances become profits, tremendously increasing the amount realized under the contract.

III. Development of Renegotiation

While Congress was aware of the need for profit control during wartime and had made extensive studies of possible means of preventing war profiteering, no general measures for this purpose were in effect at the beginning of World War II. Several years before the war, the

Vinson-Trammell Act of 1934 and the Merchant Marine Act of 1936 had been adopted to restrict profits on contracts for vessels and aircraft to specified percentages of the contract price, but these measures were suspended in 1940 when the first excess-profits tax was enacted.

Experience has plainly shown that with the enormously expanded volume of war production, taxes alone will not prevent war profiteering. The table in the appendix illustrates this truth by 200 examples of actual companies. After taxes and before renegotiation, their net earnings for 1942 greatly exceed their average annual net earnings after taxes in the pre-war years 1936–39, and in many cases represent an indefensible rate of return on the net worth of the company. These figures show clearly how profits after taxes have risen with the expanded volume of war sales. Taxes not only fail to absorb such profits; if raised too high, they even tend to discourage the control of costs and to encourage inflated prices and profits.

Early in 1942 when the first reports of large war profits were published, Congress responded to the public sentiment for profit control. At first, consideration was given to extending the principles of the Vinson-Trammell Act to war procurement as a whole, but both industry and war procurement agencies protested against this proposal. Any fixed profit limitation is too inflexible to fit the wide variety of industries and conditions in war production, and stifles incentives to reduce costs and expand volume. Accordingly, Congress turned to renegotiation as a more flexible means of profit control. The Renegotiation Act became law on April 28, 1942.

Renegotiation to date has resulted in saving the Government $5,300,000,000—two and one-half billions in cash which the procurement agencies have recovered or will recover for delivery to the Treasury and 2.8 billion dollars in reductions in prices for future deliveries under existing contracts. A large part of the 5.3 billion dollars would have come to the Treasury through excess profits taxes without renegotiation. But at the very least 1.5 billion dollars of these savings would not have been touched by taxes. Thus the present law has proved to be a strong barrier against waste in governmental expenditures for waging war. More than that, the reductions in prices have fostered efficiency in the use of manpower and materials. With wartime shortages, waste of these resources is an irreparable loss which cannot be valued merely in money.

The essential nature of renegotiation has given rise to criticisms of its administration. With few exceptions, however, even its critics admit that those engaged in its administration are fair, high-minded, capable men. They have been drawn from business and the professions.

Despite general talk of arbitrary action, the testimony before three committees of Congress has failed to justify such charges. The hearings did not bring to light a single instance of real abuse of power under the act. No one claims, of course, that renegotiation is a perfect method of profit control, but its critics have not proposed any better method. The situation demanded flexibility, and broad discretion was the price of such flexibility. No other means was then suggested or has since been suggested for dealing adequately with the wide diversity of circumstances encountered in war production.

The real choice is between renegotiation and war profiteering. On that question, we believe that enlightened businessmen, as well as

public opinion, are opposed to war profiteering. As the experience after the last war fully demonstrates, business as a whole will suffer from public reaction after this war if any substantial minority makes unconscionable profits from war production. For business generally, the stigma of war profiteering would far outweigh any temporary financial advantages it might derive from the repeal or emasculation of the renegotiation statute. In the long run, business itself will pay most dearly for any recurrence of war profiteering. It will benefit from the retention of an adequate profit-control statute. For 10,000,000 men in the armed forces and for their families the war has meant heavy sacrifices. The control of wages, rationing, and the other restraints of total war have imposed burdens upon the people at large. Having endured these sacrifices and burdens, the people will not tolerate any relaxation of wartime profit controls.

IV. Requisites for Effective Renegotiation

In the light of these facts what are the essentials for effective profit control through renegotiation?

Coverage.—To protect the public against excessive war profits, renegotiation must extend to all aspects of the procurement program, as widely as practicable. Profiteering in wartime is just as reprehensible in the manufacture of machine tools for war as in airplane parts. War profiteering in standard commercial articles for war purposes is just as injurious to morale and will be just as strenuously condemned as war profiteering in the production of howitzers. We must prevent any group from making heavy profits from the necessities of war. Excessive profits from any source will do violence to the public demand for substantial equality of sacrifice during wartime.

Administration.—The conditions in war production are so diverse that no simple formula will fit the variety of cases presented. Each case must be considered on its own facts, in the light of general principles applicable to all. Thus the task of renegotiating with the tens of thousands of contractors and subcontractors engaged in war production is enormous. And in order to avoid discrimination, the whole field of war contractors must be covered.

Consequently, if the job is to be done with the requisite speed and completeness, the procedures must be kept as informal and simple as possible. Furthermore, Congress should not impose upon the administrative officials unnecessary burdens which will impede their work.

Repricing.—On this subject we agree fully with the following language from the majority report:

> Recapture of past profits does not wholly solve the problem of adequate profit control. It is even more important to prevent the recurrence of excessive profits by adjusting prices to a fair and reasonable basis for the future.
>
> Such reductions of prices for future deliveries are vital in the interest of efficiency and inflation control as well as profit control. Taxes, flat profit limitations, or other methods of profit recapture reach only what is left after all payments, costs, and expenses of the producer have been met. For this reason they may tend to foster wasteful or unnecessary expenditures and even at best can do little to encourage reductions in costs. But in the war program control of costs is as important as the control of profits. With shortages of materials and labor, all producers must be encouraged to operate at their highest efficiency in order to obtain maximum production of war materials from available resources. The reduction of prices to a sound basis is one of the best methods to induce contractors to maintain efficiency. This pressure on prices of war materials tends

to prevent waste of labor or materials, and unnecessary expenditures which contribute to inflation.

Consequently, effective methods for reducing prices under war contracts and subcontracts to a sound and fair basis are essential to the war program.

V. The Finance Committee Bill

The proposed revision of the Renegotiation Act presented by the Finance Committee will seriously cripple effective profit control through renegotiation. The committee bill will substantially narrow the field of renegotiation for profit recapture and will seriously hamper its administration. Fortunately, however, the committee bill does continue adequate authority for repricing. Aside from minor effects, the major objections to the committee's proposal are as follows:

1. *Exemption of standard commercial articles.*—The bill submitted by the Senate Finance Committee exempts from renegotiation any contract or subcontract for the making or furnishing of a standard commercial article. These include any articles which were produced and sold commercially under competitive conditions before the war and which are now sold for war purposes under the Office of Price Administration price ceilings, or at January 1, 1941 prices.

This exemption will exclude from renegotiation a large part of war procurement on which exorbitant profits are being realized.

The Maritime Commission estimates that this amendment will exempt contracts for $2,000,000,000 of standard commercial articles to be incorporated in ships still to be built by it. About one-third ($600,000) of the cost of each Liberty ship is for steel, propulsion equipment, piping, valves, fittings, lifeboats, etc., which would be exempt under the committee bill, although experience has clearly shown that unconscionable profits have been and are being realized in these fields. If these component parts of each ship are excluded from renegotiation, their producers will probably receive unwarranted profits of about $400,000,000, and will retain over $100,000,000 of this after taxes. The amendment will permit almost everyone except the shipbuilder to retain excessive profits.

The situation of the Navy is similar. For example, the Navy estimates that in its program of 4.7 billion dollars for auxiliary and landing craft, about 30 percent of the money will be spent for standard commercial products. At present prices these products will yield their manufacturers $250,000,000 in excessive profits. At least $70,000,000 of this sum will not be recaptured by taxation. In the present program, the total estimated cost of all other types of ship construction is approximately $23,000,000,000, of which about $3,450,000,000 will be spent for standard commercial articles.

In War Department procurement, standard commercial articles comprise a large part of the medical supplies and personal equipment and components of communications equipment, tanks, motor vehicles, and aircraft. In many of these fields, the expanded volume of production has yielded extremely high profits, often ranging from 25 to 35 percent of the price.

Specific examples make the danger of this amendment clear:

> The Timken-Detroit Axle Co., in its fiscal year ended June 30, 1942, did a total business of $127,800,000, or approximately six times its average annual business during the period from 1936 to

1939, inclusive. On this business it realized a total profit (after taxes) of 8¼ million dollars—more than four times as much as it realized in an average pre-war year. Thus, on every dollar employed in its business during 1941–42, the Timken Co. made a net return after taxes but before renegotiation[1] of more than 50 cents. This company would appear to be largely exempted by the proposed amendment.

The Elastic Stop Nut Corporation, which is continuing its peacetime production of self-locking nuts, also would seem to be largely exempted. With an average 1936–39 business of $744,000 annually, the company had total sales of $25,000,000 for 1942 of which two-thirds were for war purposes and one-third was non-renegotiable commercial business. On this large volume of business the company has sharply increased its profit margin to 55 percent. With this expanded volume and higher margin the company realized a net profit after taxes for 1942 of $3,480,000 as compared with its net income after taxes of $432,000 in 1939, its best year up to that date. This represents 122 percent of its net worth at the begining of 1942.[2]

These cases are not exceptional instances; similar profit figures are general for such articles. In 1942, the profits (after taxes) of 19 companies making perishable tools were 11 times their pre-war (1936–39) average. The 1942 profits for 25 woolen textile companies had increased ninefold. Profits of 10 lumber companies for the same period quadrupled. Fifty-three cotton textile companies realized 8 times as much profit (after taxes) in 1942 as in the average pre-war (1936–39) years. These figures represent profits before renegotiation. They will, of course, be substantially reduced through renegotiation proceedings completed or in progress.

These facts refute the argument that profits are not excessive on sales of standard commercial articles under the Office of Price Administration ceiling prices. That argument overlooks two essential points. First, the Office of Price Administration ceilings are ordinarily fixed at figures that will allow a profit even to the small-quantity, high-cost marginal producer; and second, the enormously expanded sales of such articles have greatly reduced their cost of production. In peacetime such increased production would have brought about sharp reductions in price. In time of war the Government obviously should not pay a peacetime unit price on a wartime volume of purchases.

Surely exemption from renegotiation should not be granted where profits are certain to be excessive.

Nothing in the nature of this kind of business justifies exemption. As a matter of fact, contractors making standard commercial articles hold a more advantageous position than other war contractors. Since they are making their peacetime products, they have had few conversion problems and will have few reconversion problems. In many cases they have spent little for additional facilities and have been able

[1] Of its total business, only about 49½ million dollars were subject to renegotiation since much of its war business had been completed before the Renegotiation Act became effective. On this 49½ million dollars of renegotiable business, the company realized before taxes a profit of 16½ million dollars. As a result of renegotiation, the profit on renegotiable business was reduced by 12½ million dollars to a net figure of $4,072,000 before taxes.

[2] The renegotiation of this company has not yet been concluded. On its $17,000,000 of renegotiable business, the company made over 9½ million dollars of profits before taxes. The Government has proposed a refund of $8,000,000 which would reduce the company's operating profit before taxes on renegotiable business to approximately 1½ million dollars, or 14.4 percent of adjusted sales.

to use to full capacity their peacetime facilities. And their swollen volumes of sales have come not so much from business initiative or enterprise as from the aggression of Hitler and Tojo.

Nor is it sound to argue that the Government can prevent excessive profits in this field by better buying. Even if the Government were able to obtain low prices on its direct purchases of such commodities, it has no contact with the subcontractors of the various tiers, whose excessive prices pyramid upward through the tiers of contractors and create inflated costs, prices, and profits. Sellers of such products strenuously resist efforts to reduce their prices and seek to maintain price lists at pre-war commercial levels. To exempt such standard commodities will inevitably increase the cost of the war, and will also condone profiteering in these fields.

One further point should be noted. It is difficult to define "standard commercial products" so as to avoid numerous doubtful questions as to whether a particular commodity is exempt or not. In attempting to apply the definition in the Finance Committee bill, the departments that procure munitions and supplies would become involved in endless disputes with contractors over this exemption, wasting valuable time and delaying the completion of the large job.

2. *Retroactive redefinition of subcontracts.*—With specified exceptions, the existing law applies to prime contracts and also to all subcontracts for any of the work or for any article required for the performance of a prime contract or another subcontract. Thus the statute covers substantially all of the contracts and subcontracts involving war business. The Finance Committee bill would limit the subcontracts subject to renegotiation to those for component articles to be incorporated into or as a part of an item covered by the prime contract. Worse still, the proposed bill will make this new restricted definition retroactive to the original date of the statute—April 28, 1942.

Scope of definition.—The new definition will operate to exempt from renegotiation the sales of many articles whose costs enter into war production. Its chief advocate is the machine-tool industry which, through the amendment, would escape price adjustment and profit review on about a billion dollars worth of tools sold for war use. In view of the profit which such companies have realized from the enormous expansion in sales for war purposes, their exemption from renegotiation is difficult to justify.

> The Warner & Swasey Co. is an example. This company's machine tools have been sold principally on subcontracts and are not incorporated into finished munitions—but their prices affect the cost of the munitions. During 1942 Warner & Swasey did $42,000,000 of war business, or about six times its average pre-war volume of $7,000,000 per year. On its war business Warner & Swasey took a bigger profit mark-up (38.8 percent) than it customarily received during peacetime. As a result, without renegotiation, Warner & Swasey would have made a profit after taxes of $5,461,000 in 1942, or approximately four times its peacetime average. That is a return of 49 percent in 1942 on each dollar invested in the business.[3]

[3] Of the company's $42,000,000 of war business, $22,000,000 represented contracts with the Defense Plant Corporation which were not included in the original renegotiation conducted by the War Department. On the balance of $20,000,000, the company realized a net profit before taxes of $7,800,000, of which $5,500,000 was found to be excessive and was eliminated through renegotiation, leaving the company with a net profit before taxes on this portion of its business, of $2,300,000, or approximately 15.9 percent of adjusted sales. The renegotiation of the Defense Plant Corporation business is in progress, and if concluded on a similar basis will require a further refund of approximately $6,000,000 before taxes.

This amendment is not confined to the machine-tool industry, but would also be a windfall to makers of building equipment, electrical equipment, and factory machinery and supplies, and many others.

> For example, the Harnischfeger Corporation, a manufacturer of cranes, excavators, electric arc-welding machines, and electrodes, apparently would escape renegotiation on most of its war business. In 1940, the best year in its recent history up to that time, the company had a net profit after taxes of $561,000, as compared with a net profit after taxes in 1942 estimated to be $2,795,000. This is almost five times the net earnings of the company in its best pre-war year.[4]

Retroactive effect.—This new definition of subcontract not only restricts the scope of renegotiation for the future—it is retroactive to April 28, 1942.

This is both illogical and inequitable. It will require the Government to refund to such subcontractors very large amounts which they themselves have already conceded to be excessive profits on war business. While any exact computation of the amounts of such refunds is not possible, some have estimated that it may run up to half a billion dollars. For instance, at least $2,970,000 would have to be returned to one concern out of $5,300,000 recovered; even after taxes the net refund would be approximately $830,000. Another company would have a refund of approximately $3,900,000 out of $5,500,000 recovered, which would net over $1,000,000 after taxes. A third company would receive a net refund of $527,000 after taxes, virtually trebling this company's net profit after taxes. Similar illustrations could be multiplied indefinitely.

In the midst of war it is impossible to justify such payments of public money to industrial concerns, which they themselves have recognized represent excessive profits from war business and have refunded to the Government. By adopting this retroactive amendment the Congress will virtually indorse the payment of excessive prices for war goods. This would be unusual at any time, but to provide for such windfall refunds of excessive profits to war contractors seems especially ironical in a wartime Revenue Act. Its adoption cannot fail seriously to affect the morale both of the soldiers and of the public generally.

In addition, this amendment will impose administrative burdens so serious as to impair the current operation of the statute, for it will require the reopening of thousands of renegotiations that have been completed on the basis of the present definition. Renegotiation agreements for the year 1942 have been reached with over three-fourths of the contractors subject to the statute. In a large percentage of these cases the settlement has included war work which the new subcontract definition would exclude. Frequently a manufacturer sells the same type of article as an end item or component part and for use by prime and subcontractors in processing end items or component parts. Under the present definition it is not necessary to segregate these two types of uses and in making the 1942 renegotiation agreements both types of sales were included in determining excessive

[4] Renegotiation with this company has not yet been concluded. Of a total business of about 34½ million dollars, approximately $24,000,000 was considered to be renegotiable. On its renegotiable business the company made about $8,600,000 before taxes. The Government has proposed a refund of $6,100,000 before taxes, leaving the company about 2½ million dollars before taxes. It is estimated that the effect of this refun would be to reduce the company's net profit after taxes in 1942 to approximately $1,500,000.

profits. Consequently there is no way to determine now what part of the refund of excessive profits was derived from subcontracts which would be excluded under the retroactive definition without repeating the entire process of renegotiation in such cases. In order to do this, the excluded sales would have to be segregated, the proper costs allocated to these sales, and the profits realized thereon also segregated. If this great mass of cases must be reopened and the work repeated, the agencies engaged in renegotiation would not be able to carry this additional burden and the work on current cases. Proper administration of the statute would therefore appear to be impossible under this amendment.

3. *Articles furnished in obedience to War Production Board directives.*—The Finance Committee bill exempts from renegotiation—

any contract or subcontract for any article made or furnished in obedience to a directive of the War Production Board and at or below a maximum price established and in effect under the Emergency Price Control Act of 1942, as amended.

The meaning and effect of this curious provision are not at all clear. Does it cover any article supplied for war purposes under a War Production Board priority order? Does it cover all materials supplied to war contractors and subcontractors under the Controlled Materials Plan? If this is not its intent what does this provision mean? If it does exempt all articles supplied under any type of War Production Board directives, it would appear to emasculate the Renegotiation Act. If it is intended to have this effect it should obviously not be enacted. On top of this, the amendment is made retroactive to April 28, 1942, and would apparently require reopening of all closed cases to which the exemption applies. No reason whatever has been offered to justify such a windfall.

In any case Congress should not adopt this peculiar provision until and unless its meaning has been clarified and explained.

4. *Court review of closed agreements.*—This bill proposed by the Finance Committee provides for a court review not only of departmental orders determining excessive profits without the consent of the contractor but also of all voluntary agreements made by contractors and the Government since passage of the statute. In our opinion this amendment is indefensible and will seriously impede the admintration of the law.

As originally passed, the Renegotiation Act did not provide for any method of ending liability for excessive profits. In order to correct this situation, contractors urged the adoption of a provision to allow renegotiated cases to be closed by agreement and to make such agreements final except for fraud, malfeasance, or willful misrepresentation. Such a provision was enacted by the Revenue Act of 1942 with the approval of the Government departments. On the basis of this provision, thousands of bilateral agreements have been made between the Government and contractors and subcontractors as a result of renegotiation. More than 99 percent of all completed renegotiation cases have been settled by such voluntary agreements. These agreements have been treated as final by the Government and by the contractors. They have given the contractors the assurance that they would not later be required to refund additional amounts under the statute.

The provision in the Finance Committee bill would allow contractors who have entered such closed agreements with the Government to go

into a court for redetermination of the excessive profits, notwithstanding their agreement. As a result, thousands of such agreements under which contractors have made refunds and price reductions aggregating more than $5,000,000,000, would be made subject to court review. With such a provision even companies which are now satisfied with their agreements would probably feel forced to take advantage of an appeal. This amendment is a mandate for litigation which neither party wants. The courts would be swamped with petitions to review these closed voluntary agreements.

The resulting administrative burden upon the interested departments would be enormous. The necessity of duplicating the completed work in the thousands of cases already settled would surely impede the renegotiation officials in carrying on current renegotiations. It might even bog down renegotiation completely.

In addition to this administrative burden, this amendment would place in jeopardy the provisions for past and future price reductions included in such agreements. Many renegotiation agreements contain clauses providing for price reductions to eliminate excessive profits likely to be realized in the future, without specifying the amount of such reductions on specific articles or contracts. These reductions are estimated to represent over 2½ billion dollars. If the agreements were reopened, serious questions would be presented as to the status of the price reductions made in accordance with these provisions.

5. Renegotiation after Federal income and excess profits taxes.—The Finance Committee bill requires that in the determination of excessive profits consideration should be given to—

whether the profits remaining after the payment of estimated Federal income and excess profits taxes will be excessive.

If this provision means, as it seems to, that renegotiation must deal only with the profits remaining after the payment of these taxes, it is altogether unsound. In the first place, such a provision is an invitation to war contractors to increase their prices to the extent necessary to pay increased war taxes. If this is done and the increased profits cannot be reached except after taxes, the Government will pay the contractor's taxes for him. This transfers the tax load incident to the war from his own shoulders to those of other taxpayers generally.

In the second place, this provision is completely inconsistent with the purposes of the Renegotiation Act. The statute was passed to allow the Government to reexamine the prices of the articles and services supplied under war contracts to determine the amount which the contractor should fairly earn for supplying them. Obviously, the tax burden of a particular contractor does not affect the value of the articles and services which he has supplied. It is anomalous to allow one contractor a higher price or profit than another simply because of differences in their tax bases. Accordingly, renegotiation should be conducted on the basis of the profits before taxes.

6. *Reconversion costs in determining excessive profits.*—The Finance Committee bill includes as one of the factors to be taken into consideration in the determination of excessive profits, the "financial problems in connection with reconversion." If the language is intended to mean, as it seems to mean, that in determining excessive profits full allowances must be made for the probable costs of reconversion to civilian production, it is not only impossible to administer, but it is also economically unsound.

The costs of conversion to war production are properly chargeable to such war production and should be paid for by the Government in the price of the war goods produced. But capital expenses for future civilian production should certainly not be added to the cost of the war. In addition, Congress has already made substantial provisions to aid business in the post-war period. Among these provisions the 2-year loss carry-back, the 2-year unused excess profits credit carry-back, and the carry-back of the amortization deduction, offer very substantial benefits to business in its post-war readjustment period. It seems apparent that the allowance of further post-war reserves, particularly through renegotiation, is unjustified. Finally, need for a reconversion reserve in any industry or in any individual business is so uncertain and the extent thereof so indefinite that from a practical standpoint it is impossible to make a present evaluation of it.

While it is admitted that the post-war economic problems of industry will be substantial and need the fullest consideration by the Congress, it is equally clear that these problems connot be settled or dealt with in the renegotiation of war contracts. They are much broader in scope. They exist for all business, whether or not engaged in war production, or, if engaged in war production, whether or not earning excessive profits, and should be dealt with on a broad general basis by the Congress, quite apart from the question of renegotiation.

VI. Recommendations

1. *Subsection (i) (1) (F).*—This section will exempt from renegotiation the prices and profits on any "standard commercial" products, which are defined as any article sold commercially before January 1, 1940, and now subject to O. P. A. ceilings (subsection (a) (7)).

This amendment is a cross between an error and a pretense. The error is in the assumption that no excessive profits are made on standard commercial articles, whereas the record shows (see pp. 6–8 of this report) that unconscionable war profits are being made on these items. The pretense lies in the fact that the amendment would permit war profiteering on most of the components going into an Army truck, for example, while pretending to prevent excessive profits on the completed truck. Subsections (i) (1) (F) and (a) (7) should be stricken from the bill.

2. *Subsection (a) (5).*—This section, by redefining "subcontract" exempts from renegotiation profits on articles which are not physically incorporated into a contract item. It exempts the welding machine at the shipyards, the lathe in the gun factory, the bulldozer at the Army camp, the catalytic chemicals at the powder plant.

This amendment springs from the curious doctrine that war profiteering is sanctified as long as it remains one step removed from the finished gun, tank, ship, or plane.

The amendment does not stop here. The exemption of such subcontracts is made retroactive (sec. 701 (d) (1)). The result is indefensible: In the midst of a war for survival the Government must hand back to corporations hundreds of millions of dollars which the corporations have already admitted are excessive profits. (See pp. 8–10.) This amendment compels war profiteering.

At worst, the retroactive feature should be stricken from section 701 (d) (1). At best, the existing definition should be continued.

3. *Subsection (i) (1) (H).*—This provision exempts agreements for articles made or furnished in obedience to a War Production Board directive at or below an Office of Price Administration ceiling, and makes the exemption retroactive.

The meaning of this provision is hard to fathom, but taken literally it would exempt most of war production from renegotiation. In addition since retroactive to April 28, 1942, it would require reopening of all previous settlements and cripple current administration.

This exemption should be dropped from the bill.

4. *Subsection (e).*—This amendment provides for a de novo appeal to the Court of Claims, not only of the cases on which the contractor and Government cannot agree, but also of all cases, already closed by agreement.

This section invites litigation which neither party wants. It reopens cases which contractors have agreed to close, tempting management to wring the last ounce of litigious delay out of what has already been accepted as a good business deal. Moreover, the de novo nature of the appeal places a staggering burden on the administrative departments.

Subsection (e) should be amended to restrict appeal to past and future cases where excessive profits are determined by order. The petitioner should have the burden of establishing that the determination is unreasonable or unfair.

5. *Subsection (a) (4).*—The Finance Committee's amendments to this subsection require renegotiation to consider a company's probable net income after taxes, its possible carry-back of hypothetical future losses, its potential reconversion problem, etc.

The meaning and effect of these changes are unclear. We doubt if they can ever be made clear. Indeed, they seem to be a Pandora's box of vexing and intangible problems which the committee has dumped into the renegotiation procedure for lack of any other solution. They all appear to spring from the mistaken notion that, even though a company is not entitled to enormous war profits, it has a vested right in certain collateral benefits which hinge on those profits.

The amendments can work only mischief. They should be dropped from the bill.

VII. Conclusion

To wage this war, the Nation must expend its substance and the lives of its young men on an appalling scale. Despite much talk of equalizing the sacrifices, that can never be done in sober fact. To achieve the defeat of Hitler and Japan, thousands must contribute their lives or broken bodies. Measured by their sacrifice, any lesser contribution of time, or effort, or money seems but a paltry mite. Equality of sacrifice there can never be. To those who die or are maimed we must remain eternally in debt.

But if we cannot match their supreme sacrifices we must do our best to spread the burdens of the war as fairly as we can. Every class and group must do its share to carry the Nation's war load. Above all else, we must make certain that no group or class shall exploit the war for its selfish benefit. This is but simple fairness to our soldiers and sailors and also to our people—who are enduring unwonted restraints and burdens for the common good.

In the two decades since the last war, the people made the firm and deep resolve that in another war no one should be allowed to enrich himself by inordinate profits from the nation's war goods. In this war, profiteering must be outlawed.

In our opinion the Finance Committee bill departs radically from this national determination to prevent profiteering. By narrowing the scope of renegotiation and by hobbling its administration, this bill will nullify profit control over large areas. Under renegotiation, business is allowed liberal profits; the statute restrains only unconscionable profiteering. Under the revised bill, many will enjoy free license to make exorbitant profits out of war business, and millions of dollars of public money will be paid back to a specially favored group who have already made and kept generous war profits. The bill sows the seeds of a new crop of war millionaires. It will breed bitterness and resentment among the people.

As the representatives of the whole people, the Congress should not disrupt the machinery of effective wartime profit control. It would be more honest to repeal the Renegotiation Act altogether than to weaken it fatally by these amendments.

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APPENDIX A

Examples of high increases in dollar profit in 1942 over the base period along with high percentage of earnings on net worth in 1942 (all before renegotiation)

Company	Net earnings after taxes		Percent earned on net worth, 1942, after taxes	Company	Net earnings after taxes		Percent earned on net worth, 1942, after taxes
	Base period (1936–39)	1942			Base period (1936–39)	1942	
1	Deficit	210,000	73.2	64	345,000	1,711,000	43.2
2	89,000	321,000	36.9	65	19,000	150,000	45.6
3	690,500	2,152,000	33.3	66	91,000	374,000	39.1
4	36,000	356,000	63.9	67	5,400	147,000	132.6
5	20,000	207,000	37.5	68	(1)	369,000	112.0
6	102,000	352,000	26.5	69	4,000	336,000	41.5
7	30,000	345,000	84.8	70	19,000	100,000	37.2
8	302,000	656,000	34.7	71	5,000	344,000	76.0
9	388,000	1,033,000	23.0	72	144,000	844,000	38.2
10	Deficit	966,000	109.9	73	1,425,000	2,766,000	26.1
11	98,000	1,446,000	96.6	74	41,000	276,000	62.6
12	9,000	380,000	65.18	75	62,000	754,000	23.8
13	239,000	641,000	33.4	76	12,000	312,000	182.9
14	87,000	549,000	137.5	77	No base	258,000	143.3
15	57,000	385,000	54.5	78	64,000	1,004,000	46.6
16	35,000	412,000	52.1	79	20,709,000	30,325,000	16.9
17	89,000	545,000	35.0	80	2,112,000	6,942,000	41.02
18	1,127,000	5,380,000	38.9	81	No base	124,000	100.0
19	874,000	3,511,000	30.96	82	3,000	677,000	138.0
20	20,000	386,000	57.0	83	99,000	289,000	29.4
21	184,000	984,000	62.5	84	142,000	532,000	28.2
22	186,000	900,000	26.0	85	595,000	5,283,000	81.0
23	162,000	978,000	37.0	86	No base	2,670,000	68.2
24	106,000	[2] 411,000	38.4	87	80,000	277,000	44.7
25	22,000	213,000	43.1	88	Deficit	806,000	157.7
26	Deficit	417,000	62.1	89	9,000	278,000	151.0
27	Deficit	330,000	63.0	90	Deficit	303,000	142.0
28	136,000	918,000	43.1	91	22,000	214,000	43.13
29	12,000	202,000	108.9	92	No base	280,000	43.5
30	43,000	322,000	74.2	93	192,000	832,000	45.4
31	215,000	696,000	26.1	94	12,000	737,000	28.2
32	77,000	221,415	43.5	95	No base	559,000	306.7
33	750	181,000	83.8	96	5,000	200,000	120.0
34	607,000	2,511,600	28.3	97	24,000	297,000	75.2
35	27,000	247,000	70.8	98	338,000	1,454,000	51.2
36	Deficit	1,748,000	29.0	99	Deficit	930,000	54.5
37	785,000	3,492,000	34.4	100	Deficit	215,000	50.1
38	7,000	1,035,000	500.0	101	Deficit	465,000	52.1
39	135,500	994,000	18.0	102	232,000	1,383,000	24.8
40	15,000	229,000	93.4	103	36,000	281,000	57.6
41	107,000	506,000	36.1	104	No base	227,000	266.5
42	161,000	1,059,000	51.9	105	428,000	1,376,000	26.8
43	Deficit	331,000	45.8	106	144,000	1,978,000	75.3
44	Deficit	7,922,000	79.8	107	61,000	290,000	41.1
45	125,000	564,000	49.0	108	996,000	5,300,000	57.0
46	160,000	584,000	28.5	109	No base	5,964,000	435.0
47	Deficit	315,000	630.0	110	Deficit	1,208,000	55.2
48	11,250	232,000	37.1	111	91,000	513,000	35.2
49	89,000	795,000	171.0	112	68,000	895,000	137.0
50	366,000	3,001,000	71.4	113	14,000	236,000	31.6
51	77,000	352,000	26.4	114	35,000	207,000	82.8
52	2,000	138,000	197.1	115	24,000	883,000	166.0
53	Deficit	159,000	42.7	116	94,000	464,000	29.0
54	47,000	561,000	96.4	117	17,000	595,000	83.2
55	65,000	1,549,000	124.3	118	No base	1,353,000	119.0
56	431,000	2,877,000	37.9	119	93,000	410,000	39.9
57	4,300	277,000	53.8	120	14,000	464,000	22.8
58	95,000	347,000	28.3	121	Deficit	15,546,000	23.0
59	6,000	154,000	68.4	122	Deficit	33,820,000	42.8
60	11,000	150,000	102.0	123	25,000	495,000	86.0
61	79,000	565,000	48.9	124	51,000	749,000	45.0
62	6,000	81,000	965.0	125	243,000	844,000	34.7
63	19,000	376,000	101.9	126	11,400	2,546,000	548.4

[1] Organized July 1939.
[2] Before taxes—proprietorship in base period, corporation in 1942.

Examples of high increases in dollar profit in 1942 over the base period along with high percentage of earnings on net worth in 1942 (all before renegotiation)—Con.

Company	Net earnings after taxes		Percent earned on net worth, 1942, after taxes	Company	Net earnings after taxes		Percent earned on net worth, 1942, after taxes
	Base period (1936-39)	1942			Base period (1936-39)	1942	
127	131,000	2,426,000	27.0	164	54,000	741,000	100.0
128	47,000	1,061,000	63.1	165	150,000	1,310,000	36.5
129	90,000	1,063,000	32.9	166	953,000	23,719,000	95.0
130	21,000	3,201,000	39.3	167	Deficit	2,163,000	29.7
131	76,000	621,000	46.8	168	209,000	776,000	25.7
132	215,000	557,000	31.2	169	324,000	798,000	27.4
133	Deficit	4,375,000	284.0	170	73,000	1,005,000	63.4
134	2,740,000	29,935,000	55.3	171	1,172,000	10,200,000	51.5
135	180,000	496,000	40.1	172	Deficit	1,844,000	33.7
136	Deficit	1,362,000	52.2	173	Not shown	5,622,000	22.2
137	459,000	3,581,000	66.4	174	Deficit	185,000	108.3
138	173,000	918,000	31.5	175	Deficit	553,000	26.3
139	105,000	727,000	21.1	176	82,500	1,561,000	36.5
140	181,000	934,000	32.0	177	5,000	293,000	121.7
141	Deficit	417,000	62.1	178	2,372,000	14,040,000	85.0
142	35,000	913,000	25.1	179	9,500	152,000	80.4
143	7,000	683,000	226.0	180	3,995,000	8,851,000	26.2
144	869,000	3,772,000	35.0	181	55,000	324,000	28.0
145	189,000	516,000	31.8	182	6,500	233,000	25.0
146	Deficit	3,008,000	123.2	183	Not shown	515,000	29.7
147	192,000	2,482,000	74.2	184	13,500	313,000	269.7
148	860,000	1,421,000	34.3	185	Not shown	115,000	102.0
149	12,000	218,000	136.0	186	6,000	173,000	56.0
150	349,000	780,000	24.4	187	22,000	222,000	80.0
151	Deficit	888,000	68.7	188	24,000	301,000	31.5
152	498,000	1,786,000	31.1	189	27,500	365,000	44.0
153	589,000	1,792,000	21.1	190	3,000	130,000	44.8
154	Deficit	184,000	81.8	191	74,000	544,000	29.0
155	287,000	1,667,000	47.0	192	Not shown	187,000	98.9
156	74,000	540,000	58.7	193	44,000	271,000	41.0
157	178,000	592,000	27.4	194	13,000	308,000	31.4
158	Deficit	248,000	38.6	195	44,500	286,000	107.0
159	10,000	702,000	380.0	196	324,000	1,303,000	121.2
160	81,500	722,000	52.4	197	617,000	1,470,000	16.1
161	73,000	1,007,000	85.1	198	121,000	601,000	22.3
162	22,000	401,000	54.8	199	330,000	760,000	41.0
163	1,464,000	3,093,000	27.1	200	5,000	340,000	25.7

(The above consists solely of cases that had been assigned to the War Department before renegotiation.)

APPENDIX B

[From Congressional Record of September 29, 1942]

Profit Limitations on Naval and Army Contracts

Mr. Walsh. Mr. President, in view of the fact that the Senate is soon to consider changes in the law pertaining to renegotiation of contracts, I ask unanimous consent to have printed in the Record a brief history of the efforts of Congress since 1934 to place profit limitations on Naval and Army contracts.

There being no objection, the statement was ordered to be printed in the Record, as follows:

History of Profit Limitations on Naval and Army Contracts

(By David I. Walsh)

I have had prepared, with the assistance of the Treasury, for the information of the Members of the Senate and the Finance Committee a brief history of profit-limiting legislation.

(1) The first attempt in recent years providing for limitation of profits on Government contracts was in connection with the manufacture and construction of naval vessels and naval aircraft in 1934 (Vincent-Trammell Act). This law required the contractor, or subcontractor, to pay into the Treasury any excess profit realized on a particular contract by limiting the allowable profit to 10 percent of the total contract price.

(2) In June 1936 this act was amended forbidding contractors, or subcontractors, to combine all contracts or subcontracts completed in any taxable year to determine whether a profit in excess of 10 percent had been made. This law also permitted any contractor, or subcontractor, to carry forward a net loss on any contract completed in an income taxable year and take it as a credit in determining the excess profits on contracts completed in the next succeeding income taxable year.

(3) The next action taken was on April 3, 1939. One of the sections of this act provided that contracts for Army aircraft (heretofore the law only applied to naval contracts) should be subject to the limitation of profits contained in the Vincent-Trammell Act of 1934. It also increased the allowable profit from 10 to 12 percent in the case of Army and Navy aircraft, retaining the allowable profit to 10 percent in the case of naval vessels. A more liberal net loss carry-over was also provided, extending the time for carrying forward such losses in determining the excess profits to 4 succeeding income taxable years.

It should be noted that these provisions, increasing the allowable profit and providing for a more liberal net loss carry-over, were applicable only to contracts in the manufacture of Army and Navy aircraft and not applicable to the contracts for construction of naval vessels.

(4) In the following year, on June 28, 1940, in an effort to limit profits because of the large building expansion, an act was passed changing the allowable profits on naval vessels and Army and Navy aircraft to 8 percent of the contract price, or 8.7 percent of the cost of performing the contract on other than prime contracts made on a cost-plus-a-fixed-fee basis, in lieu of the 10 percent previously applicable to naval vessels and the 12 percent applicable to the Army and Navy aircraft.

(5) Shortly after this act was adopted, because of contractors' complaints of uncertainty of costs and delays in obtaining supplies and parts, Congress in the Second Supplemental National Defense Appropriation Act, September 9, 1940, amended the profit-limiting provisions of the act of June 28, 1940, by removing from the operations of such section contracts entered into after September 9, 1940, for the manufacture of Army and Navy aircraft. The effect of this amendment was to increase the allowable profit under the Vincent-Trammell Act on

contracts for Army and Navy aircraft from 8 to 12 percent and to retain the allowable profit at 8 percent on naval vessels, as fixed by the act of June 28, 1940.

(6) A few weeks later another change in policy was made. In section 401 of the Second Revenue Act of 1940, October 8, 1940, the profit-limiting provisions of the Vincent-Trammell Act and those of the act of June 28, 1940, were suspended in cases of all contracts and subcontracts which were entered into during taxable years and to which the excess-profit tax is applicable (taxable years beginning after December 31, 1939). This suspension was applicable also to contracts and subcontracts which were entered into prior to the date when the contractor, or subcontractor, became subject to the excess-profits tax and which were not completed before such date. The effect of this section was to remove profit-limiting provisions affecting particular Army and Navy contracts (naval vessels and Army and Navy aircraft), and, thereby, made contractors who since 1934 had been subject to profit limitations subject only in the future to the excess profits tax the same as the other corporations.

NEGOTIATION OF CONTRACTS

In Public Law No. 43, approved April 23, 1939, Congress for the first time since World War I, authorized the Secretary of the Navy to negotiate, without competitive bidding, contracts for certain public works projects outside the continental limits of the United States on a cost-plus-a-fixed-fee basis. This act provided that the fixed-fee should not exceed 10 percent of the estimated cost of the contract, exclusive of the fee. This method of negotiating contracts has been extended from time to time to include practically all public works contracts, but the fixed fee is now limited to 6 percent of the estimated cost of the contract and in actual practice averages about 4 or 5 percent.

A few months later the Navy Department requested authorization to negotiate, without competitive bidding, contracts for construction of naval vessels and aircraft, the Army already having such authority in contracting for Army Aircraft. Section 2A of Public Law 671 of June 28, 1940, authorized the Secretary of the Navy to negotiate contracts for the acquisition, construction, repair, or alteration of naval vessels or aircraft and of machine tools and their equipment without advertising or competitive bidding. This section, however, provided that if the fixed-fee contract was used the amount to be paid by the War Department or Navy Department (so as to put them both on an equal basis) should not exceed 7 percent of the estimated cost of the contract, exclusive of the fee.

Section 2b (2) of this same law, Public Law 671 of June 28, 1940, however, provided that any profit in excess of 8.7 percent of the cost of performing such contracts, except prime contracts, made on a cost-plus-a-fixed-fee basis, shall be considered to be profits in excess of 8 percent of the total contract prices of such contracts.

It is to be noted that this law of June 28, 1940, places a distinct limitation on the profits on contracts negotiated on a fixed-price basis as well as contracts made on a cost-plus-a-fixed-fee basis.

Very shortly after this law was adopted, Congress, in the appropriation bill of September 9, 1940, increased the allowable profit to 12 percent on both Army and Navy aircraft and left it at 8 percent on naval vessels. Within a few weeks thereafter, namely in the Second Revenue Act of 1940, October 8, 1940, Congress removed all profit limitation provisions on competitive bid contracts or negotiated contracts at a fixed price leaving the contractors with war contracts in the same position as all other taxpayers subject only to the excess-profits tax.

TYPES OF CONTRACTS

There are now four methods of making contracts with the Government, to wit:

1. By competitive bidding at a fixed price.
2. By negotiation at a fixed price.
3. By negotiation on a cost-plus-a-fixed-fee basis for certain articles and equipment where the fixed fee is not to be more than 7 percent of the estimated cost.
4. By negotiation on a cost-plus-a-fixed-fee basis for naval public works projects where the fixed fee shall not exceed 6 percent of the estimated cost.

ATTEMPTS OF 8 YEARS

It is a fact that during the past 8 years attempts have been made to limit excessive profits on the manufacture of war materials and that neither the Congress, the Treasury Department, the War Department, the Navy Department, the

aritime Commission, nor any other department of the Government has as yet been able to formulate a satisfactory plan of eliminating excessive profits or recapturing excess profits on the production of war materials.

It is also a fact that during the past 8 years, without consultation or unity of action, the Naval Affairs Committee, the Military Affairs Committee, the Appropriations Committee, and the Finance Committee have at various times dealt with this subject with the result that one law after the other has been repealed and constant changes have been made in the attempts to control war-contract profits.

RENEGOTIATION OF WAR CONTRACTS LAW

It became apparent to the Senate Appropriations Committee that many negotiated contracts were awarded before either of the contracting parties had any accurate idea as to the actual cost of producing the article on a mass production basis. Firms and corporations naturally bid very high or negotiated at a very high price in order to play safe. When the actual cost of manufacturing the article became known it was apparent that some firms were making an excessive profit, and both the Government and the manufacturer desired to renegotiate the contract in order to reduce the cost to the Government.

This led to the enactment of section 403 of Public Law No. 528 (April 8, 1942), authorizing the renegotiation of contracts, but did not set any standards for determining excess profits and left this matter entirely in the hands of officials of the Government.

This law authorized and directed the Secretaries of the War and Navy Departments and the Maritime Commission to insert in any contract where the amount is in excess of $100,000 provisions for the renegotiating of the contract prices at a period or periods when, in the judgment of the Secretaries, profits can be determined with reasonable certainty.

It also contained a provision for the retention by the United States or the repayment to the United States any amount of the contract prices which were found to be excessive profits. It permits the renegotiation of subcontracts as well as prime contracts where excessive profits could be determined.

This law is to remain in force during the continuation of the present war and for 3 years after the termination of the war.

PROPOSED CHANGES IN RENEGOTIATION OF WAR-CONTRACTS LAW

The Finance Committee of the Senate is now studying the operation of this law and considering changes and amendments that have been proposed by the Departments and representatives of contractors having Government war contracts.